

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

LYNCH INTERACTIVE CORP  
Form 10-K/A  
September 09, 2005

sec document

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K/A

AMENDMENT NO. 2

/X/ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2004  
-----

/ / 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 1-15097  
-----

LYNCH INTERACTIVE CORPORATION  
(Exact name of Registrant as specified in its charter)

Delaware 06-1458056  
-----  
(State or other jurisdiction of (I.R.S. employer  
incorporation or organization) identification no.)

401 Theodore Fremd Avenue  
Rye, New York 10580  
(Address of principal executive offices) (Zip code)

(914) 921-8821  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class -----	Name of each Exchange on which Registered -----
Common Stock, \$.0001 par value	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

NONE

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

Indicate by check mark 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

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

Form 10-K. / /

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-20). Yes / / No / X /

The aggregate market value of voting stock held by non-affiliates of the Registrant as of June 30, 2004 (based upon the closing price of the Registrant's Common Stock on the American Stock Exchange of \$34.54 per share) was \$72.0 million. (In determining this figure, the Registrant has assumed that all of the Registrant's directors and officers are affiliates. This assumption shall not be deemed conclusive for any other purpose.)

The number of outstanding shares of the Registrant's Common Stock was 2,752,251 as of July 25, 2005.

2

### EXPLANATORY NOTE

This Report on Form 10-K/A amends Lynch Interactive's Annual Report on Form 10-K for the year ended December 31, 2004, initially filed with the Securities and Exchange Commission on April 1, 2005 as amended by Form 10-K/A, filed with the Securities and Exchange Commission on May 2, 2005. This Form 10-K/A includes Part I, Item 1, Business; Part I, Item 7, Management's Discussion and Analysis of Financial Conditions and Results of Operations; and the Company's Financial Statements and Financial Statement Schedules. The Company has revised its business description to expand several sections, add captions to more easily locate certain information and add a paragraph discussing government contracts. Additionally, the Company has re-named the non-GAAP financial measure, "EBITDA from operations" as "Adjusted Operating Profit" and has provided a reconciliation to net income. The Company has also revised its disclosure to indicate that management uses Adjusted Operating Profit as an indicator of operating performance and that it believes this non-GAAP financial measure provides useful information to investors.

### PART I

#### ITEM 1. BUSINESS

Lynch Interactive Corporation ("Interactive" or the "Company") was incorporated in 1996 under the laws of the State of Delaware. On September 1, 1999, Interactive was spun off by Lynch Corporation to its shareholders (the "Spin Off") and became a public company. In its first day of trading, Interactive closed at \$28.00 (adjusted for stock splits). Prior to the Spin Off, Interactive had no significant assets, liabilities or operations. As a successor to certain businesses of Lynch Corporation, Interactive, at that time, became a diversified holding company with subsidiaries primarily engaged in multimedia and transportation services. Interactive spun off its ownership interest in Sunshine PCS to its shareholders in 2001 and its 63% interest in the Morgan Group, Inc. to its shareholders in 2002. Interactive's executive offices are located at 401 Theodore Fremd Avenue, Rye, New York 10580-1430. Its telephone number is 914-921-8821.

Interactive's business development strategy is to expand its existing operations through internal growth and acquisitions. It may also, from time to time, consider the acquisition of other assets or businesses that are not related to its present businesses. The Company currently operates in one business segment,

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

multimedia, which consists of telecommunications, security, cable television and broadcasting. As used herein, Interactive includes subsidiaries.

LYNCH INTERACTIVE CORPORATION TO CONSIDER DELISTING, AND GOING TO WHAT WALL STREET REFERS TO AS "PINK SHEETS", AND OTHERS REFER TO AS "GOING DARK"

The Company's Board of Directors has voted to include in our proxy statement for the 2005 annual meeting a proposal that the shareholders give the Board of Directors authority to execute a "going dark" transaction, pursuant to which the company would reduce its number of shareholders of record below 300 through a reverse split and then delist from the American Stock Exchange, thereby suspending its reporting obligations under the Securities Exchange Act of 1934. If this transaction is consummated, the Company's common stock would be quoted, if at all, in the "pink sheets". We point out that notwithstanding trading volumes, the Company currently intends voluntarily to disseminate press releases, quarterly financial statements, and audited annual financial statements to its stockholders and the investment community generally.

The principal reason for considering this step is the cost required to comply with section 404 of the Sarbanes-Oxley Act of 2002. While the Company is committed to having in place and consistently improving those controls necessary to generate reliable financial statements, the documentation and testing process required by section 404 of Sarbanes-Oxley will likely impose considerable costs and a staffing strain on the Company and its subsidiaries unless the standards are revised for smaller companies. The Company believes it is appropriate to consider ways to mitigate these significant burdens.

### I. MULTIMEDIA OPERATIONS

#### WIRELINE TELECOMMUNICATIONS

OPERATIONS. Interactive conducts its telecommunications operations through subsidiary companies. The telecommunications group has been expanded through the selective acquisition of local exchange telephone companies serving rural areas and by offering additional services such as Internet service, alarm services, long distance service and competitive local exchange carrier service. Since 1989, Interactive has acquired fourteen telephone companies, four of which have indirect minority ownership of 2% to 19%, whose operations range in size from approximately 900 to over 10,000 access lines. The Company's telephone operations are located in Iowa, Kansas, Michigan, New Hampshire, New Mexico, New York, North Dakota, Utah and Wisconsin. Our service areas are largely residential and not densely populated. As of December 31, 2004, total lines, including both access and DSL, were 54,901, 100% of which are served by digital switches.

In March 2004, the Company signed an agreement to acquire California-Oregon Telecommunications Company ("Cal-Ore") located in Dorris, California. Cal-Ore's subsidiary Cal-Ore Telephone Company is the incumbent service provider for a

rural area of about 850 square miles along the Northern California border with Oregon with approximately 2,500 access lines. Cal-Ore's other businesses include an Internet service provider, Competitive Local Exchange Carrier ("CLEC") that is planning to provide services in the surrounding area and interests in certain cellular partnerships. The acquisition price is \$21.2 million, subject to certain closing adjustments. In March 2005, the administrative law judge for the California Public Utilities Commission issued a proposed opinion approving the transaction subject to various conditions. The Company is reviewing the opinion, which remains subject to the approval of the Commission.

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

PRINCIPAL PRODUCTS AND SERVICES. The principal business of Interactive's telephone companies is to provide telecommunications services. These services fall into three major categories:

LOCAL NETWORK SERVICES. We provide telephone wireline access services to residential and non-residential customers in our service areas. We provide our local network customers a number of calling features including call forwarding, conference calling, caller identification, voicemail and call waiting. We offer packages of telecommunications services. These packages permit customers to bundle their basic telephone line with their choice of enhanced services, or to customize a set of selected enhanced features that fit their specific needs.

NETWORK ACCESS SERVICES. We provide network access services to long distance carriers and other carriers in connection with the use of our facilities to originate and terminate interstate and intrastate telephone calls. Such services are generally offered on a month-to-month basis and the service is billed on a minutes-of-use basis. Access charges to long distance carriers and other customers are based on access rates filed with the Federal Communications Commission ("FCC") for interstate services and with the respective state regulatory agency for intrastate services.

OTHER BUSINESS. Interactive also provides non-regulated telephone-related services, including Internet access service and long distance resale service in certain of its telephone service (and adjacent) areas. Interactive also provides and intends to provide more local telephone and other telecommunications service outside certain of its franchise areas by establishing CLEC operations in certain nearby areas. In selected areas, Interactive provides security installation and monitoring services to homes and businesses and cable television services ("CATV").

PRODUCT STATUS. The Company is always trying to roll out new services based on technological advances. We expect future growth in telephone operations to be derived from the acquisition of additional telephone companies, from providing service to new customers or additional services to existing customers, from upgrading existing customers to higher grades of service, and from new service offerings. Interactive is currently exploring how to best incorporate Voice over Internet Protocol ("VoIP") into its business model.

The following table summarizes certain information regarding Interactive's multimedia operations:

	Years Ended December 31,		
	2002	2003	2004
-----			
TELECOMMUNICATIONS OPERATIONS			
Access lines (a)	53,963	52,517	50,803
DSL Lines	1,466	2,709	4,098
-----			
Total access lines	55,429	55,226	54,901
% Residential	74%	73%	76%
% Business	26%	27%	24%
Internet subscribers (including DSL)	21,890	20,853	20,240
Security customers	6,500	6,712	6,667
Cable subscribers	2,831	2,731	3,630
-----			
TOTAL MULTIMEDIA REVENUES			
Local service	14%	14%	13%
Network access	61%	62%	63%
Other businesses	24%	24%	25%
-----			
Total multimedia revenues	100%	100%	100%

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

=====

(a) An "access line" is a telecommunications circuit between the customer's establishment and the central switching office.

(b) Other Businesses includes Internet, security, CLEC, CATV and other non-regulated revenues.

TELEPHONE ACQUISITIONS. Interactive pursues an active program of acquiring operating telephone companies. Since 1989, Interactive acquired fourteen telephone companies serving a total of approximately 45,600 access lines, at the time of these acquisitions, for an aggregate consideration totaling approximately \$153.6 million. Such acquisitions are summarized in the following table:

	YEAR OF ACQUISITION	NUMBER OF ACCESS LINES YR. OF ACQ.	NUMBER OF ACCESS LINES 12/31/04
Western New Mexico Telephone Co.	1989	4,200	6,906
Inter-Community Telephone Co.	1991	2,550 (a)	2,569
Cuba City Telephone Co. & Belmont Telephone Co.	1991	2,200	2,629
Bretton Woods Telephone Co.	1993	250	908
JBN Telephone Co.	1993	2,300 (b)	2,653
Haviland Telephone Co.	1994	3,800	3,705
Dunkirk & Fredonia Telephone Co. & Cassadaga Telephone Co.	1996	11,100	11,682
Upper Peninsula Telephone Co.	1997	6,200	6,641
Central Scott Telephone Co.	1999	6,000	5,837
Central Utah Telephone Co./Skyline Telephone Company/Bear Lake Telephone Company	2001	7,000	7,273

(a) Includes 1,350 access lines acquired in 1996.

(b) Includes 354 access lines acquired in 1996.

(c) Does not include a 36% interest in a company that owns the 16.9% minority interest. The Company is in the process of acquiring the remaining 64% interest subject to final negotiations. Closing is expected by the second quarter of 2005.

Interactive continually evaluates acquisition opportunities targeting domestic rural telephone companies with a strong market position, good growth potential and predictable cash flow. In addition, Interactive generally seeks companies with excellent local management already in place who will remain active with their company. At times, certain large telephone companies have offered certain of their rural telephone exchanges for sale, often on a statewide or larger area basis. Interactive has and in the future may, bid on such groups of exchanges. Telephone holding companies and others actively compete for the acquisition of telephone companies and such acquisitions are subject to the consent or approval

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

of regulatory agencies in most states. While management believes it will be successful in making additional acquisitions, any acquisition program is subject to various risks, including being able to find and complete acquisitions at an attractive price and being able to integrate and operate successfully any acquisition made.

RELATED SERVICES AND INVESTMENTS. Affiliates of twelve of Interactive's telephone companies now offer Internet access service. At December 31, 2004, Internet access customers totaled 20,240 compared to 20,853 at December 31, 2003. Interactive companies have increased DSL service offset by a decrease in dial up service. Affiliates of six of Interactive's telephone companies now offer long distance service, and affiliates of two of Interactive's telephone companies now offers CLEC services.

An affiliate of Dunkirk & Fredonia Telephone Company ("DFT") provides CLEC service on a resale basis in neighboring Dunkirk, New York, certain areas of Buffalo, New York, and two other western New York counties. Some of DFT's CLEC services are being provided via an unbundled network elements platform (UNE-P), which allows for increased margins over a resale CLEC business model. In

5

addition, DFT is in position with network functions and agreements to begin offering services through their own facilities. Giant Communications also provides CLEC services to selected areas in Northeast Kansas.

Giant Communications (formerly CLR Video, L.L.C.), a 98% owned subsidiary of Interactive, is a provider of cable television in northeast Kansas with approximately 2,400 subscribers.

Central Telcom Services, LLC, a 100% owned subsidiary of the Company based in Fairview, Utah, acquired certain cable television assets in February 2004 and has entered into an agreement in January 2005 to acquire a cable television system located in nearby counties. The acquisition closed in March 2005, after completion of necessary regulatory approvals and other steps. The acquisition expanded Lynch Interactive's existing customer base by 2,411 cable subscribers and positions the company to promote additional services to its customer base.

DFT Security Systems, Inc. (which is 63.6% owned by Interactive), another affiliate of DFT, acquired American Alarm Company in December 2001. DFT Security Systems provides alarm services to western New York, including the Buffalo area, and now serves 6,667 alarm customers. As part of Company's effort to reduce debt and or monetize certain assets, it is considering selling a portion of its alarm accounts.

A subsidiary of Inter-Community Telephone Company in North Dakota, and Western New Mexico Telephone Company in New Mexico have filed with their respective state regulatory commissions to provide CLEC services in those states. Final plans to offer CLEC service in areas adjacent to Interactive's telephone operations in those states have not been completed. There is no assurance that Interactive can successfully develop these businesses or that these new or expanded businesses can be made profitable within a reasonable period of time. Such businesses, in particular any CLEC business, would be expected to operate at losses initially and for a period of time.

REGULATORY ENVIRONMENT. Operating telephone companies are regulated by state regulatory agencies with respect to intrastate telecommunications services and the FCC with respect to interstate telecommunications services.

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

TELECOMMUNICATIONS ACT OF 1996. In recent years, various aspects of federal and state telephone regulation have been subject to re-examination and on-going modification. In February 1996, the Telecommunications Act of 1996 (the "1996 Act"), which is the most substantial revision of communications regulations since the 1930's, became law. The 1996 Act is intended generally to allow telephone, cable, broadcast and other telecommunications providers to compete in each other's businesses, while loosening regulation of those businesses. Among other things, the 1996 Act (i) allows major long distance telephone companies and cable television companies to provide local exchange telephone service; (ii) allows new local telephone service providers to connect into existing local telephone exchange networks and purchase services at wholesale rates for resale; (iii) provides for a commitment to universal service for high-cost, rural areas and authorizes state regulatory commissions to consider their status on certain competition issues; (iv) allows the Regional Bell Operating Companies to offer long distance telephone service and enter the alarm services and electronic publishing businesses; (v) removes rate regulation over non-basic cable service; and (vi) increases the number of television stations that can be owned by one party. The 1996 Act had dual goals of fostering local and intrastate competition while ensuring universal service to rural America.

NATIONAL EXCHANGE CARRIER ASSOCIATION. For interstate services, Interactive's telephone subsidiaries participate in the National Exchange Carrier Association ("NECA") common line and traffic sensitive tariffs and access revenue pools. Where applicable, Interactive's subsidiaries also participate in similar pooling arrangements approved by state regulatory authorities for intrastate services. Such interstate and intrastate arrangements are intended to compensate local exchange carriers ("LECs"), such as Interactive's operating telephone companies, for the costs, including a fair rate-of-return, of facilities furnished in originating and terminating interstate and intrastate long distance services.

In addition to access pool participation, certain of Interactive's subsidiaries are compensated for their intrastate costs through billing and keeping intrastate access charge revenues (without participating in an access pool). Intrastate access charge revenues are based on intrastate access rates filed with the state regulatory agency.

6

INTERCARRIER COMPENSATION REFORM. The FCC released a Further Notice of Proposed Rulemaking ("FNPRM") on March 3, 2005 to examine all aspects of intercarrier compensation including access charges, reciprocal compensation, transport and transiting services, as well as, various network interconnection issues. Currently, the rate for intercarrier compensation depends on the type of traffic at issue, the types of carriers involved, and the end points of the communication. Many believe these rate differentials create both opportunities for regulatory arbitrage and incentives for inefficient investment and deployment decisions. The intent of this proceeding is to replace the existing patchwork of intercarrier compensation rules with a unified approach.

UNIVERSAL SERVICE FUND. The FCC has completed numerous regulatory proceedings required to implement the 1996 Act. For certain issues, the FCC bifurcated the proceedings between price-cap and rate-of-return companies or in the case of the Universal Service Fund ("USF") mechanisms between rural and non-rural companies. All of Interactive's telephone subsidiaries are rural, rate-of-return companies for interstate regulatory purposes. Rate-of-return companies receive support based on their costs while price cap companies receive support based on the prices of communications services. USF is intended, among other things, to provide special support funds to high cost rural LECs so that they can provide affordable services to their customers, notwithstanding their high cost due to low population density.

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

On February 25, 2005, the FCC adopted measures addressing the minimum requirements for a telecommunications carrier to be designated as an eligible telecommunications carrier ("ETC") and thus be eligible to receive federal USF. All of Interactive's companies are already designated as ETCs. New carriers seeking ETC designation must now:

- o Provide a five-year plan demonstrating how high-cost universal service support will be used to improve its coverage, service quality or capacity throughout the service area for which it seeks designation.
- o Demonstrate its ability to remain functional in emergency situations.
- o Demonstrate that it will satisfy consumer protection and service quality standards.
- o Offer local usage plans comparable to those offered by the incumbent local exchange carrier ("ILEC") in the areas for which it seeks designation.
- o Acknowledge that it may be required to provide equal access, if all other ETCs in the designated service area relinquish their designations.

The FCC added that these same requirements are applicable to ETCs previously designated by the commission, and these carriers must submit evidence by October 1, 2006, showing compliance. The FCC encourages states that have jurisdiction over ETC designations to adopt these requirements.

The FCC adopted the Rural Task Force ("RTF") order related to USF for rural carriers in May 2001 that mandates the continued use of actual embedded costs as the basis for USF support for rural carriers through June 2006. In such order, the FCC emphasized that it would provide predictability, certainty and stability to rural LECs for five years, so as to allow rural carriers to continue to provide supported telecommunications services at affordable rates to American consumers. On June 28, 2004, the FCC referred the issue of what modifications are needed for rural carriers for a post-RTF USF mechanism to a Federal-State Joint Board on Universal Service after June 2006.

The federal and state USF mechanisms, including that which the Company receives, are subject to considerable scrutiny and possible modification by the FCC. It is not possible to predict what modifications the FCC may adopt regarding USF, the timing of such modifications or the impact of those modifications on the Company.

VOICE OVER INTERNET PROTOCOL. Interactive's local exchange carrier telephone operations do not have significant wireline competition at the present time. However, wireless usage and VoIP is continuing to increase across the nation, including in the areas served by Interactive, which could have substantial detrimental impact on future revenues and create additional uncertainty for the Company. It is not possible to predict the extent these complimentary or substitutable services might impact Interactive's revenues. Because of the rural

nature of their operations and related low population density, Interactive's rural LEC subsidiaries are primarily high cost operations, which receive substantial Federal and state support. However, the regulatory environment for LEC operations has begun to change. VoIP usage is increasing as both a transport



## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

facility to haul traffic between switching centers, as well as the means to serve the end user customer's voice telephone needs. As a transport facility, it is expected to decrease the overall cost of transport in the long run. Interactive is analyzing if VoIP could be utilized for transport in a cost effective manner in the most rural portions of the nation, such as those served by the Company.

The Interexchange carriers ("IXCs") would like to have access minutes that are transported over VoIP exempt from paying access charges. If the IXCs were exempted from paying access charges on traffic transported over VoIP, it would have a significant detrimental impact to the Company's access charge revenues. While the FCC has initially determined that computer-to-computer VoIP traffic should not be considered a telecommunications service, it is not possible to predict the FCC's actions regarding the transport issue since the FCC has not issued a decision on this matter. The FCC has opened a more comprehensive proceeding to determine the extent VoIP should be subject to regulation.

In addition to transport, companies are increasing the use of VoIP in providing voice services to the end user. The VoIP end user traffic requires the use of a broadband service, such as DSL or cable, in order to receive the low price (or free) VoIP voice service. Since DSL cannot be purchased from the ILEC without the customer first purchasing a traditional local access line service, the ILEC still receives the DSL and the local service revenue as long as the end user purchases the DSL from the ILEC. Obviously, if the end user purchases the broadband service from a competitor, such as a cable or wireless broadband company, the ILEC loses all revenue associated with the customer switching to VoIP. Of greater concern is the fact that the Company loses the access charge revenue associated with intrastate calls that previously were provided through the Company's switched network. It is not possible to determine the potential lost revenue from calls that are handled by VoIP rather than the public switched network. This is very similar to revenue losses due to wireless usage where minutes of use are being removed from the Company's switching platform to the wireless carrier's switch thus reducing the Company's access revenues.

COMPETITION. Competition in the telecommunications industry is increasing. Competition in our specific wireline telecommunications markets is becoming more significant in the areas closest to larger towns or metropolitan areas. Although all of Interactive's current telephone companies have historically been monopoly wireline providers in their respective area for local telephone exchange service, except to a very limited extent in Iowa, the regulatory landscape has begun to change and we now experience competition from long distance carriers, from cable companies and internet service providers with respect to internet access and potentially in the future from cable telephony, and from wireless carriers. Competition may result in a greater loss of access lines and minutes of use and the conversion of retail lines to wholesale lines, which negatively affects revenues and margins from those lines. Competition also puts pressure on the prices we are able to charge for some services, particularly for some non-residential services. The total number of competitors is difficult to estimate since many of the companies do not have a local presence but, instead compete for services via the internet using Vo IP or wireless operations.

As a result of the 1996 Act, FCC and state regulatory authority initiatives and judicial decisions aimed at increasing competition, certain telecommunications providers have attempted to bypass local exchange carriers to connect directly with high-volume toll customers. For example, in the last few years, the States of New Mexico, New York, Michigan, Wisconsin and Kansas passed or amended telecommunications bills intended to reduce regulations and introduce more competition among providers of local services. In addition, regulatory authorities in certain states, such as New York, have taken steps to promote competition in local telephone exchange service by requiring certain companies to offer wholesale rates to resellers. To date, no substantial impact has been seen on Interactive's telephone subsidiaries, which do not consider this a

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

significant near-term competitive threat due to the limited number of high-volume customers they serve.

### OTHER MULTIMEDIA SERVICES

#### BROADCASTING

STATION WHBF-TV - Lynch Entertainment, L.L.C. ("Lynch Entertainment I"), a wholly-owned subsidiary of Interactive, and Lombardo Communications, Inc., wholly-owned by Philip J. Lombardo, are the general partners of Coronet Communications Company ("Coronet"). Lynch Entertainment I has a 20% interest in

8

Coronet and Lombardo Communications, Inc. has an 80% interest. In addition, on the sale of the stations, Interactive is entitled to an additional fee of 5% of the Capital Proceeds (as defined). Coronet owns a CBS-affiliated television station WHBF-TV serving Rock Island and Moline, Illinois and Davenport and Bettendorf, Iowa.

STATION WOI-TV - Lynch Entertainment Corporation II ("LEC-II"), a wholly-owned subsidiary of Interactive, owns 49% of the outstanding common shares of Capital Communications Corporation which owns Station WOI-TV ("Capital") and convertible preferred stock, which when converted, would bring LEC-II's common share ownership to 50%. WOI-TV is an ABC affiliate and serves the Ames/Des Moines, Iowa market. Lombardo Communications, Inc. II, controlled by Philip J. Lombardo, has the remaining share interest in Capital.

The Company's investments in broadcasting investments are carried on the equity basis and do not materially impact our current operating results.

Based upon a multiple of twelve times broadcast cash flow, plus cash, less debt, Interactive estimates its value in these stations at almost \$16 million as compared to the net book value of these investments of a negative \$0.6 million. It is not assured that the results of these stations will continue at the current level or that they could be sold at twelve times cash flow.

OPERATIONS. Revenues of a local television station depend to some extent upon its relationship with an affiliated television network. In general, the affiliation contracts of WHBF-TV and WOI-TV with CBS and ABC, respectively, provide that the network will offer to the affiliated station the programs it generates, and the affiliated station will transmit a number of hours of network programming each month. The programs transmitted by the affiliated station generally include advertising originated by the network, for which the network is compensated by its advertisers.

The affiliation contract has historically provided that the network will pay to the affiliated station an amount which is determined by negotiation, based upon the market size and rating of the affiliated station. Recently, however, the networks have begun in some instances to charge affiliated stations for certain programming. Typically, the affiliated station also makes available a certain number of hours each month for network transmission without compensation to the local station, and the network makes available to the affiliated station certain programs, which will be broadcast without advertising, usually public information programs. Some network programs also include "slots" of time in which the local station is permitted to sell spot advertising for its own account. The affiliate is permitted to sell advertising spots preceding, following, and sometimes during network programs.

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

A network affiliation is important to a local station because network programs, in general, have higher viewer ratings than non-network programs and help to establish a solid audience base and acceptance within the market for the local station. Because network programming often enhances a station's audience ratings, a network-affiliated station is often able to charge higher prices for its own advertising time. In addition to revenues derived from broadcasting network programs, local television stations derive revenues from the sale of advertising time for spot advertisements, which vary from 10 seconds to 120 seconds in length, and from the sale of program sponsorship to national and local advertisers. Advertising contracts are generally short in duration and may be canceled upon two-weeks notice. WHBF-TV and WOI-TV are represented by a national firm for the sale of spot advertising to national customers, but have local sales personnel covering the service area in which each is located. National representatives are compensated by a commission based on net advertising revenues from national customers.

COMPETITION. WHBF-TV and WOI-TV compete for revenues with local television and radio stations, cable television, and other advertising media, such as newspapers, magazines, billboards and direct mail. Generally, television stations such as WHBF-TV and WOI-TV do not compete with stations in other markets.

Other sources of competition include cable television systems, which carry television broadcast signals by wire or cable to subscribers who pay a fee for this service. CATV systems retransmit programming originated by broadcasters, as well as providing additional programming that is not originated on, or transmitted from, conventional broadcasting stations. Direct Broadcast Services ("DBS") are satellites providing local to local video services to a growing percentage of the population in the United States. In addition, some alternative media operators provide for a fee and, on a subscription basis, programming that is not a part of regular television service. Additional program services are provided by low-power television stations as well.

9

FEDERAL REGULATION. Television broadcasting is subject to the jurisdiction of the FCC under the Communications Act of 1934, as amended (the "Communications Act"). The Communications Act, and/or the FCC's rules, among other things, (i) prohibit the assignment of a broadcast license or the transfer of control of a corporation holding a license without the prior approval of the FCC; (ii) prohibit the common ownership of a television station and a daily newspaper in the same market; (iii) restrict the total number of broadcast licenses which can be held by a single entity or individual or entity with attributable interests in the stations and prohibits such individuals and entities from operating or having attributable interests in most types of stations in the same service area (loosened in the 1996 Act); and (iv) limit foreign ownership of FCC licenses under certain circumstances. In June 2003, the FCC adopted substantial rule changes that relax many of the prohibitions on the ownership of broadcast licenses. Currently, however, these rule changes are being challenged in federal court. In calculating media ownership interests, The Company's interests may be aggregated under certain circumstances with certain other interests of Mr. Mario J. Gabelli, Chairman and Chief Executive Officer of the Company, and certain of his affiliates.

Television licenses are issued for terms of eight years and are renewable for terms of eight years. The current licenses for WHBF-TV and WOI-TV expire on December 1, 2005 and February 1, 2006, respectively.

OTHER

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

SUNSHINE PCS CORPORATION. On December 31, 2003, Sunshine PCS Corporation ("Sunshine") completed the sale of its three C-Block personal communications services licenses to Cingular Wireless LLC ("Cingular") for \$13,750,000 in cash. The licenses, which are for the provision of C-Block personal communications services in the Florida cities of Tallahassee, Panama City and Ocala, represented substantially all of the assets of Sunshine. In related transactions, Sunshine used a portion of the sales proceeds to acquire all of its preferred stock and warrants held by Interactive for an aggregate amount of \$7,587,000 (the "Preferred Stock and Warrant Repurchase") and all of its outstanding Class B Common Stock for an aggregate amount of \$613,862 (the "Class B Stock Repurchase"). Interactive's cash investment in Sunshine and its predecessor companies, beginning in 1993, was a cumulative \$21.9 million. In 1997 and in 1999, Interactive recorded impairment losses of \$7.0 million and \$15.4 million, respectively, which included the impairment of interest the Company capitalized on these investments during the development of the licenses. Following the Preferred Stock and Warrant Repurchase and the Class B Stock Repurchase, Interactive owns 294,117 shares of Sunshine's Class A Common Stock, representing 6.4% of all outstanding Class A Shares of Sunshine. During 2004, the Company received a cash distribution from Sunshine equal to \$.83 per share and on March 25, 2005, Sunshine was quoted at \$.12 per share on bulletin board market.

LAS CRUCES, NM PCS LICENSE. Another subsidiary of Interactive, Lynch PCS Corporation G ("LPCSG") holds a 10 MHz PCS license for the Basic Trading Area (BTA) covering Las Cruces, New Mexico. Las Cruces is the principal city in the BTA, which covers a population of approximately 249,902 (as of the 2000 census). In April 2002, LPCSG completed a build-out of the licensed area sufficient to meet the FCC requirement that it provide service coverage to at least one-quarter of the population in this BTA. In a February 2005 FCC auction for similar spectrum, the price per MHz of population was materially lower than the price paid by Interactive for this spectrum. Accordingly, at December 31, 2004, Interactive recorded a \$0.3 million impairment of this investment, which is included in amortization expense.

LOGAN, UT PCS LICENSE. As part of the acquisition of Central Utah Telephone Company by Interactive in June 2001, Interactive acquired Central Telecom Services, LLC, a related entity that now owns a 10 MHz PCS license in the Logan, Utah, BTA, which has a population of approximately 102,702 (as of 2000 census). Similar to LPCSG, Central Telecom Services has completed a build-out sufficient to meet the FCC requirement that service coverage be available to at least one-quarter of the population in this BTA. In respect of the traditions of many staff members and former owners, Interactive committed to donate 20% of the net profits (as defined in the donation letter) from any sale of the Logan license to the Church of Jesus Christ of Latter Day Saints. In a February 2005 FCC auction for similar spectrum, the price per MHz of population was materially lower than the price paid by Interactive for this spectrum. Accordingly, at December 31, 2004, Interactive recorded a \$0.4 million impairment of this investment, which is included in amortization expense.

10

IOWA PCS LICENSES. Central Scott has a 10 MHz PCS License for its wireline territory covering a population of 11,470. Central Scott is also an approximately 14% minority owner of an entity that has a 10 MHz PCS license for portions of Clinton and Jackson Counties in Iowa, with a total population of 68,470.

RSA CELLULAR INTERESTS. Interactive owns minority interests in certain entities that provide wireless cellular telephone service in two Rural Service Areas ("RSAs") in New Mexico and two RSA's in North Dakota, covering areas with a

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

total population of approximately 163,000. Equity in earnings from these two operations was \$2.9 million in 2004 on a combined basis and the combined book value of these entities was \$6.3 million at December 31, 2004. Interactive's proportional share of these operations combined revenues, EBITDA and operating profits were \$3.9 million, \$1.9 million and \$1.6 million respectively, for the year ended December 31, 2004, and we received \$0.7 million in cash distributions, net of cash paid to minority interests, from these investments in 2004. An additional \$0.9 million was received from these investments in the first quarter of 2005. The difference between EBITDA and operating profit is depreciation of plant and equipment. EBITDA is presented because it is a widely accepted financial indicator of value and ability to incur and service debt in this industry. The Company utilizes the EBITDA metric for valuing potential acquisitions. EBITDA is not a substitute for operating profit, in accordance with generally accepted accounting principles. The entities have no debt and Interactive's proportional share of their cash equivalents is \$1.1 million.

OTHER INTERESTS IN WIRELESS LICENSES. In 1997, LPCSG entered into an agreement with Bal/Rivgam LLC (in which an affiliate of the CEO has a 49.9% equity interest), which won licenses in the FCC's Wireless Communications Services ("WCS") Auction in 1997, to receive a fee equal to 5% of the realized net profits of Bal/Rivgam (after an assumed cost of capital), in return for providing bidding and certain other services to Bal/Rivgam. Bal/Rivgam holds 5 WCS licenses covering a population of approximately 42 million with an aggregate cost of \$0.7 million and certain Local Multipoint Distribution Services ("LMDS") licenses. Betapage Communications, L.L.C., in which Interactive has a 49.9% equity interest, was a winning bidder in the FCC auction for 929 MHz paging licenses, which was conducted in 2000. Betapage won 24 paging licenses covering a population of 76.7 million at a cost of approximately \$77,000. Interactive also has the right to receive a fee equal to 20% of the realized net profits of Betapage (after an assumed cost of capital).

Another subsidiary of Interactive is a 49.9% owner of PTPMS Communications, L.L.C. ("PTPMS"), which was a winning bidder in the FCC auction of licenses for fixed point-to-point microwave services, which was conducted in 2000. PTPMS won 22 licenses covering a population of 27.6 million for an aggregate cost of \$1.5 million. Interactive's subsidiary has loaned PTPMS approximately \$1.4 million. Interactive's subsidiary also has the right to receive a fee equal to 20% of the realized net profits of PTPMS (after an assumed cost of capital).

Another subsidiary of Interactive is a 49.9% owner of PTPMS Communications II, L.L.C. ("PTPMS II"), which was a winning bidder in the FCC auction of licenses for 700 MHz Guard Band spectrum for wireless data transmission and wireless Internet services, which was conducted in 2000. PTPMS II won three licenses covering a population of 6.4 million in BTAs including the cities of Buffalo, NY, Des Moines-Quad-Cities, IA and El Paso, TX, at an aggregate cost of approximately \$6.3 million. Interactive has loaned PTPMS II approximately \$6.1 million. Interactive's subsidiary has the right to receive a fee equal to 20% of the realized net profits of PTPMS II (after an assumed cost of capital). In a FCC auction conducted in September 2002 for similar spectrum, called the LOWER 700 MHZ BAND AUCTION, the price per MHz of population was materially lower than the price paid by PTPMS II in 2000. Accordingly, during 2002, Interactive provided a reserve for impairment for its investment in PTPMS II of \$5.5 million.

Another subsidiary of Interactive, Lynch 3G Communications Corporation, participated in the Lower 700 MHz auction conducted in August 2002. Lynch 3G won eight 12 MHz licenses in the following areas: Reno, NV; Santa Barbara, CA; Des Moines, IA; Quad Cities area of Davenport and Bettendorf, IA and Rock Island and Moline, IL; Las Cruces, NM; Elmira, NY; and two RSAs in the western part of New Mexico. The total population covered by these licenses is approximately 1.7 million. Lynch 3G paid \$1.1 million for these licenses.

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

In June 2003, Lynch 3G participated in a re-auction of Lower 700 MHz spectrum that was not licensed in the August 2002 auction and won four 12 MHz licenses in the following areas: Dubuque, IA, Gogebic, MI, San Juan, NM and Chautauqua, NY. The total population covered by these licenses is approximately 1.1 million. Lynch 3G paid \$620,000 for these licenses.

11

In July 2004, Lynch 3G participated in the Auction for 24 GHz Spectrum and was high bidder for two licenses, Buffalo - Niagara, NY and Davenport, IA - Moline, IL, for a total cost of \$49,000.

In February 2005, Lynch 3G participated in Auction 58 for PCS Spectrum and was high bidder for two licenses, Marquette, MI and Klamath Falls, OR, for a total cost of \$0.5 million.

Interactive expects to continue to participate in the spectrum auctions being conducted by the FCC in order to have the flexibility to accommodate present and future needs of existing and future customers as well as establish high bandwidth opportunities.

In addition to the build out requirements for PCS licenses, FCC rules impose build-out requirements for WCS, LMDS, paging licenses, point-to-point microwave services and the licenses granted in 700 MHz (guard band) and Lower 700 MHz spectrum. There are also substantial restrictions on the transfer of control of licensed spectrum.

There are many risks relating to PCS and other FCC wireless licenses including without limitation, the high cost of PCS and certain other licenses, the fact that it involves start-up businesses, raising the substantial funds required to pay for the licenses and the build out, determining the best way to develop the licenses and which technology to utilize, the small size and limited resources of companies compared to other potential competitors, existing and changing regulatory requirements, additional auctions of wireless telecommunications spectrum and actually building out and operating new businesses profitably in a highly competitive environment (including already established cellular telephone operators and other new PCS licensees). There can be no assurance that any licenses granted to entities in which subsidiaries of Interactive have interests, can be successfully sold or financed or developed, thereby allowing Interactive's subsidiaries to recover their debt and equity investments.

MORGAN GROUP HOLDING COMPANY. In January 2002, Interactive spun off its interest in The Morgan Group, Inc. ("Morgan"), its only services subsidiary, via a tax-free dividend to its shareholders.

### II. OTHER INFORMATION

PATENTS, LICENSES, FRANCHISES. While Interactive holds licenses of various types, Interactive does not believe they are critical to its overall operations, except for (1) the television-broadcasting licenses of WHBF-TV and WOI-TV; (2) Interactive's telephone subsidiaries' franchise certificates to provide local-exchange telephone service within their service areas; (3) FCC licenses to operate point-to-point microwave systems; (4) licenses held by partnerships and corporations in which certain of Interactive's subsidiaries own minority interests to operate cellular telephone systems covering various service areas in New Mexico and North Dakota, (5) Giant Communications' franchises to provide cable television service within its service areas and (6) personal communications services and other wireless communication licenses held by companies in which Interactive's subsidiaries have investments, including the PCS licenses for Las Cruces, New Mexico, Logan, Utah, and portions of Iowa as

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

described above in more detail.

COMPLIANCE. The capital expenditures, earnings and competitive position of Interactive have not been materially affected by compliance with current federal, state, and local laws and regulations relating to the protection of the environment; however, Interactive cannot predict the effect of future laws and regulations.

SEASONALITY. No portion of the business of Interactive is regarded as seasonal. While Interactive's New Hampshire and Michigan operations usage varies during the year due to tourism and vacation homes in their areas, this is not material for Interactive's telephone operations as a whole.

DEPENDENCE ON CUSTOMERS. Interactive does not believe that its multimedia business is dependent on any single customer of local telephone service. Most local exchange carriers, including Interactive's, received a significant amount of revenues in the form of access fees from long distance companies which are referred to as interexchange carriers (IXCs). Bankruptcy of a significant IXC or of several IXCs in the same period could have a material adverse effect on Interactive. Interactive cannot predict which, if any, IXCs may go bankrupt in the future.

12

GOVERNMENT CONTRACTS. Interactive provides service to the government under tariff or special contract. Interactive's government contracts are not significant and it would not adversely impact its operations if those contracts were eliminated.

EMPLOYEES. Interactive had a total of 356 employees at December 31, 2004, including 6 corporate employees and the remainder responsible for providing rural telephone services, compared to 349 employees at December 31, 2003.

### III. EXECUTIVE OFFICERS OF THE REGISTRANT

Pursuant to General Instruction G (3) of Form 10-K, the following list of executive officers of the Registrant is included in Part 1 of this Annual Report on Form 10-K in lieu of being included in the Proxy Statement for the 2004 Annual Meeting of Shareholders. Such list sets forth the names and ages of all executive officers of the Registrant indicating all positions and offices with the Registrant held by each such person and each such person's principal occupations or employment during the past five years.

Name	Offices and Positions Held	Age
Mario J. Gabelli	Chairman and Chief Executive Officer of Lynch Interactive since December 2004 (and also from September 1999 to December 2002) and Vice Chairman and Chief Executive Officer from December 2002 to December 2004. He is also Chairman, Chief Executive Officer, and a director of Gabelli Asset Management Inc. and its predecessors (since November 1976) (and in connection with those responsibilities, he serves as director or trustee and/or an officer of registered investment companies managed by subsidiaries of Gabelli Asset Management); and Chairman and Chief Executive Officer of GGCP, Inc., a private company.	62

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

Robert E. Dolan	Chief Financial Officer (since January 2004); Chief Financial Officer and Controller from September 1999 to January 2004; Chief Financial Officer (1992-2000) and Controller (1990-2000) of Lynch Corporation.	53
Evelyn C. Jerden	Senior Vice President-Operations (since September 2003); Vice President-Regulatory Affairs (2002-2003); Director of Revenue Requirements of Western New Mexico Telephone Company, Inc. (since 1992).	47
John A. Cole	Vice President-Corporate Development, Secretary and General Counsel (since December 2004); Counsel at LeBoeuf, Lamb, Greene & MacRae, LLP (1994 to 2004).	54

The executive officers of the Registrant are elected annually by the Board of Directors at its meeting in May and hold office until the organizational meeting in the next subsequent year and until their respective successors are chosen and qualified.

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion should be read together with the Consolidated Financial Statements of Interactive and the notes thereto included elsewhere in this Annual Report.

13

### RESULTS OF OPERATIONS

#### OVERVIEW

Interactive has grown primarily through the selective acquisition of rural local exchange carriers ("RLECs") and by offering additional services such as Internet service, alarm services, long distance service and competitive local exchange carrier ("CLEC") service. From 1989 through the current reporting period, Interactive (and its predecessor corporation) acquired fourteen telephone companies, four of which have indirect minority ownership of 2% to 19%, whose operations range in size from approximately 800 to over 10,000 access lines. The Company's telephone operations are located in Iowa, Kansas, Michigan, New Hampshire, New Mexico, New York, North Dakota, Utah and Wisconsin.

The telecommunications industry in general and the RLECs that comprise Interactive's business face a number of economic or industry-wide issues and challenges.

- o REGULATORY- The Telecommunications Act of 1996 and other federal and state legislation and regulations have a significant impact on the industry and on rural carriers in particular. Interactive's telephone companies are all RLECs serving very high cost areas with a significant portion of their revenues being derived from federal or state support mechanisms, which are referred to as Universal Service Funds ("USF"). The revenues and margins of our RLEC subsidiaries are largely dependent on the continuation of such support mechanisms.
- o COMPETITION- The effects of competition from CLECs, wireless service,



## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

high speed cable, Voice Over Internet Protocol ("VoIP") and other internet providers is an industry-wide issue that is felt to varying degrees by our rural telephone companies.

- o THE ECONOMY- Unemployment, building starts, business bankruptcies and the overall health of the economy have a significant effect on demand for our services.
- o TELECOMMUNICATION BANKRUPTCIES- Interactive's telephone companies have significant, normal course of business receivables from interexchange carriers, such as MCI or Global Crossings who filed for bankruptcy and, as a result, have been written-off. Additional bankruptcies could have a significant effect on our financial condition. The Company expects to recover settlements from MCI in 2005.
- o MARKET CHALLENGES- Our phone companies are required to comply with industry-wide initiatives such as local number portability and the requirements of the Communications Assistance for Law Enforcement Act ("CALEA") that are expensive to implement and that in some cases have limited demand in our markets.

Interactive generates cash and earns telecommunications revenues primarily from local network access, intrastate and interstate access revenue and from state and federal USF support mechanisms. Due to the nature of the Company's regulated telephone operations, revenues and operating expenses are relatively stable period to period.

- o Local Revenues - The number of access lines is the primary driver of local network access revenues. In addition, the ratio of business to residential lines, as well as the number of features subscribed to by customers are secondary drivers.
- o Intrastate access revenues - Customer usage, primarily based on minutes of use, and the number of access lines are the primary drivers of intrastate access revenues since the Company's RLECs are on a "bill-and-keep" basis.
- o All of our RLECs participate in the National Exchange Carrier Association ("NECA") access pools. Interstate access revenues depend upon whether the RLEC has elected to be "cost-based" or has remained an "average schedule" carrier. The revenues of our nine cost-based carriers directly correlate to the rate-of-return on regulated net investment earned by the NECA access pools plus the amount of

14

regulated operating expenses including taxes. The revenues of the Company's five average schedule subsidiaries correlate to usage based measurements such as access lines, interstate minutes-of-use, and the number and mileage of different types of circuits. The average schedule formulas are intended to be a proxy for cost-based recovery.

- o USF subsidies are primarily driven by investments in specific types of infrastructure, as well as certain operating expenses and taxes of the Company. Interstate and intrastate USF subsidies are included in the respective interstate and intrastate access revenue captions in the breakdown of revenue and operating expenses which follows.
- o Other business revenue: Interactive's companies also provide

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

non-regulated telecommunications related services, including Internet access service, wireless and long distance resale service, in certain of its telephone service and adjacent areas. Interactive also provides and intends to provide more local telephone and other telecommunications service outside certain of its franchise areas by establishing CLEC operations in selected nearby areas. In addition, certain of Interactive's companies have expanded into cable and security businesses in the areas in which they operate.

- o Long Distance revenues are only retained by the Company if it is providing the long distance service to the end user customer as the toll provider. For unaffiliated IXCs who contract with Interactive for billing services, the Company provides billing services and receives an administrative handling fee.

The following are material opportunities, challenges and risks that Interactive's executives are currently focused on, as well as actions that are being taken to address the concerns:

- o Universal Service Reform: Efforts to modify universal service mechanisms are currently underway at the FCC. In June 2004, the FCC asked the Federal-State Joint Board on Universal Service ("Joint Board") to review the rules relating to the high-cost universal service support mechanisms for rural carriers and to determine the appropriate rural mechanism to succeed the five-year plan adopted in the RURAL TASK FORCE ORDER. In particular, the FCC asked the Joint Board to make recommendations on a long-term universal service plan that ensures that support is specific, predictable, and sufficient to preserve and advance universal service. The FCC asked the Joint Board to ensure that its recommendations are consistent with the goal of ensuring that consumers in rural, insular, and high-cost areas have access to telecommunications and information services at rates that are affordable and reasonably comparable to rates charged for similar services in urban areas. The FCC also asked the Joint Board to consider how support can be effectively targeted to rural telephone companies serving the highest cost areas, while protecting against excessive fund growth. In conducting its review, the Joint Board is supposed to take into account the significant distinctions among rural carriers, and between rural and non-rural carriers and consider all options for determining appropriate universal service support. The Company participated with the RLEC industry in comments to the FCC regarding the potential impact to customers and RLECs in rural America. Total USF support payments are material to the Company's financial results.
- o Intercarrier Compensation and Access Charge Reform: The Company is actively participating in the RLEC industry's efforts to determine how intercarrier compensation and access charges should be modified without sustaining revenue losses for RLECs.
- o Loss of Access Revenues from VoIP and wireless usage: The Company is experiencing revenue losses as usage transfers from landline service provided by the Company's subsidiaries to either VoIP or wireless services. VoIP traffic currently does not pay access charges or contribute to universal service. The FCC has several proceedings underway to determine whether VoIP traffic should contribute for the use of the network and contribute to USF. The Company is participating in the RLEC industry efforts to have VoIP traffic contribute for use of the underlying network on which the VoIP call travels. To offset revenue losses from traditional voice services, Interactive is installing more broadband services and is exploring how to best incorporate VoIP into its business model.

- o Intrastate revenue at our Michigan telephone company could be substantially reduced in the future due to a state requirement to expand the local calling area. The Company intends to file with the state commission recover some or all of the revenue deficiency, however, there is no assurance that it will be successful.

In January 2002, Interactive spun off its investment in Morgan, its only services subsidiary, via a tax-free dividend to its shareholders of the stock of Morgan Group Holding Co., a corporation that was initially formed to serve as a holding company for Interactive's controlling interest in Morgan. Accordingly, the amounts for Morgan are reflected on a one-line basis in the consolidated financial statements as "to be distributed to shareholders."

#### YEAR 2004 COMPARED TO 2003

The following is a breakdown of revenues and operating costs and expenses for 2004 and 2003 (in thousands):

	----- 2004	2003 -----	Increase (Decrease)
(Unaudited)			
<b>Revenues:</b>			
Local access	\$ 11,851	\$ 11,836	\$ 15
Interstate access	39,644	37,686	1,958
Intrastate access	15,263	15,352	(89)
Other business	21,036	20,518	518
	-----	-----	-----
Total	87,794	85,392	2,402
	-----	-----	-----
<b>Operating Cost and Expense:</b>			
Cost of revenue, excluding depreciation	29,992	29,460	532
General and administrative costs at operations	13,800	12,693	1,107
Corporate office expenses	6,401	4,529	1,872
Depreciation and amortization	21,870	20,282	1,588
	-----	-----	-----
Total	72,063	66,964	5,099
	-----	-----	-----
Operating profit	\$ 15,731	\$ 18,428	\$ (2,697)
	=====	=====	=====

Total revenues in 2004 increased \$2.4 million, or 2.8%, to \$87.8 million compared to \$85.4 million in 2003. Local access revenue increased by \$15,000 in 2004 resulting from the sale of additional features and rate increases, partially offset by a 3.3% decrease in access lines. The decrease in access lines is due to the increase in cell phone usage and reduction in dial-up internet service. Interstate access revenue increased \$2.0 million in 2004

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

primarily due to infrastructure development undertaken in 2002 and 2003, which entitled the Company to increased network access and USF support primarily at the Haviland Telephone Company in Kansas. Such increase was partially offset by the loss of a telecommunications transport contract in Utah and by a one-time NECA adjustment to our reported rate base, which reduced revenue. Intrastate network access revenue decreased \$0.1 million as increases resulting from the infrastructure development in Haviland were offset by an increase in local dial-up access to the internet at our Michigan telephone company. Other business revenues increased \$0.5 million due to increased DSL penetration, the sale of telecommunications equipment to an Iowa school district, revenues from a small cable company in Utah that the Company acquired in February 2004, and partially offset by lower revenues in the Company's security operation.

Total costs and expenses increased by \$5.1 million to \$72.1 million in 2004. Costs of revenue increased \$0.5 million, or 1.8%, due to additional operating costs related to the infrastructure development in Haviland, costs related to the sale of equipment to the Iowa school district, costs generated by the cable television operation acquired in February 2004 and partially offset by cost savings in the Company's security operation. General and administrative costs incurred at the operations increased \$1.1 million primarily due to increased staffing, increased audit and consulting costs resulting from Sarbanes-Oxley implementation, increased advertising, and higher professional fees offset by a \$0.1 million decrease in consulting fees relating to the Kansas Commission audit incurred in 2003. Corporate office expenses increased \$1.9 million resulting

16

from \$3.2 million of legal costs incurred defending the False Claims Act litigation in 2004, partially offset by the absence in 2004 of a \$1.6 million management incentive accrual recorded in 2003. Depreciation and amortization increased \$1.6 million including an increase of \$0.5 million in depreciation and \$1.1 million of amortization expense. The increase in depreciation was primarily as a result of the infrastructure development at Haviland, as well as a regulatory approved change in depreciable lives, which resulted in increased depreciation expense at our Michigan telephone company. The increase in amortization resulted from the Company's 2004 annual test of goodwill and other indefinite life intangible assets for impairment in accordance with SFAS No.142. Interactive recorded a \$0.7 million impairment of its investments in certain 10MHz PCS licenses in Las Cruces, NM and Logan, UT. Such impairment was based on a February 2005 FCC auction of similar spectrum in which the price per MHz of population was materially lower than the price Interactive paid for such spectrum. In addition, \$0.5 million of goodwill was considered to be impaired and was written off in amortization expense.

As a result of the above, operating profit in 2004 decreased by \$2.7 million to \$15.7 million compared to 2003.

### ADJUSTED OPERATING PROFIT

Adjusted operating profit is used by our management as a supplemental financial measure to evaluate the operating performance of our business that, when viewed with our GAAP results and the accompanying reconciliations, we believe provides a more complete understanding of factors and trends affecting our business than the GAAP results alone. We also regularly communicate our adjusted operating profit to the public through our earnings releases because it is the financial measure commonly used by analysts that cover the telecommunications industry and our investor base to evaluate our operating performance. In addition, we routinely use adjusted operating profit as a metric for valuing potential acquisitions. We understand that analysts and investors regularly rely on

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

non-GAAP financial measures, such as adjusted operating profit, to provide a financial measure by which to compare a company's assessment of its operating performance against that of other companies in the same industry. This non-GAAP financial measure is helpful in more clearly reflecting the sales of our products and services, as well as highlighting trends in our core business that may not otherwise be apparent when relying solely on GAAP financial measures, because this non-GAAP financial measure eliminates from earnings financial items that have less bearing on our performance.

Interactive's management believes strongly in growing intrinsic value as a long-term prescription for managing an enterprises health. Our local management teams run their respective businesses as stand-alone, entrepreneurial units. We believe that adjusted operating profit is the clearest indicator of the cash flow generating ability and long-term health of such units. We value potential acquisitions on the same basis.

The term "adjusted operating profit" as used in this Form 10-K/A refers to, for any period, net income (loss) before all components of "Other income (expense)" (consisting of investment income, interest expense, equity in earnings of affiliates, gains and losses on disposition of or impairment of assets), income taxes, depreciation, amortization, minority interests and income or loss from discontinued operations.

Set forth below are descriptions of the financial items that have been excluded from net income (loss) to calculate adjusted operating profit and the material limitations associated with using this non-GAAP financial measure as compared to the use of the most directly comparable GAAP financial measure:

- o The amount of interest expense we incur is significant and reduces the amount of funds otherwise available to use in our business and, therefore, is important for investors to consider. However, management does not consider the amount of interest expense when evaluating our core operating performance.
- o Investment income is considered to be similar to interest expense. Although it is important for investors to consider, management does not consider the amount of investment income when evaluating our core operating performance.

17

- o Management does not consider income tax expense when considering the profitability of our core operations. Nevertheless, the amount of taxes we are required to pay reduces the amount of funds otherwise available for use in our business and thus may be useful for an investor to consider.
- o Depreciation and amortization are important for investors to consider, even though they are non-cash charges, because they represent generally the wear and tear on our property, plant and equipment, which produce our revenue. We do not believe these charges are indicative of our core operating performance.
- o Income from equity investments relates to our proportionate share of income or loss from the entities in which we hold minority interests. We do not control these entities and, as such, do not believe the income we receive from such entities is indicative of our core operating performance.
- o Minority interest in (income) loss of subsidiaries relates to our

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

minority investors' proportionate share of income or losses in our non-wholly owned subsidiaries, which generated non-cash charges to our operating results. Operating results attributable to these minority investors' investments do not necessarily result in any actual benefit or detriment to us and, therefore, we believe it would be more helpful for an investor to exclude such items as being more reflective of our core operating performance.

- o Gain or losses on the disposition of assets or impairment of investments may increase or decrease the cash available to us and thus may be important for an investor to consider. We are not in the business of acquiring or disposing of assets and, therefore, the effect of the dispositions of assets may not be comparable from year-to-year. We believe such gains or losses recorded on the disposition of an asset do not reflect the core operating performance of our business.

Management compensates for the above-described limitations of using a non-GAAP financial measure by using this non-GAAP financial measure only to supplement our GAAP results to provide a more complete understanding of the factors and trends affecting our business. Adjusted operating profit should not be considered to be a substitute for net income or (loss) as an indicator of the Company's operating performance.

The following table provides the components of Adjusted Operating Profit and reconciles it to net income:

	----- 2004 -----	2003 -----	Increase (Decrease) -----
Adjusted operating profit from:	\$ 44,002	\$ 43,239	\$ 763
Operating units			
Corporate expense:			
False Claims Act litigation and SOX consulting	(3,501)	(24)	(3,477)
Bonus accrual	--	(1,600)	1,600
Other	(2,900)	(2,905)	5
Total corporate expenses	(6,401)	(4,529)	(1,872)
Adjusted operating profit	\$ 37,601 =====	\$ 38,710 =====	\$ (1,109) =====

RECONCILIATION TO NET INCOME:			
Adjusted operating profit	\$ 37,601	\$ 38,710	\$ (1,109)
Depreciation and amortization	(21,870)	(20,282)	(1,588)
Investment income	1,289	1,120	169
Interest expense	(11,204)	(11,864)	660
Equity in income of affiliates	3,564	2,280	1,284
Gains/ losses/ impairments, net	185	3,919	(3,734)
Income tax	(3,078)	(4,968)	1,890
Minority interests	(2,021)	(1,525)	(496)
Net income	\$ 4,466 =====	\$ 7,390 =====	\$ (2,924) =====

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

### OTHER INCOME (EXPENSE)

In 2004, investment income increased by \$0.2 million primarily due to an increase in CoBank patronage refunds offset by a reduction in interest income due to lower interest rates.

Interest expense decreased by \$0.7 million in 2004 compared to 2003 due primarily to lower outstanding borrowings partially offset by higher interest rates.

Equity in earnings of affiliates in 2004 increased \$1.3 million compared to 2003 due to higher earnings at the Company's New Mexico cellular investments (RSA 3 and 5).

### INCOME TAX PROVISION

The income tax provision includes federal, as well as state and local taxes. The tax provision for the 2004 and 2003, represent effective tax rates of 36.8% and 35.8%, respectively. The difference between these effective rates and the federal statutory rate is principally due to state income taxes, including the effect of earnings attributable to different state jurisdictions. In addition, in December 2004 Interactive reversed certain tax reserves that were no longer required.

### MINORITY INTERESTS

Minority interests decreased earnings by \$2.0 million in 2004, as compared to \$1.6 million in 2003. The change was due to higher earnings from the Company's New Mexico cellular investments.

### NET INCOME

Net income in 2004, was \$4.5 million, or \$1.61 per share (basic and diluted), compared to a net income last year of \$7.4 million, or \$2.64 per share (basic and diluted). The Company has no dilutive instruments outstanding.

19

### YEAR 2003 COMPARED TO 2002

The following is a breakdown of revenues and operating costs and expenses for 2003 and 2002:

	----- 2003	2002	Increase (Decrease) -----
(Unaudited)			
Revenues:			
Local access	\$ 11,836	\$ 11,890	(54)
Interstate access	37,686	34,830	2,856
Intrastate access	15,352	16,723	(1,371)
Other business	20,518	20,782	(264)
	-----	-----	----
Total	85,392	84,225	1,167
	-----	-----	----

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

### Operating Cost and Expense:

Cost of revenue, excluding depreciation,	29,460	29,020	440
General and administrative costs at operations	12,693	13,285	(592)
Corporate office expenses	4,529	3,334	1,195
Depreciation and amortization	20,282	19,353	929
	-----	-----	----
Total	66,964	64,992	1,972
	-----	-----	----
Operating profit	\$ 18,428	\$ 19,233	(805)
	=====	=====	=====

Total revenues in 2003 increased \$1.2 million, or 1.4%, to \$85.4 million compared to \$84.2 million in 2002. Local access revenue decreased by \$54,000 in 2003 compared to 2002 as a 2.7% decrease in the number of access lines, due primarily to additional DSL lines sold, offset a 1% increase in the percentage of business lines, which typically generate higher revenues, compared to residential access lines. Interstate revenues increased \$2.9 million in 2003 compared to 2002 primarily due to the effect of infrastructure development, which entitled the Company to increased USF support primarily at the Haviland Telephone Co. and Central Utah Telephone Co. ("CUT"). In addition, interstate access revenue increased \$0.8 million primarily due to the recovery in revenue of increased operating expenditures, in accordance with our ratemaking structure, associated with the increased infrastructure development. Under the rate of return model in which these companies are regulated, further increases in revenue are expected in 2004, as the 2003 capital expenditures are fully recognized by the model. Intrastate revenues decreased \$1.4 million in 2003 compared to 2002 primarily due to state initiatives in Kansas and New York. The Kansas initiative has been fully recognized in the regulatory model, but additional revenue reductions are expected in New York of approximately \$0.1 million per year over the next four years.

Other Business revenues, which include the Company's internet, CLEC, wireless, long-distance, cable and security operations, decreased \$0.3 million in 2003 compared to 2002. The sale of a wireless equipment operation in upstate New York with 2002 revenues of \$0.8 million was offset by a \$0.6 million increase due to additional subscribers in the Company's 63.6% owned security business in upstate New York. In addition, decreased revenue in long-distance resale and other lines of business offset an increase of \$0.6 million in the Company's CLEC operations in New York.

20

Total costs and expenses increased by \$2.0 million to \$67.0 million in 2003. Cost of revenue increased \$0.4 million, or 1.5%, due to additional operating costs related to the infrastructure development in Haviland, additional bandwidth and system maintenance costs in 2003, and a \$0.8 million reduction in costs due to the sale of a wireless business in upstate New York in late 2002. General and administrative costs at the operations decreased \$0.6 million in 2003 compared to 2002, primarily due to \$0.9 million of bad debt expense in 2002 associated with the bankruptcies of MCI/Worldcom and Global Crossings. Corporate costs increased \$1.2 million in 2003, primarily due to a \$1.2 million increase in the bonus accrual. The Company recorded a \$1.6 million accrual in 2003 in accordance with a shareholder approved management incentive program compared to a \$0.4 million bonus accrual in 2002. The gain on the sale of the Sunshine Preferred Stock and warrants resulted in \$0.8 million of such increase to the bonus accrual. Depreciation expense increased by \$1.6 million in 2003, of which \$0.8 million was due to increased capital expenditures at one of our Kansas



## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

operations and \$0.3 million was due to revised depreciation rates that more accurately reflect asset lives at our Michigan subsidiary. Amortization expense decreased by \$0.7 million during 2003, as the Dunkirk & Fredonia security operation increased the amortization period for its subscriber lists from three to ten years in the fourth quarter of 2002.

As a result of the above, operating profit was \$18.4 million in 2003, \$0.8 million less than the \$19.2 million recorded in 2002.

### ADJUSTED OPERATING PROFIT

The following table provides the components of Adjusted Operating Profit and reconciles it to net income:

	----- 2003	2002	Increase (Decrease) -----
Adjusted operating profit from:			
Operating units	\$ 43,239	\$ 41,920	\$ 1,319
Corporate expense:			
False Claims Act litigation and SOX consulting	(24)	(515)	491
Bonus accrual	(1,600)	(463)	(1,137)
Other	(2,905)	(2,356)	(549)
	-----	-----	-----
Total corporate expenses	(4,529)	(3,334)	(1,195)
	-----	-----	-----
Adjusted operating profit	\$ 38,710	\$ 38,586	\$ 124
	=====	=====	=====
 Reconciliation to net income:			
Adjusted operating profit	\$ 38,710	\$ 38,586	\$ 124
Depreciation and amortization	(20,282)	(19,353)	(929)
Investment income	1,120	1,765	(645)
Interest expense	(11,864)	(13,031)	1,167
Equity in income of affiliates	2,280	1,938	342
Gains/losses/impairments, net	3,919	(514)	4,433
Income tax	(4,968)	(3,924)	(1,044)
Minority Interests	(1,525)	(1,706)	181
	-----	-----	-----
Loss from Morgan (discontinued)	-	(1,888)	1,888
Net income	\$ 7,390	\$ 1,873	\$ 5,517
	=====	=====	=====

### OTHER INCOME (EXPENSE)

Investment income was \$1.1 million in 2003 as compared to \$1.8 million in 2002. The decrease was attributed to absence of interest income associated with an escrow account securing our previously outstanding convertible note which was repaid in November 2002, interest on an IRS refund that was recorded in 2002, lower realized gain on sales of marketable securities and lower patronage capital income associated with our long term borrowings.

Interest expense was \$11.9 million in 2003, as compared to \$13.0 million in 2002, primarily due to the repayment in November 2002 of a \$10 million

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

Convertible Note. The company recorded \$0.7 million of interest expense associated with the note in 2002. The remaining decrease was the result of lower interest rates on the Company's variable rate borrowings. The Company is considering converting a significant portion of its current variable interest rate debt to fixed interest rate debt, which would increase interest expense in the future, based on current interest rate levels.

On December 31, 2003, Sunshine sold its three PCS licenses to Cingular Wireless for \$13.75 million in cash. As part of this sale, Interactive received \$7.2 million in exchange for all its preferred stock in Sunshine and \$0.4 million for its warrants, resulting in a pre-tax gain of \$3.9 million. Interactive's cash investment in Sunshine and its predecessor companies, beginning in 1995, was a cumulative \$21.9 million. In 1997 and in 1999, Interactive recorded impairment losses of \$7.0 million and \$15.4 million, respectively, which included the impairment of interest the Company capitalized on these investments during the development of the licenses.

The Company has made loans to and has investments in PTPMS Communications II, LLC, totaling \$6.2 million. PTPMS II acquired wireless spectrum in an auction conducted by the Federal Communications Commission in 2000 called the 700 MHZ GUARD BAND AUCTION. In a FCC auction conducted in September 2002 for similar spectrum, called the LOWER 700 MHZ BAND AUCTION, the price per MHz of population was materially lower than the price paid by PTPMS II in 2000. Accordingly, during 2002, Interactive provided for the impairment for its investment in PTPMS II of \$5.5 million (\$3.6 net of income tax effects).

During 2002, the Company sold its interest in a cellular partnership in New Mexico RSA # 1 (North) for \$5.5 million resulting in a pre-tax gain of \$5.0 million (\$2.5 million net of income tax and minority interests effect).

Equity in earning of affiliates increased by \$0.3 million in 2003 compared to 2002 due to higher revenues and earnings of our investments in cellular telephone affiliates in New Mexico.

### INCOME TAX PROVISION

The income tax provision includes federal, as well as state and local taxes. The tax provision in 2003 and 2002, represent effective tax rates of 35.8% in 2003 and 41.8% in 2002. The differences from the federal statutory rate are primarily due to the effects of state income taxes. In addition, in 2003, no state provision was required on the gain on sale of the investment in Sunshine and the Company reassessed certain tax accruals.

### MINORITY INTERESTS

Minority interests decreased earnings by \$1.5 million in 2003 and \$1.7 million in 2002. The gain in 2002 from the sale of New Mexico RSA #1 (North) resulted in a \$0.5 million reduction in minority interests in 2003 when compared to 2002. Such reduction in minority interests was offset by higher earnings in 2003 at several of our less than 100% owned subsidiaries.

### INCOME FROM CONTINUING OPERATIONS

As a result of all of the above, income from continuing operations of \$7.4 million in 2003, or \$2.65 per share (basic and diluted), increased by \$3.6 million from the \$3.8 million, or \$1.34 per share (basic and diluted), recorded in 2002.

### LIQUIDITY AND CAPITAL RESOURCES

#### LIQUIDITY

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

The debt at each of Interactive's subsidiary companies contains restrictions on the amount of funds that can be transferred to their respective parent companies. The Interactive parent company ("Parent Company") needs cash primarily to pay corporate expenses, federal income taxes and to invest in new opportunities, including spectrum licenses. The Parent Company receives cash to meet its obligations primarily through management fees charged to its

22

subsidiaries, a tax sharing agreement with its subsidiaries, usage of a line of credit facility, and has obtained additional liquidity by refinancing certain subsidiary debt. In addition, the Parent Company considers various alternative long-term financing sources: debt, equity, or sale of investments and other assets.

The Parent Company's short-term line of credit facility, which expires August 31, 2005, has a maximum availability totaling \$5.0 million, \$3.8 million of which was available at December 31, 2004. The Company is pursuing various financing alternatives including a replacement for its current line of credit with a larger business base renewal of the line of credit, refinancing substantially all or individual pieces of its currently outstanding debt, and sale of certain investments. The Company expects to obtain an additional line of credit in the next year. While it is management's belief that the Company will have adequate resources to fund operations over the next twelve months, there can be no assurance that the Company will obtain financing on terms acceptable to management. The obtaining of a replacement line of credit is a critical element of the Company's financing strategy.

The Company's RLECs and other businesses need cash to fund their current operations, as well as future long-term growth initiatives. Each RLEC and other business finances its cash needs with cash generated from operations, by utilizing existing borrowing capacity or by entering into new long-term debt agreements. New business acquisitions are generally financed with a combination of new long-term debt, secured by the acquired assets, as well as cash from the Parent. While management expects that both Parent and the operating subsidiaries will be able to obtain adequate financing resources to enable the Company to meet its obligations, there is no assurance that such can be readily obtained or at reasonable costs. The Company is obligated under long-term debt provisions and lease agreements to make certain cash payments over the term of the agreements. The following table summarizes, as of December 31, 2004 for the periods shown, these contractual obligations and certain other financing commitments from banks and other financial institutions that provide liquidity:

	Total	Payments Due by Period (In thousands)	
		Less than 1 year	1 - 3 years
Long-term debt (a)	\$168,966	\$ 14,364	\$ 66,085
Operating leases	1,343	283	503
Notes payable to banks	4,793	4,793	--
Guarantees	3,750	--	3,750
<hr style="border-top: 1px dashed black;"/>			
Total contractual cash obligations			

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

and commitments	\$178,852	\$ 19,440	\$ 70,338
	=====		

(a) Does not include interest payments on debt.

23

A subsidiary of the Company has guaranteed \$3.8 million of an equity investees' total debt of \$10.1 million. The guarantee is in effect for the duration of the loan which expires on December 31, 2005 and would be payable if the equity investee fails to make such payment in accordance with the terms of the loan.

At December 31, 2004, total debt (including notes payable to banks) was \$173.8 million, a decrease of \$5.5 million from December 31, 2003. At December 31, 2004, there was \$106.5 million of fixed interest rate debt outstanding averaging 7.0% and \$67.2 million of variable interest rate debt averaging 5.3%. The debt at fixed interest rates includes \$39.0 million of subordinated notes at interest rates averaging 9.5% issued to sellers as part of acquisitions. The long-term debt facilities at certain subsidiaries are secured by substantially all of such subsidiaries assets, while at other subsidiaries it is secured by the common stock of such subsidiaries. In addition, the debt facilities contain certain covenants restricting distribution to Lynch Interactive. At December 31, 2003 and 2004, substantially all of the subsidiaries' net assets are restricted.

Interactive has a high degree of financial leverage. As of December 31, 2004, the ratio of total debt to equity was 5.0 to 1. Certain subsidiaries also have high debt to equity ratios. Management believes that it is currently more beneficial to hold excess cash at certain of our subsidiaries rather than utilizing the cash to pay-down existing credit facilities.

As of December 31, 2004, Interactive had current assets of \$39.4 million and current liabilities of \$35.5 million resulting in a working capital surplus of \$3.9 million compared to a surplus of \$7.2 million at December 31, 2003. This \$3.3 million reduction in the surplus was primarily due to the receipt in 2004 of a \$2.4 million federal income tax refund included in the December 31, 2003 balance sheet. In 2004, net cash provided by operations of \$27.8 million was used to invest in plant and equipment, to invest in cable assets and to repay debt.

SOURCES AND USES OF CASH

Cash at December 31, 2004, was \$27.2 million, an increase of \$0.7 million compared to 2003. In 2004, net cash provided by operations of \$27.3 million was used to invest in plant and equipment, to invest in cable assets and repay debt. In 2003, net cash provided by operations of \$29.1 million and \$7.6 million proceeds from the sale of Interactive's investment in Sunshine were used to invest in plant and equipment and repay debt. In 2002, the Company used \$7.6 million of restricted cash as part of the repurchase of \$10.5 million of convertible debt. In addition, in 2002, Interactive received \$3.0 million of cash proceeds for the sale of a minority interest in a cellular operation and issued \$7.1 million in long-term debt.

Capital expenditures were \$16.5 million in 2004, \$22.7 million in 2003, and \$23.8 million in 2002 which is predominantly spent at the RLECs and will be included in their rate bases for rate setting purposes. Capital expenditures in 2005 are expected to be approximately \$10 million, most of which will be added

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

to the RLEC rate bases.

24

On December 31, 2003, Sunshine sold its three PCS licenses to Cingular Wireless for \$13.75 million in cash. As part of this sale, Interactive received \$7.2 million in exchange for all its preferred stock in Sunshine and \$0.4 million for its warrants. The cash proceeds were used to repay amounts outstanding under the \$10 million credit facility. As part of this transaction, Interactive agreed to provide an indemnification to Cingular for up to \$8 million of losses that Cingular might incur in the event of an adverse ruling in the False Claims Act litigation (see Contingencies below) in which Interactive and Sunshine are defendants. Management believes the probability that Cingular will incur such losses is highly remote.

The Company has initiated an effort to monetize certain of its assets, including selling a portion or all of its investment in certain of its operating entities and equity investments. These initiatives may include the sale of certain telephone operations where growth opportunities are not readily apparent. There is no assurance that all or any part of this program can be effectuated on acceptable terms.

Subsequent to the spin-off by Lynch Corporation, the Board of Directors of Lynch Interactive Corporation authorized the purchase of up to 100,000 shares of common stock. Through December 31, 2004, 67,000 shares had been purchased at an average cost of \$32.32 per share including 22,000 shares purchased in 2004 at an average investment of \$31.05 per share. Subsequent to year-end, an additional 5,700 shares have been acquired at an average investment of \$31.53 per share.

President Bush's proposed Budget for Fiscal Year 2006 establishes the process and terms to implement the dissolution of the Rural Telephone Bank ("RTB"). Under RTB's By-Laws, on dissolution, the holders of its Class B and Class C stock would be paid the par value of their stock. As of December 31, 2004, the total par value of RTB Class B and Class C stock at the Company's subsidiaries was \$11.3 million. The net book value and tax basis of this stock, at that date, was \$1.1 million. The dissolution of the RTB and payments to the stock holders is subject to numerous approvals and actions, including Congressional approval of President Bush's proposed Budget for Fiscal Year 2006 and actions by RTB's Board of Directors. Therefore, the Company cannot predict whether, or when, such payments will actually be made to the Company's subsidiaries.

Lynch Corporation, the Company's predecessor, has not paid any cash dividends on its common stock since 1989. The Company has not paid any cash dividends since its inception in 1999 and does not expect to pay cash dividends on its common stock in the foreseeable future. Interactive currently intends to retain its earnings, if any, for use in its business. Further financing may limit or prohibit the payment of dividends.

### CONTINGENCIES

#### FALSE CLAIMS ACT LITIGATION.

Interactive and several other parties, including Interactive's CEO, and Fortunet Communications, L.P., which was Sunshine PCS Corporation's predecessor-in-interest, have been named as defendants in a lawsuit brought under the so-called "qui tam" provisions of the federal False Claims Act in the United States District Court for the District of Columbia. The complaint was filed under seal with the court on February 14, 2001. At the initiative of one of the defendants, the seal was lifted on January 11, 2002. Under the False Claims Act, a private plaintiff, termed a "relator," may file a civil action on

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

the U.S. government's behalf against another party for violation of the statute. In return, the relator receives a statutory bounty from the government's litigation proceeds if he is successful.

The main allegation in the case is that the defendants participated in the creation of "sham" bidding entities that allegedly defrauded the federal Treasury by improperly participating in certain FCC spectrum auctions restricted to small businesses, as well as obtaining bidding credits in other spectrum auctions allocated to "small" and "very small" businesses. While the complaint seeks to recover an unspecified amount of damages, which would be subject to mandatory trebling under the statute, a document filed by the relator with the Court on February 24, 2004 discloses an initial computation of damages of not less than \$88 million resulting from bidding credits awarded to the defendants in FCC auctions and \$120 million of unjust enrichment through the sale or assignment of licenses obtained by the defendants in FCC auctions, in each case prior to trebling. Later filings have increased this amount and the bidding credits the defendants received were considerably less than the \$88 million amount reported.

25

Interactive strongly believes that this lawsuit is completely without merit and that relator's initial damage computations are without basis, and intends to defend the suit vigorously. The U.S. Department of Justice has notified the court that it has declined to intervene in the case. Nevertheless, we cannot predict the ultimate outcome of the litigation, nor can we predict the effect that the lawsuit or its outcome will have on our business or plan of operation. Interactive does not have any insurance to cover its cost of defending this lawsuit, which costs will be material. Interactive does have a directors and officers liability policy but the insurer has reserved its rights under the policy and, as a result, any coverage to be provided to any director or officer of Interactive in connection with a judgment rendered in this action is unclear at this time.

Interactive was formally served with the complaint on July 10, 2002. On September 19, 2002, the defendants filed two motions with the United States District Court for the District of Columbia: a motion to dismiss the lawsuit and a motion to transfer the action to the Southern District of New York. On November 25, 2002, the relator filed an opposition reply to our motion to dismiss and on December 5, 2002; the defendants filed a reply in support of its motion to dismiss. On September 30, 2003, the Court granted our motion to transfer the action to the Southern District of New York. A scheduling conference was held on February 10, 2004, at which time, the judge approved a scheduling order and discovery commenced.

On July 28, 2004, the judge denied in part and granted in part the motion to dismiss. Defendant bidding entities that did not win licenses were dismissed and the "reverse" False Claims Act count was dismissed as redundant. Interactive and its subsidiaries remain parties to the litigation.

In December 2004, the defendants filed a motion in the United States District Court for the District of Columbia to compel the FCC to provide certain information subpoenaed by them in order to enable them to conduct a defense. This motion was denied in May 2005 and the defendants have filed a notice of appeal with the United States Court of Appeals for the D.C. Circuit.

See also "Item 3. Legal Proceedings - History of Lynch's C-Block Activities" above for a history of our involvement in Auction 5.

OTHER LITIGATION.

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

In addition to the litigation described above, Interactive is a party to routine litigation incidental to its business. Based on information currently available, Interactive believes that none of this ordinary routine litigation, either individually or in the aggregate, will have a material effect on its financial condition and results of operations.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of consolidated financial statements requires Interactive's management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, Interactive evaluates its estimates, including those related to revenue recognition, carrying value of its investments in spectrum entities and long-lived assets, purchase price allocations, and contingencies and litigation. Interactive bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Interactive believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

We believe that revenue from interstate access is based on critical accounting estimates and judgment. Such revenue is derived from settlements with the National Exchange Carrier Association ("NECA"). NECA was created by the FCC to administer interstate access rates and revenue pooling on behalf of small local exchange carriers who elect to participate in a pooling environment. Interstate settlements are determined based on the various subsidiaries' cost of providing interstate telecommunications service. Interactive recognizes interstate access revenue as services are provided based on an estimate of the current year cost of providing service. Estimated revenue is adjusted to actual upon the completion of cost studies in the subsequent period.

26

Interactive's business development strategy is to expand its existing operations through internal growth and acquisition. From 1989 through 2001, the Company has acquired twelve telephone companies. Significant judgments and estimates are required to allocate the purchase price of acquisitions to the fair value of tangible assets acquired and identifiable intangible assets and liabilities assumed. Any excess purchase price over the above fair values is allocated to goodwill. Additional judgments and estimates are required to determine if identified intangible assets have finite or indefinite lives.

Annually, the Company tests goodwill and other intangible assets with indefinite lives for impairment. The Company screens for potential impairment by determining fair value for each reporting unit. We estimate the fair value of each reporting unit based on a number of subjective factors, including: (a) appropriate weighting of valuation approaches (income approach, market approach and comparable public company approach), (b) estimates of our future cost structure, (c) discount rates for our estimated cash flows, (d) selection of peer group companies for the public company approach, (e) required level of working capital, (f) assumed terminal value and (g) time horizon of cash flow forecasts.

We consider the estimate of fair value to be a critical accounting estimate because (a) a potential goodwill impairment could have a material impact on our financial position and results of operations and (b) the estimate is based on a

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

number of highly subjective judgments and assumptions, the most critical of which is that the regulatory environment will continue in its current form. In 2004, \$0.5 million of goodwill was considered impaired and was charged to income as amortization expense.

Interactive tests its investments and other long-term non-regulated assets annually whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Significant judgment is required to determine if an impairment has occurred and whether such impairment is "other than temporary." In 2004, Interactive recorded a \$0.7 million impairment of its investment in certain 10 MHz spectrum based on a materially lower price paid for similar spectrum in a 2005 auction. In 2002, Interactive provided \$5.5 million for the impairment of an investment in wireless spectrum purchased in 2001, based on a materially lower price paid for similar spectrum in 2002. In 2001, we wrote down the investment in Spinnaker Industries to zero, based on our judgment that the decline in the quoted value was "other than temporary."

The calculation of depreciation and amortization expense is based on the estimated economic useful lives of the underlying property, plant and equipment and intangible assets. Although Interactive believes it is unlikely that any significant changes to the useful lives of its tangible or intangible assets will occur in the near term, rapid changes in technology, the discontinuance of accounting under SFAS No. 71 by the Company's wireline subsidiaries, or changes in market conditions could result in revisions to such estimates that could materially affect the carrying value of these assets and the Company's future consolidated operating results.

### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board ("FASB") issued Financial Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" (FIN 46) in January 2003 and revised it in December 2003 (FIN 46R). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The provisions of FIN 46R were applicable for the first interim or annual period ending after March 15, 2004 for both new and existing variable interest entities. Certain less than 50% owned investments in limited liability companies, which were considered to be variable interest entities, needed to be consolidated as a result of the implementation of FIN 46. The effect of consolidating such operations resulted in increasing intangible assets and decreasing investments in and advances to affiliated companies by approximately \$2 million and had no other significant effect on the Company's consolidated financial statements.

In November 2002, the Emerging Issues Task Force of the FASB reached a consensus on EITF No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables" ("EITF No. 00-21"). EITF No. 00-21 addresses how to account for arrangements that may involve multiple revenue-generating activities. The Company adopted this guidance on January 1, 2003, which did not have a material effect on our consolidated results of operations, consolidated financial position or consolidated cash flows.

In December 2003, the SEC issued Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition," which revises or rescinds certain sections of SAB No. 101, "Revenue Recognition," in order to make this interpretive guidance



## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on the Company's consolidated results of operations, consolidated financial position or consolidated cash flows.

In December 2004, the FASB issued SFAS No.153, "Exchanges of Nonmonetary Assets", which eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No.153 will be effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not believe the adoption of SFAS No.153 will have a material impact on its consolidated financial statements.

In December 2004, the FASB issued SFAS No.123(R), "Share-Based Payment", which establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. This standard requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This eliminates the exception to account for such awards using the intrinsic method previously allowable under APB Opinion No.25. SFAS No.123(R) will be effective for interim or annual reporting periods beginning on or after June 15, 2005. The Company is currently evaluating the impact of the adoption of SFAS No.123(R) will have on its consolidated financial statements.

28

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

- (a) The following documents are filed as part of this Form 10-K/A Annual Report:

Financial Statements:

Reports of Independent Registered Public Accounting Firms and the following Financial Statements of the Company are included herein:

Consolidated Balance Sheets - December 31, 2003 and 2004 Consolidated Statements of Operations - Years ended December 31, 2002, 2003 and 2004 Consolidated Statements of Shareholders' Equity - Years ended December 31, 2002, 2003 and 2004 Consolidated Statements of Cash Flows - Years ended December 31, 2002, 2003 and 2004 Notes to Consolidated Financial Statements

Financial Statement Schedules:

Schedule I - Condensed Financial Information of Registrant  
Schedule II - Valuation and Qualifying Accounts

All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required under the related instructions, or are inapplicable, and therefore have been omitted.

- (b) Exhibits: The following Exhibits listed in the Exhibit Index are filed with this Form 10-K/A Annual Report:

31.1 Rule 13a-14(a) Certification of the Chief Executive Officer

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

- 31.2 Rule 13a-14(a) Certification of the Chief Financial Officer
- 32.1 Section 1350 Certification of the Chief Executive Officer
- 32.2 Section 1350 Certification of the Chief Financial Officer

29

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Lynch Interactive Corporation  
Rye, New York

We have audited the accompanying consolidated balance sheets of Lynch Interactive Corporation and subsidiaries (the "Company") as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended. Our audit also includes the 2004 financial statement schedules listed in the Index at Item 15(a) (2). These consolidated financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Lynch Interactive Corporation and subsidiaries as of December 31, 2004 and 2003, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such 2004 and 2003 financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

/s/ DELOITTE & TOUCHE LLP  
-----

New York, New York  
March 31, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Lynch Interactive Corporation

We have audited the accompanying consolidated statements of operations, shareholders' equity, and cash flows of Lynch Interactive Corporation (the "Company") and subsidiaries for the year ended December 31, 2002. Our audit also included the 2002 financial statement schedules listed in the index at Item 15(a). These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audit. We did not audit the following: the financial statements of Cuba City Telephone Exchange Company and Belmont Telephone Company, indirect wholly-owned subsidiaries of Lynch Interactive Corporation, which statements reflect total revenues of \$2,117,000 for the year ended December 31, 2002; and the financial statements of Upper Peninsula Telephone Company, an indirect wholly-owned subsidiary of Lynch Interactive Corporation, which statements reflect total revenues of \$10,986,000 for the year ended December 31, 2002. Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included in the consolidated financial statements and financial statement schedules for Cuba City Telephone Exchange Company and Belmont Telephone Company and Upper Peninsula Telephone Company, is based solely on the reports of the other auditors.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated results of operations and cash flows of Lynch Interactive Corporation and subsidiaries for the year ended December 31, 2002, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, based on our audit and the reports of other auditors, the related 2002 financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

/s/ Ernst & Young LLP  
-----

Stamford, Connecticut  
March 14, 2003

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(IN THOUSANDS)

	December 31,	
	2003	2004
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 26,556	\$ 27,214
Receivables, less allowances of \$262 and \$260, respectively	8,183	8,225
Material and supplies	2,597	2,314
Prepaid expenses and other current assets	1,272	1,685
Total current assets	38,608	39,438
Property, plant and equipment:		
Land	840	983
Buildings and improvements	13,336	17,640
Machinery and equipment	213,939	216,429
	228,115	235,052
Accumulated depreciation	(102,556)	(114,724)
	125,559	120,328
Excess of cost over fair value of net assets acquired, net (goodwill)	60,580	60,042
Other intangibles	8,168	10,026
Investments in and advances to affiliated entities	7,223	12,340
Other assets	12,657	14,906
Total assets	\$ 252,795	\$ 257,080

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

	December 31,	
	2003	2004
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Notes payable to banks	\$ 3,456	\$ 4,793
Trade accounts payable	5,336	4,326
Accrued interest payable	697	825
Accrued liabilities	8,732	11,238
Current maturities of long-term debt	13,162	14,364
Total current liabilities	31,383	35,546
Long-term debt	162,621	154,602
Deferred income taxes	15,517	17,549
Other liabilities	3,624	3,268
Total liabilities	213,145	210,965
Minority interests	9,763	11,543
Commitments and contingencies (Note 12)		
Shareholders' equity		
Common stock, \$0.0001 par value-10,000,000 shares authorized; 2,824,766 issued; 2,779,951 and 2,757,951 outstanding	--	--
Additional paid-in capital	21,406	21,406
Retained earnings	9,269	13,735
Accumulated other comprehensive income	686	1,588
Treasury stock, 44,815 and 66,815 shares, at cost	(1,474)	(2,157)
	29,887	34,572
Total liabilities and shareholders' equity	\$ 252,795	\$ 257,080

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

	Years Ended December 31,	
	2002	2003
Revenues	\$ 84,225	\$ 85,392
Operating costs:		
Cost of revenue, excluding depreciation	29,020	29,460
General and administrative costs at operations	13,285	12,693
Unallocated corporate costs	3,334	4,529
Depreciation and amortization	19,353	20,282
Operating profit	19,233	18,428
Other income (expense):		
Investment income	1,765	1,120
Interest expense	(13,031)	(11,864)
Equity in earnings of affiliated companies	1,938	2,280
Impairment of investment in spectrum license holders	(5,479)	--
Gain on sale of investment in cellular partnership	4,965	--
Gain on sale of investments in Sunshine PCS	--	3,919
	(9,842)	(4,545)
Income before income taxes, minority interests, and operations of The Morgan Group, Inc. ("Morgan") distributed to Shareholders	9,391	13,883
Provision for income taxes	(3,924)	(4,968)
Minority interests	(1,706)	(1,525)
Income from continuing operations before operations of Morgan distributed to shareholders	3,761	7,390
Loss from operations of Morgan to be distributed to shareholders net of income taxes of \$0 and minority interests of \$868	(1,888)	--
Net income	\$ 1,873	\$ 7,390
Basic and diluted weighted average shares outstanding	2,805	2,786
Basic and diluted earnings (loss) per share:		
Income before operations of Morgan to be distributed to Shareholders	\$ 1.34	\$ 2.65
Loss from operations of Morgan distributed to Shareholders	(0.67)	--

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

Net income per share \$ 0.67 \$ 2.65

=====

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

34

LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
(IN THOUSANDS, EXCEPT SHARE DATA)

	Shares of Common Stock Out- standing	Common Stock	Additional Paid-in Capital	Retained Earnings	Accum Oth Compre Inc
Balance at December 31, 2001	2,820,051	\$ 0	\$ 21,406	\$ 1,800	\$ 1
Dividend of shares of Morgan Group Holding Inc.	--	--	--	(1,794)	
Net income for the period	--	--	--	1,873	
Unrealized loss on available for sale securities, net	--	--	--	--	
Reclassification adjustment	--	--	--	--	
Comprehensive income	--	--	--	--	
Purchase of Treasury Stock	(27,400)	--	--	--	
-----					
Balance at December 31, 2002	2,792,651	0	21,406	1,879	
Net income for the period	--	--	--	7,390	
Unrealized gain on available for sale securities, net	--	--	--	--	
Reclassification adjustment	--	--	--	--	
Comprehensive income	--	--	--	--	
Purchase of Treasury Stock	(12,700)	--	--	--	
-----					
Balance at December 31, 2003	2,779,951	0	21,406	9,269	
Net income for the period	--	--	--	4,466	
Unrealized gain on available for sale securities, net	--	--	--	--	
Reclassification adjustment	--	--	--	--	
Comprehensive income	--	--	--	--	
Purchase of Treasury Stock	(22,000)	--	--	--	
-----					
Balance at December 31, 2004	2,757,951	\$ 0	\$ 21,406	\$ 13,735	\$ 1

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

35

LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(IN THOUSANDS)

	Years Ended	
	2002	2001
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 1,873	\$ 7,333
Depreciation and amortization	19,353	20,200
Minority interests	1,706	1,500
Equity in earnings of affiliated companies	(1,938)	(2,200)
Provision for impairment of investment in spectrum license holders	5,479	--
Gain on sale of investment in cellular partnership	(4,965)	--
Gain on sale of investment in Sunshine PCS	--	(3,900)
Gain on sale of securities	(228)	(1,500)
Deferred income taxes	398	8,800
Non-cash items and changes in operating assets and liabilities from operations of Morgan Group Holding Co. to be distributed to shareholders	1,888	--
Changes in operating assets and liabilities, net of effects of acquisitions:		
Trade accounts receivable (increase) decrease	1,047	700
Trade accounts payable and accrued liabilities increase (decrease)	563	(4,200)
Other	328	800
Net cash provided by operating activities	25,504	29,100
<b>INVESTING ACTIVITIES</b>		
Acquisitions (net of debt assumed and cash equivalents acquired)	--	--
Capital expenditures	(23,785)	(22,700)
Acquisition of subscriber lists	(301)	(300)
Investment in affiliated companies	--	--
Returns from spectrum partnerships	333	--
Acquisition of spectrum licenses	(1,121)	(600)
Proceeds from sale of cellular partnership	2,958	--
Proceeds from sale of investment in Sunshine PCS	--	7,500
Proceeds from sale of securities	398	200
Distributions received from investments	--	1,500
Other	516	(300)
Net cash used in investing activities	(21,002)	(14,700)
<b>FINANCING ACTIVITIES</b>		



## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

Issuance of long-term debt	7,087	11,7
Payments to reduce long-term debt	(21,056)	(12,6
Net borrowings (payments) related to lines of credit	2,546	(9,4
Purchase of Treasury stock	(956)	(2
Other	--	(6
	(12,379)	(11,1
Net increase (decrease) in cash and cash equivalents	(7,877)	3,2
Cash and cash equivalents at beginning of year	31,233	23,3
	\$ 23,356	\$ 26,5

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

36

### LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2004

#### 1. ACCOUNTING AND REPORTING POLICIES

##### ORGANIZATION

Lynch Interactive Corporation, (the "Company" or "Interactive") was formed on September 1, 1999, when Lynch Corporation ("Lynch") distributed 100 percent of the outstanding shares of common stock of Interactive, its wholly owned subsidiary, to the then holders of record of Lynch's common stock ("Spin-Off"), in the form of a tax-free distribution. As part of the Spin-Off, Interactive received one million shares of common stock of Spinnaker Industries, Inc. representing an approximately 13.6% equity ownership interest (and an approximate 2.5% voting interest) and Interactive also assumed certain short term and long term debt obligations of Lynch Corporation.

Interactive and Lynch have entered into certain agreements governing various ongoing relationships, including the provision of support services and a tax allocation agreement. The tax allocation agreement provides for the allocation of tax attributes to each company as if it had actually filed with the respective tax authority.

The Company's long term debt facilities contain covenants that restrict the distribution of cash and other net assets between subsidiaries or to the parent company.

In January 2002, Interactive spun off its interest in The Morgan Group, Inc. ("Morgan"), its only services subsidiary, via a tax-free dividend to its shareholders of the stock of Morgan Group Holding Co., a corporation that was initially formed to serve as a holding company for, among other business purposes, Interactive's controlling interest in Morgan.

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

### BASIS OF PRESENTATION

The accompanying consolidated financial statements represent the accounts of Interactive and its majority owned subsidiaries which primarily consists of its telephone (81%-100% owned), cable television (100% owned) and security (63.6% owned from date of acquisition of American Alarm on November 30, 2001) subsidiaries. All material intercompany transactions and balances have been eliminated. Investments in affiliates in which the Company does not have a majority voting control but has the ability to significantly influence financial and operating policies are accounted for in accordance with the equity method. The Company accounts for the following affiliated companies on the equity basis of accounting:

- o Coronet Communications Company (20% owned),
- o Capital Communications Company, Inc. (49% of common equity owned and 100% of convertible preferred owned, when converted, equals 50% of all equity),
- o KMG Holdings Group, Inc. (37% owned from May 2004),
- o Two cellular telephone providers in New Mexico, both 33% owned,
- o Telecommunications operations in North Dakota, Iowa and New York (5% to 14% owned through partnerships).

The Company's telephone subsidiaries are public utilities that are regulated by both the Federal Communications Commission (FCC) and various state commissions. These subsidiaries follow the accounting prescribed by the Uniform System of Accounts of the FCC and the state commissions and Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation." Where applicable, this accounting recognizes the economic effects of rate regulation by recording costs and a return on investment as such amounts are recovered through rates authorized by regulatory authorities.

37

### USE OF ESTIMATES/RECLASSIFICATIONS

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that effect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Certain prior year amounts in the accompanying consolidated financial statements have been reclassified to conform to current year presentation.

### CASH AND CASH EQUIVALENTS

Cash equivalents consist of highly liquid investment with a maturity of three months or less when purchased.

### MARKETABLE SECURITIES

Marketable securities, included in other assets, consist principally of publicly traded common stocks. At December 31, 2003 and 2004, Interactive's investment in marketable securities, which had carrying values of \$2.5 million and \$3.9 million, respectively, were entirely classified as available-for-sale. Such carrying values include Interactive's 4.8% investment in Hector Communications (AMEX:HCT) valued at \$2.3 million and \$3.6 million at December 31, 2003 and

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

2004, respectively. Available-for-sale securities are stated at fair value with unrealized gains or losses included in equity as a component of comprehensive income (loss). Unrealized (losses) gains on available-for-sale securities were (\$1.3 million), (\$0.4 million), and \$1.4 million for the years ended December 31, 2002, 2003 and 2004, respectively and have been included in the Consolidated Statements of Shareholder's Equity, as "Accumulated other comprehensive income."

The cost of marketable securities sold is determined on the specific identification method. Realized gains included in investment income were \$0.4 million, \$0.3 million and \$-- million for the years ended December 31, 2002, 2003 and 2004, respectively.

### INVESTMENT INCOME - PATRONAGE

CoBank, from which the Company has loans totaling \$51.9 million at December 31, 2004, is a cooperative, owned and controlled by its customers. Each customer borrowing from the bank shares in the bank's net income through payment of patronage refunds. Approximately 50% of patronage refunds are received in cash, with the balance in CoBank stock. Patronage stock is redeemable at its face value for cash when the related debt is paid off. Total patronage refunds were \$0.6 million, \$0.4 million and \$0.8 million in 2002, 2003 and 2004, respectively and were included as investment income in the Company's statement of operations. The Company cannot predict what patronage refunds might be in future years.

### FAIR VALUE OF FINANCIAL INSTRUMENTS

Cash and cash equivalents, trade accounts receivable, short-term borrowings, trade accounts payable and accrued liabilities are carried at cost which approximates fair value due to the short-term maturity of these instruments. The carrying amount of the Company's borrowings under its revolving line of credit approximates fair value, as the obligations bear interest at a floating rate. The fair value of other long-term obligations approximates carrying value based on borrowing rates for similar instruments.

### ACCOUNTS RECEIVABLE

Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends, and other information. Receivable balances are reviewed on an aged basis

38

and account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is doubtful. Due to dispersed geographic nature of the Company operations and residential nature of its customers, no customer account for significant amount of Company's receivable balances, other than from the National Exchange Carrier Association discussed below.

### PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are recorded at cost and include expenditures for additions and major improvements and, for our regulated telephone companies, include an allowance for funds used during construction (AFUDC). Maintenance and repairs are charged to operations as incurred. Depreciation of telephone plant is computed on the straight-line method using class or overall group rates

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

acceptable to regulatory authorities. Depreciation of non-telephone property is computed on the straight-line method over the estimated useful lives of the assets. Depreciable lives for the Company's telephone and non-telephone properties, excluding land, range from 19 to 45 years for building, 3 to 50 years for machinery and equipment and 4 to 20 years for other assets. During 2003, a Michigan subsidiary revised its depreciation rates to more accurately reflect asset lives. For income tax purposes, accelerated depreciation methods are used.

When a portion of the Company's depreciable property, plant and equipment relating to its telephone operations business is retired, the gross carrying value of the assets, including cost of disposal and net of any salvage value, is charged to accumulated depreciation, in accordance with regulated accounting procedures.

The Company adopted SFAS No. 143 "Accounting for Asset Retirement obligations" on January 1, 2003. This standard provides accounting guidance for legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction or development and (or) normal operation of that asset. According to the standard, the fair value of an asset retirement obligation (ARO liability) should be recognized in the period in which (1) a legal obligation to retire a long-lived asset exists and (2) the fair value of the obligation based on retirement cost and settlement date is reasonably estimable. In accordance with federal and state regulations, depreciation expense for the Company's wireline operations has historically included an additional provision for cost of removal. The additional cost of removal provision does not meet the recognition and measurement principles of an asset retirement obligation under SFAS No. 143. In connection with SFAS No. 143, \$1.6 million and \$1.7 million at December 31, 2003 and 2004, respectively, for cost of removal has been classified as a regulatory liability included in long term liabilities.

### GOODWILL AND OTHER INTANGIBLE ASSETS

The Company tests goodwill and other intangible assets with indefinite lives for impairment using the two-step process prescribed in SFAS No. 142 Goodwill and Other Intangible Assets. The first step is a screen for potential impairment, in which we determine the fair value for each reporting unit. We estimate the fair value of each reporting unit based on a number of subjective factors, including: (a) appropriate weighting of valuation approaches (income approach, market approach and comparable public company approach), (b) estimates of our future cost structure, (c) discount rates for our estimated cash flows, (d) selection of peer group companies for the public company approach, (e) required level of working capital, (f) assumed terminal value and (g) time horizon of cash flow forecasts.

If such tests indicate potential impairment, then a second step measures the amount of impairment, if any. The Company performed its annual impairment tests of goodwill as of October 1, 2003 and 2004 and determined that there were no impairments in 2003, but in 2004, \$0.5 million of goodwill was considered impaired and was charged to income as amortization expense.

In addition to goodwill, intangible assets with indefinite lives consist of cellular licenses, with a carrying value of \$3.3 million and \$4.9 million at December 31, 2003 and 2004 respectively. The increase in 2004 includes the \$2.0 million effect of implementing FIN 46 in the first quarter of 2004 (See Recently Issued Accounting Pronouncements). At December 31, 2004, Interactive recorded a \$0.7 million impairment of its investment in certain 10 MHz spectrum, which is included in amortization expense. This impairment was based on a February 2005 FCC auction for similar spectrum in which the price per MHz of population was materially lower than the price paid by Interactive for this spectrum.

The Company's subscriber lists are generally amortized over a 10 to 15-year life. Subscriber lists had a gross value of \$8.0 million and \$7.9 million and accumulated amortization of \$3.2 million and \$3.6 million at December 31, 2003 and 2004, respectively. Amortization expense was \$1.5 million, \$0.7 million, and \$0.6 million for the years ended December 31, 2002, 2003 and 2004 respectively and is estimated to be between \$0.6 and \$0.9 million annually for the next five years.

#### IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell, and depreciation ceases.

#### REVENUES

Telephone service revenue is primarily derived from regulated local, intrastate and interstate access services and is recognized as services are provided. Revenues are based upon the Company's cost for providing services.

Local access revenue comes from providing local telephone exchange services and is billed to local end users in advance in accordance with tariffs approved by each state's Public Utilities Commission. Such advance billings are initially deferred and recognized as revenue when earned.

Revenue that is billed in arrears includes nonrecurring intrastate and interstate network access services, nonrecurring local services and long distance services. The earned but unbilled portion of this revenue is recognized as revenue in the period that the services are provided.

Revenue from intrastate access is based on tariffs approved by each state's Public Utilities Commission. Revenue from interstate access is derived from settlements with the National Exchange Carrier Association (NECA). NECA was created by the FCC to administer interstate access rates and revenue pooling on behalf of small local exchange carriers who elect to participate in a pooling environment. Interstate settlements, including amounts received under Universal Service Funds, are determined based on the Company's cost of providing interstate telecommunications service, including investments in specific types of infrastructure and operating expenses and taxes.

Other businesses revenues include the Company's internet, CLEC, wireless, long-distance, cable and security operations all of which are recognized as services are provided.

Alarm system installation revenues, sales revenues on equipment upgrades and direct incremental costs of installations and sales are deferred for residential customers with monitoring services contracts. Revenues from monitoring contracts are recognized in the period such services are provided.

Deferred alarm system installation revenues are recognized over the expected life of the monitoring contracts of the customer for residential and commercial

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

customers. Deferred costs in excess of deferred revenue are recognized over the initial contract term, typically three years. To the extent deferred costs are less than or equal to deferred revenues, such costs are recognized over the estimated life of the customer.

### EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per common share amounts are based on the average number of common shares outstanding during each period, excluding the dilutive effects of options, warrants, and convertible securities. Diluted earnings per share reflect the effect, where dilutive, of options, warrants and convertible securities, using the treasury stock and if converted methods as applicable.

40

### COMPREHENSIVE INCOME

The Company follows the provisions of SFAS No. 130, "Reporting Comprehensive Income" that requires unrealized gains or losses, net of tax, on the Registrant's available-for-sale securities to be included as a separate component of Shareholder Equity and in other comprehensive income (loss).

### MINORITY INTEREST

The Company consolidates certain subsidiaries that are less than 100% owned. The portion of such subsidiaries not owned by the Company is shown as Minority Interests in the Consolidated Statements of Operations and Balance Sheets.

### ISSUANCE OF STOCK BY SUBSIDIARY AND INVESTEES

Changes in the Company's equity in a subsidiary or an investee caused by issuances of the subsidiary's or investees' stock are accounted for as gains or losses where such issuance is not part of a broader reorganization.

### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board ("FASB") issued Financial Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" (FIN 46) in January 2003 and revised it in December 2003 (FIN 46R). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The provisions of FIN 46R were applicable for the first interim or annual period ending after March 15, 2004 for both new and existing variable interest entities. Certain less than 50% owned investments in limited liability companies, which were considered to be variable interest entities, needed to be consolidated as a result of the implementation of FIN 46. The effect of consolidating such operations resulted in increasing intangible assets and decreasing investments in and advances to affiliated companies by approximately \$2 million and had no other significant effect on the Company's consolidated financial statements.

In November 2002, the Emerging Issues Task Force of the FASB reached a consensus on EITF No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables" ("EITF No. 00-21"). EITF No. 00-21 addresses how to account for arrangements that may involve multiple revenue-generating activities. The Company adopted this guidance on January 1, 2003, which did not have a material effect on our consolidated results of operations, consolidated financial

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

position or consolidated cash flows.

In December 2003, the SEC issued Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition," which revises or rescinds certain sections of SAB No. 101, "Revenue Recognition," in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on the Company's consolidated results of operations, consolidated financial position or consolidated cash flows.

In December 2004, the FASB issued SFAS No.153, "Exchanges of Nonmonetary Assets", which eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No.153 will be effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not believe the adoption of SFAS No.153 will have a material impact on its consolidated financial statements.

41

In December 2004, the FASB issued SFAS No.123(R), "Share-Based Payment", which establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. This standard requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This eliminates the exception to account for such awards using the intrinsic method previously allowable under APB Opinion No.25. SFAS No.123(R) will be effective for interim or annual reporting periods beginning on or after June 15, 2005. The Company is currently evaluating the impact of the adoption of SFAS No.123(R) will have on its consolidated financial statements.

### 2. SPIN-OFF OF MORGAN

In January 2002, Interactive spun off its interest in The Morgan Group, Inc., its only services subsidiary, via a tax-free dividend to its shareholders of the stock of Morgan Group Holding Co., a corporation that was formed to serve as a holding company for Interactive's controlling interest in The Morgan Group, Inc. Morgan Group Holding Co. is now a public company. Accordingly, operating results of Morgan have been segregated from continuing operations and reported as a separate line item in the Statements of Operations for 2002.

### 3. ACQUISITIONS

In March 2004, the Company signed an agreement to acquire California-Oregon Telecommunications Company ("Cal-Ore") located in Dorris, California. Cal-Ore's subsidiary Cal-Ore Telephone Company is the incumbent service provider for a rural area of about 850 square miles along the Northern California border with Oregon with approximately 2,500 access lines. Cal-Ore's other businesses include an Internet service provider, a CLEC that is planning to provide services in the surrounding area and interests in certain cellular partnerships. The acquisition price is \$21.2 million, subject to certain closing adjustments. In March 2005, the administrative law judge for the California Public Utilities Commission issued a proposed opinion approving the transaction subject to various conditions. The Company is reviewing the opinion, which remains subject to the approval of the Commission.

In February 2004, Central Telecom Services, LLC, a 100% owned subsidiary of the Company completed the acquisition of cable television assets at a cost of \$0.4

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

million. The acquisition was accounted for a purchase, and accordingly, the assets acquired and liabilities assumed were recorded using a preliminary estimate of fair market values on the date of acquisition including \$50,000 allocated to other intangible assets for the subscriber list. The operating results of the acquired asset are included in the Statements of Operations from their acquisition date. The Company has not provided pro forma financial information for such acquisition because it is not significant.

On April 30, 2004, the Company acquired a 37% interest in an entity (KMG) whose principal asset consist of a \$6.0 million subordinated note and a 17% equity interest in Lynch Telephone Corporation, a 83% owned subsidiary of the Company. The remaining 63% ownership of KMG is held by the members or management of Western New Mexico Telephone Company, Inc. The Company issued a \$4.5 million, 8.5% five-year amortizing subordinated note and assumed an additional \$0.5 million note from the seller to acquire such interest. In addition to the above mentioned assets, KMG also owns a lumber yard in Andrews, Texas, and other investments.

#### 4. WIRELESS COMMUNICATIONS SERVICES

On February 22, 2001, Interactive spun-off to its shareholders 2,800,000 shares of Sunshine PCS Corporation ("Sunshine") Class A Common Stock. Sunshine was formed just prior to the spin-off through the merger of Sunshine with Fortunet Communications Limited Partnership. Interactive converted its 49.9% partnership interest in Fortunet into 3,000,000 shares of Class A Common Stock of Sunshine representing 49.9% of Sunshine's common equity interest. As part of the merger, Interactive exchanged \$85 million of subordinated notes of Fortunet into \$16.1 million (face value) of subordinated notes in Sunshine, Interactive's carrying value in these notes was \$3.4 million at December 31, 2001. In addition prior to the spin-off, in exchange for \$250,000, Interactive acquired 10,000 shares of preferred stock in Sunshine with an aggregate liquidation preference of \$10.0 million and warrants to purchase 4,300,000 shares of Sunshine Class A Common Stock at \$0.75 per share. Sunshine owns three 15 MHz personal communications services ("PCS") licenses in Tallahassee, Panama City and Ocala, Florida, areas covering a total population of 960,000 (based on 2000 census data). During 2002, as part of a rights offering to its shareholders by Sunshine, Interactive acquired an additional 58,824 shares of Sunshine's Class A Common Stock at \$1.00 per share. Prior to the rights offering, Interactive loaned Sunshine \$550,000. This amount, plus interest of \$12,000, was repaid by Sunshine with a portion of the proceeds of the rights offering.

42

Also during 2002, Interactive exchanged subordinated notes of Sunshine with a principal amount of \$18.5 million into two classes of preferred stock. Interactive received 12,500 shares of Sunshine's A-1 preferred stock which has a total liquidation value of \$12.5 million and 2,000 shares of Sunshine's A-2 convertible preferred stock which has a liquidation value of \$2.0 million and is convertible into 2.0 million shares of Sunshine Class A Common Stock. Since the book value of Interactive's investment in the notes was \$3.4 million, there was no impact on the carrying value of the investment in Sunshine as a result of this restructuring.

On December 31, 2003, Sunshine sold its three PCS licenses to Cingular Wireless for \$13.75 million in cash. As part of this sale, Interactive received \$7.2 million in exchange for all its preferred stock in Sunshine and \$0.4 million for its warrants, resulting in a pre-tax gain of \$3.9 million. Due to the ongoing lawsuit in which Interactive and Sunshine are defendants (see Note 12), Cingular would not complete the sale without indemnification from losses that could result from an adverse ruling. As a result, Interactive agreed to provide



## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

Cingular an indemnification for up to \$8 million of losses that Cingular might incur in the event of an adverse ruling. Interactive considers it highly unlikely that Cingular will incur losses, however, in accordance with the provisions of FIN 45, the Company recorded an immaterial liability which represented the Company's best estimate of the fair value of such indemnification.

During 2000, Interactive invested in limited liability companies, which participated in various auctions. In the Guard Band auction, PTPMS II Communications, L.L.C. acquired three licenses at a net cost of \$6.3 million; Interactive has loans to PTPMS II of \$6.1 million, and owns 49.9% of PTPMS II's equity. In a FCC auction conducted in September 2002 for similar spectrum, called the Lower 700 MHz Band Auction, the price per MHz of population was materially lower than the price paid by PTPMS II in 2000. Accordingly, during 2002, Interactive provided \$5.5 million for the impairment of its investment in PTPMS II, resulting in a net carrying value, at December 31, 2002, of \$0.7 million.

At December 31, 2004 as part of the Company's annual test for impairment of intangible assets with indefinite lives, Interactive recorded a \$0.7 million impairment of its investments in certain 10 MHz PCS licenses in Logan, UT and Las Cruces, NM. The impairment was based on a February 2005 FCC auction for similar spectrum in which the price per MHz of population was materially lower than the price paid by the Company.

### 5. INVESTMENTS IN AFFILIATED COMPANIES

Interactive has equity investments in both broadcasting and telecommunications companies.

Summarized financial information for broadcasting companies accounted for by the equity method as of and for the years ended December 31, is as follows:

	Broadcasting Combine	
	2003	2002
	(In thousands)	
Current assets	\$ 5,330	\$ 6,330
Property, plant & equipment, intangibles & other	9,615	9,615
Total Assets	\$ 14,945	\$ 16,000
Current liabilities	\$ 3,182	\$ 3,182
Long term liabilities	16,483	16,483
Equity	(4,720)	(3,665)
Total liabilities & equity	\$ 14,945	\$ 16,000
	2002	
Revenues	\$ 14,261	\$ 13,155
Gross profit	\$ 4,748	\$ 3,167

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

Net income \$ 779 \$ (292) \$ 1

43

A wholly owned subsidiary of the Company has a 20% investment in Coronet Communications Company ("Coronet"), which operates television station WHBF-TV, a CBS affiliate in Rock Island, Illinois. A second wholly owned subsidiary of the Company has a 49% investment in Capital Communications Company, Inc. ("Capital"), which operates television station WOI-TV, an ABC affiliate in Des Moines, Iowa. At December 31, 2003 and 2004, the investment in Coronet was carried at a negative \$0.8 million and a negative \$0.6 million, respectively, due to the subsidiary's guarantee of \$3.8 million of Coronet's third party debt. The guarantee is in effect for the duration of the loan which expires on December 31, 2005 and would be payable if the equity investee fails to make such payment in accordance with the terms of the loan. Long-term debt of Coronet, at December 31, 2004, totaled \$9.5 million payable quarterly through December 31, 2005 to a third party lender.

At December 31, 2003 and 2004, the investment in Capital is carried at zero as its share of net losses recognized to date have exceeded its net investment and the Company has no further commitment to Capital. The Company's shares in Capital have been pledged as security for Capital's long term debt.

Summarized financial information for telecommunications companies which includes the cellular telephone providers, spectrum license holders, and other telecommunication operations accounted for by the equity method as of and for the years ended December 31, is as follows:

	Telecommunications	
	-----	
	2003	
	-----	
	(In Thousands)	
Current assets	\$	30,347
Property, plant & equipment, intangibles & other		29,320
		-----
Total Assets	\$	59,667
		=====
Current liabilities	\$	23,086
Long term liabilities		22,614
Equity		13,967
		-----
Total liabilities & equity	\$	59,667
		=====
		2002
		-----
Revenues	\$	43,476
Gross profit	\$	13,781
Net income	\$	4,710
		\$ 47,392
		\$ 16,746
		\$ 12,710

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

In January 2002, the Company sold its interest in RSA #1 (North) for \$5.5 million (\$3.0 million in cash and \$2.5 million in satisfaction of a note payable to the acquiror), and recorded a pre-tax gain of approximately \$5.0 million.

Interactive owns a one-third interest in two cellular telephone providers in New Mexico: New Mexico RSA #3 and RSA #5. The Company's net investment in these partnerships was \$4.6 million and \$6.5 million at December 31, 2003 and 2004, respectively and included in Investment in and Advances to Affiliates.

Undistributed earnings of companies accounted for using the equity method that are included in consolidated retained earnings are \$2.0 million and \$3.1 million at December 31, 2003 and 2004, respectively.

### 6. NOTES PAYABLE TO BANKS AND LONG-TERM AND CONVERTIBLE DEBT

Long-term debt represents borrowings by specific entities, which are subsidiaries of Interactive.

44

	2003
Long-term debt consists of (all interest rates are at December 31, 2003):	
Rural Electrification Administration (REA) and Rural Telephone Bank (RTB) notes payable in equal quarterly installments through 2027 at fixed interest rates ranging from 2% to 7.5% (5.1% weighted average), secured by assets of the telephone companies of \$150 million	\$ 59,917
Bank credit facilities utilized by certain telephone and telephone holding companies through 2016, \$9.4 million at fixed interest rates averaging 8.3% and \$61.0 million at variable interest rates averaging 5.2%	78,64
Unsecured notes issued in connection with acquisitions through 2008, all at fixed interest rates averaging 9.75% (primarily held by management of telephone company's)	34,38
Other	2,83
	175,78
Current maturities	(13,16
	\$ 162,62

REA debt of \$8.0 million which bears interest at 2% has been reduced by a purchase price adjustment of \$1.7 million to discount the debt to an imputed interest rate of 5%. Such discount is being amortized into interest expense

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

based on the effective interest method over the remaining life of the notes.

Interactive maintains a short-term line of credit facility totaling \$7.0 million, on December 31, 2004, which was reduced to \$5.0 million on January 31, 2005 and will remain at that level until it expires on August 31, 2005. Borrowings under this facility were zero and \$1.1 million at December 31, 2003 and 2004, respectively. Borrowings outstanding under this facility and other lines of credit are classified as notes payable in the consolidated balance sheet. During 2004, the average balance of notes payable outstanding was \$5.7 million, the highest amount outstanding was \$7.8 million and the average interest rate was 4.6%.

In general, the long-term debt facilities are secured by substantially all of the Company's property, plant and equipment, receivables and common stock of certain subsidiaries and contain certain covenants restricting distributions to Lynch Interactive. A subsidiary of the Company with a \$3.0 million debt facility received a waiver for a covenant violation at December 31, 2003. At December 31, 2004, the Company is in compliance with all covenants. At December 31, 2003 and 2004, substantially all the subsidiaries' net assets are restricted from distribution to Lynch Interactive.

The Company has a need for resources primarily to fund future long-term growth initiatives. The Company considers various alternative long-term financing sources: debt, equity, or sale of an investment asset. While management expects to obtain adequate financing resources to enable the Company to meet its obligations, there is no assurance that such can be readily obtained or at reasonable costs.

Cash payments for interest were \$14.0 million, \$12.0 million and \$11.1 million for the years ended December 31, 2002, 2003 and 2004, respectively and \$0.2 million, \$0.2 million and \$0.2 million of interest was capitalized during such respective periods. Aggregate principal maturities of long-term debt at December 31, 2004 for each of the next five years are as follows: 2005--\$14.4 million, 2006--\$41.1 million, 2007--\$25.0 million, 2008--\$24.2 million, 2009--\$11.8 million, and the remaining \$52.5 million thereafter.

### 7. RELATED PARTY TRANSACTIONS

Interactive leases its corporate headquarters from an affiliate of its Chief Executive Officer ("CEO"). The lease was renewed in December 2002 for five years and calls for an annual payment of \$103,000 including utilities. In 2004, an additional \$8,000 was paid due to escalation clauses. Prior to the renewal, the annual payment was \$70,000. In addition, expenses relating to administrative support, transportation (includes charges for a leased airplane), and communications (approximately \$104,000, \$98,000 and \$102,000 for the years ended December 31, 2002, 2003 and 2004, respectively) are paid to an affiliate of its CEO. See Note 4 for additional references to related party transactions.

45

Expenditures for fees that the Company is incurring with regard to the False Claims Act litigation are based on allocations among defendants, and are subject to negotiation. It is expected that the final allocation may be adjusted subject to final conclusion of the litigation.

At December 31, 2003 and 2004, assets of \$15.1 million and \$15.2 million, which are classified as cash and cash equivalents, are invested in United States Treasury money market funds for which affiliates of the Company's CEO serve as investment managers to the respective funds.

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

In 1999, to assist the Company in obtaining the private placement of a \$25 million unsecured note to Cascade Investment LLC ("Cascade"), the CEO of the Company agreed to give Cascade an option to sell the note to him at 105% of the principal amount thereof. The CEO received no compensation for providing this option to sell. In 2001, Cascade exercised this option to demand payment on \$15 million of the notes. In November 2002, Cascade exercised its option to demand payment on the remaining \$10 million in notes and the Company paid such amount plus the \$0.5 million premium. During the year ended December 31, 2002, the Company's total expense, interest and fees, associated with the \$10 million was \$0.7 million and of this amount \$0.1 was paid to an affiliate of the CEO.

### 8. SHAREHOLDER'S EQUITY

In 1999, Interactive's Board of Directors authorized the purchase of up to 100,000 shares of its common stock. Through December 31, 2004, 67,000 shares have been purchased at an average investment of \$32.32 per share. Subsequent to year-end, the Company has purchased an additional 5,700 shares at an average investment of \$31.53 per share.

### 9. INCOME TAXES

Interactive files a consolidated income tax return with its subsidiaries for federal income tax purposes. Certain entities file separate state and local income tax returns, while others file on a combined or consolidated basis.

Deferred income taxes for 2003 and 2004 are provided for the temporary differences between the financial reporting bases and the tax bases of the Company's assets and liabilities. Cumulative temporary differences at December 31, 2003 and 2004 are as follows:

	2003 Deferred Tax	
	Asset	Liability
	(In Thousands)	
Fixed assets revalued under purchase		
accounting and tax over book depreciation	\$ --	\$ 9,852
Discount on long term debt	--	550
Unrealized gains on marketable securities	--	1,441
Partnership tax losses in excess of book losses	1,863	2,274
Other reserves and accruals	--	1,400
Other	800	--
Total deferred income taxes	2,663	15,517
Valuation Allowance	(2,663)	--
	\$ --	\$ 15,517

Due to uncertainty regarding its realization, a valuation allowance of approximately \$1.9 million exists against certain reserves for impairment. The Company had approximately \$16.6 million of state tax net operating loss carryforwards, expiring between 2005 and 2024. A full valuation allowance has been recorded against these net operating loss carryforwards.

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

46

The provision (benefit) for income taxes is summarized as follows:

	2002	2003	2004
-----			
(In Thousands)			
Current payable taxes:			
Federal	\$ 3,016	\$ (4,775)	\$ 831
State and local	510	874	649
	-----	-----	-----
	3,526	(3,901)	1,480
Deferred taxes:			
Federal	15	8,529	1,470
State and local	383	340	128
	-----	-----	-----
	398	8,869	1,598
	-----	-----	-----
	\$ 3,924	\$ 4,968	\$ 3,078
	=====	=====	=====

A reconciliation of the provision (benefit) for income taxes and the amount computed by applying the statutory federal income tax rate to income before income taxes, minority interest, and operations of Morgan follows:

	2002	2003	2004
-----			
(In Thousands)			
Tax at statutory rate	\$ 2,963	\$ 4,720	\$ 2,800
Increases (decreases):			
State and local taxes, net of federal benefit	589	801	500
Other	372	(553)	(200)
	-----	-----	-----
	\$ 3,924	\$ 4,968	\$ 3,000
	=====	=====	=====

Net cash payments (refunds) for income taxes were \$3.2 million, \$1.0 million, and (\$1.2) million for the three years ended December 31, 2002, 2003 and 2004, respectively.

10. ACCUMULATED OTHER COMPREHENSIVE INCOME

Balances of accumulated other comprehensive income, net of tax, which consists of unrealized gains (losses) on available for sale securities at December 31, 2003 and 2004 are as follows:

Unrealized Gain (Loss)	Tax Effect	Net
-----		

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

(In Thousands)

Balance at December 31, 2002	\$ 915	\$ (381)	\$ 534
Reclassification adjustment	(280)	110	(170)
Change in unrealized gains (losses), net	405	(83)	322
	-----	-----	-----
Balance at December 31, 2003	1,040	(354)	686
Change in unrealized gains (losses), net	1,370	(468)	902
	-----	-----	-----
Balance at December 31, 2004	\$ 2,410	\$ (822)	\$ 1,588
	=====	=====	=====

Reclassification adjustment represents realized gains (losses) on sales of available for sale securities.

11. EMPLOYEE BENEFIT PLANS

Interactive maintains several defined contribution plans at its telephone subsidiaries and corporate office. Interactive's contributions under these plans, which vary by subsidiary, are based primarily on the financial performance of the business units and employee compensation. Total expense of these plans was \$1.0 million, \$1.1 million and \$1.2 million for 2002, 2003 and 2004, respectively.

The Company has a Principal Executive Bonus Plan that has been approved by the shareholders, for which \$0.3 million, \$1.3 million, and \$0.3 million were recorded in 2002, 2003, and 2004, respectively.

47

In addition, three of the Company's telephone subsidiaries participate in a multi-employer defined benefit plan, which is administrated by a telephone industry association. Under this plan accumulated benefits and plan assets are not determined or allocated separately by individual employees. Accordingly, such data is not currently available. Total expenses of these plans were \$0.1 million for 2002 and 2003 and \$0.2 million in 2004.

12. COMMITMENTS AND CONTINGENCIES

LEASES.

The Company leases certain land, buildings, computer equipment, computer software, and network services equipment under non-cancelable operating leases that expire in various years through 2028. Rental expense under operating leases was \$0.3 million, \$0.5 million and \$0.3 million for years ended December 31, 2002, 2003 and 2004 respectively. Minimum lease payments due under non-cancelable operating leases at December 31, 2004 are as follows: \$0.3 million in 2005; \$0.3 million in 2006; \$0.2 million in 2007; \$0.1 million in 2008, \$0.1 million in 2009 and \$0.3 million thereafter.

LITIGATION. FALSE CLAIMS ACT LITIGATION.

Interactive and several other parties, including Interactive's CEO, and Fortunet Communications, L.P., which was Sunshine PCS Corporation's predecessor-in-interest, have been named as defendants in a lawsuit originally brought under the so-called "qui tam" provisions of the federal False Claims Act in the United States District Court for the District of Columbia. The complaint was filed under seal with the court on February 14, 2001. At the initiative of

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

one of the defendants, the seal was lifted on January 11, 2002. Under the False Claims Act, a private plaintiff, termed a "relator," may file a civil action on the U.S. government's behalf against another party for violation of the statute. In return, the relator receives a statutory bounty from the government's litigation proceeds if he is successful.

The main allegation in the case is that the defendants participated in the creation of "sham" bidding entities that allegedly defrauded the federal Treasury by improperly participating in certain Federal Communications Commission (FCC) spectrum auctions restricted to small businesses, as well as obtaining bidding credits in other spectrum auctions allocated to "small" and "very small" businesses. While the complaint seeks to recover an unspecified amount of damages, which would be subject to mandatory trebling under the statute, a document filed by the relator with the Court on February 24, 2004 discloses an initial computation of damages of not less than \$88 million resulting from bidding credits awarded to the defendants in FCC auctions and \$120 million of unjust enrichment through the sale or assignment of licenses obtained by the defendants in FCC auctions, in each case prior to trebling. Later computations have increased this amount. As discussed below, the bidding credits the defendants received were considerably less than the \$88 million amount reported.

Interactive strongly believes that this lawsuit is completely without merit and that relator's damage computations are without basis, and intends to defend the suit vigorously. The U.S. Department of Justice has notified the court that it has declined to intervene in the case. Nevertheless, we cannot predict the ultimate outcome of the litigation, nor can we predict the effect that the lawsuit or its outcome will have on our business or plan of operation. Interactive does not have any insurance to cover its cost of defending this lawsuit, which costs will be material. Interactive does have a directors and officers liability policy but the insurer has reserved its rights under the policy and, as a result, any coverage to be provided to any director or officer of Interactive in connection with a judgment rendered in this action is unclear at this time.

Interactive was formally served with the complaint on July 10, 2002. On September 19, 2002, the defendants filed two motions with the United States District Court for the District of Columbia: a motion to dismiss the lawsuit and a motion to transfer the action to the Southern District of New York. On November 25, 2002, the relator filed an opposition reply to our motion to dismiss and on December 5, 2002; the defendants filed a reply in support of its motion to dismiss. On September 30, 2003, the Court granted our motion to transfer the action to the Southern District of New York. A scheduling conference was held on February 10, 2004, at which time, the judge approved a scheduling order and discovery commenced.

On July 28, 2004, the judge denied in part and granted in part our motion to dismiss. Defendant bidding entities that did not win licenses were dismissed and the "reverse" false claims act count was dismissed as redundant. Interactive and its subsidiaries remain parties to the litigation.

In December 2004, the defendants filed a motion in the United States District Court for the District of Columbia to compel the FCC to provide certain information subpoenaed by them in order to enable them to conduct a defense. This motion was denied in May 2005 and the defendants have filed a notice of appeal with the United States Court of Appeals for the D.C. Circuit. See "History of Lynch's "C" Block Activities" below.



## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

Also see Footnote 4 - Wireless Communication Services with regards to a potential indemnification obligation of the Company.

### HISTORY OF LYNCH'S "C" BLOCK ACTIVITIES.

As part of the Omnibus Budget Resolution of 1993, Congress authorized the FCC to employ competitive bidding procedures to select among mutually exclusive applicants for certain spectrum licenses. Initially the FCC had an initiative to include, among others, African Americans, Native Americans, Asian Americans and women. As a result of this, the FCC conducted auctions beginning in 1995 to allocate spectrum in a competitive manner. Interactive was a participating investor and/or service provider to various entities in this "C-Block" auction.

By December 18, 1995, Interactive (through its predecessor Lynch Corporation) had investments in five entities that participated in the FCC auction for broadband PCS "C" block spectrum (Auction 5). When the auction closed, on May 6, 1996, these five entities, on a combined basis, were the higher bidders for thirty-one 30 MHz licenses at a gross cost of \$288.2 million. These entities were initially put together under the FCC's initiative to include, among others, women, African Americans, Native Americans and Asian Americans. As a result of changes in these initiatives, these same individuals were qualified as small businesses and remained eligible as bidders. These entities received \$72 million of bidding credits, and accordingly the net cost was \$216.2 million. The federal government provided financing for 90% of the cost of these licenses, or \$194.6 million. Interactive's investments in these entities totaled \$21 million.

Events during and subsequent to Auction 5, made financing these licenses through the capital markets much more difficult than originally anticipated. On April 18, 1997, among other reasons, in order to obtain some economies of scale, such as financing, the five entities merged into Fortunet Communications, Inc. The FCC, in partial response to actions by Nextwave and others, promoted a plan for refinancing the "C" block licenses. In 1997, many of the license holders from Auction 5, including Fortunet, petitioned the FCC for relief in order to afford these small businesses the opportunity to more realistically restructure and build out their systems. The President of Fortunet, Karen Johnson, participated in an FCC sponsored forum on this issue on June 30, 1997. The response from the FCC, which was announced on September 26, 1997 and modified on March 24, 1998, afforded license holders four options. One of these options was the resumption of current debt payments, which had been suspended earlier in 1997 for all such license holders. Another option, amnesty, was to return all licenses and forgo any amounts deposited in exchange for forgiveness of the FCC debt. Other options included: disaggregation, splitting a 30 MHz license into two 15 MHz licenses and forgoing 50% of the amount deposited; and prepayment, return of certain licenses and utilizing 70% of the amount deposited to acquire other licenses, with the other 30% of the deposits to be forfeited.

On June 8, 1998, Fortunet elected to apply its eligible credits relating to its original down payment to the purchase of three licenses for 15 MHz of PCS spectrum in Tallahassee, Panama City and Ocala, Florida. Consistent with an FCC promulgated disaggregation alternative, Fortunet surrendered all the remaining licenses and forfeited 30% of its original down payment in full satisfaction of its government obligations, including forgiveness of all accrued interest. Accordingly, Fortunet retained 15 MHz of spectrum in the three Florida markets covering a population of approximately 962,000 at a net auction cost of \$15.8 million. As a result of this FCC process, disaggregation resulted in a reduction of the bidding credits to \$5.3 million. Fortunet also lost \$6.0 million of its down payment. A lawyer who worked on many applications for FCC licenses, Mr. Taylor, the relator in this case, is aware of the details of these FCC initiated alternatives for the "C" Block, as presumably are his law firms. As a result of this decision, during 1997, Interactive recorded a \$7.0 million write down of its investment in Fortunet.

On April 15, 1999, the FCC completed a reauction of all the C-Block licenses

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

that were surrendered, including the 15 MHz of spectrum that Fortunet returned to the FCC on June 8, 1998 in respect of the Tallahassee, Panama City and Ocala, Florida markets. In that reauction, the successful bidders paid a total of \$2.7 million for those three 15 MHz licenses returned by Fortunet versus the \$15.8 million paid by Fortunet. As a result of this auction, Interactive recorded a further write down of its investment of \$15.4 million, including capitalized costs, to reflect the amount bid for the similar licenses in the reauction.

49

In February 2000, Fortunet merged with Sunshine PCS Corporation, which by way of a spin-off from Lynch Interactive became a public company. It traded under the symbol SUNPA.

On December 31, 2003, Sunshine, after appropriate corporate and regulatory steps, sold its three 15 MHz licenses to Cingular Wireless for \$13.75 million. Interactive received \$7.6 million as part of the sale transaction versus its cash investment of \$21 million initially invested in the original five entities in 1992.

### OTHER LITIGATION.

In addition to the litigation described above, Interactive is a party to routine litigation incidental to its business. Based on information currently available, Interactive believes that none of this ordinary routine litigation, either individually or in the aggregate, will have a material effect on its financial condition and results of operations.

### 13. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

	2003-Three Months Ended		
	March 31	June 30	Sept. 30
	(In Thousands, Except Per Share)		
Revenues	\$ 20,773	\$ 20,928	\$ 21,827
Operating profit	4,774	4,693	5,379
Net Income	1,413	1,156	1,432
Basic and diluted earnings per share:	\$ .51	\$ .41	\$ .51
	2004-Three Months Ended		
	March 31	June 30	Sept. 30
	(In Thousands, Except Per Share)		
Revenues	\$ 21,401	\$ 21,141	\$ 22,865
Operating profit	4,888	3,227	5,087
Net Income	1,603	384	1,542
Basic and diluted earnings per share:	\$ .58	\$ .14	\$ .56

(a) Includes a \$3.9 million gain on the sale of investments in Sunshine PCS.

### 14. EARNINGS (LOSS) PER SHARE

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

Basic and dilutive earnings per share are based on the average weighted number of shares outstanding. On December 13, 1999, Lynch Interactive issued a \$25 million 6% convertible promissory note, which was convertible into 588,235 shares of the Company's common stock. In January 2001, \$15 million of the note was repaid. The remaining \$10 million convertible note was convertible into 235,294 shares of the Company's common stock. In November 2002 the remaining \$10 million was repaid. This security was excluded from the calculation of dilutive earnings per share in 2002, since assuming conversion would have been anti-dilutive.

### 15. SEGMENT INFORMATION

The Company is engaged in one business segment: multimedia.

### 16. SUBSEQUENT EVENTS

In February 2005, Lynch 3G participated in Auction 58 for PCS Spectrum and was high bidder for two licenses, Marquette, MI and Klamath Falls, OR, for a total cost of \$0.5 million.

On March 18, 2005, a subsidiary of the Company, Central Telecom Services, LLC, has closed on an agreement with Precis Communications, LLC, to acquire a cable television system for a purchase price of \$3.5 million. The system has 2,411 cable subscribers located in Sanpete and Sevier Counties, Utah.

50

### SCHEDULE I - CONDENSED FINANCIAL INFORMATION OF REGISTRANT LYNCH INTERACTIVE CORPORATION CONDENSED STATEMENT OF OPERATIONS

	Years Ended	
	2002	2001
	(In Thousands)	
Income:		
Interest and dividend income	\$ 326	\$ 1,000
Gain on sale of investment in Sunshine PCS and other securities	--	3,910
Equity in earnings of affiliated companies	--	--
	326	3,910
Cost and expenses:		
Unallocated corporate administrative expense	1,994	3,090
Interest expense	1,620	820
Total cost and expenses	3,614	3,910

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

Loss before income taxes and equity in income (loss) of subsidiaries	(3,288)	
Income tax benefit	1,117	(
Equity in income (loss) of subsidiaries	5,932	7,38
Loss from operations of Morgan - net	(1,888)	-
	-----	
Net income	\$ 1,873	\$ 7,39
	=====	

51

SCHEDULE I - CONDENSED FINANCIAL INFORMATION OF REGISTRANT  
 LYNCH INTERACTIVE CORPORATION  
 CONDENSED BALANCE SHEETS

	Decem
	-----
	2003
	-----
	(In Th
Assets	
Current assets	
Cash and cash equivalents	\$ 1,087
Deferred income taxes	85
Other current assets	194
	-----
	1,366
Office equipment (net)	18
Marketable securities	2,494
Investment in affiliated companies	--
Other assets (principally investment in and advances to subsidiaries)	39,589
	-----
Total assets	\$ 43,467
	=====
Liabilities and Shareholders' Equity	
Current liabilities	\$2,725
Long term debt	8,475

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

Deferred credits	2,380
Total shareholders' equity	29,887
Total liabilities and shareholders' equity	\$ 43,467

52

SCHEDULE I - CONDENSED FINANCIAL INFORMATION OF REGISTRANT  
 LYNCH INTERACTIVE CORPORATION  
 CONDENSED STATEMENT OF CASH FLOWS

	Years Ended December	
	2002	2003
	(In Thousands)	
Operating activities:		
Net income	\$ 1,873	\$ 7,390
Depreciation	14	4
Equity in earnings of affiliated companies	--	--
Gain on sale of investment in Sunshine PCS	--	(3,919)
Changes in current assets and liabilities	(3,147)	1,683
Cash provided by (used in) operating activities	(1,260)	5,158
Investing activities:		
Investment and advances to Brighton communications	2,479	(1,891)
Purchase of securities	(158)	(84)
Investment in affiliates	--	--
Proceeds from sale of investment in Sunshine PCS	--	7,587
Capital expenditures	(3)	(9)
Net cash provided by (used in) investing activities	2,318	5,603
Financing activities:		
Net borrowings under:		
Lines of credit	2,400	(10,000)
Issuance of long term debt	--	480
Repayment of long term debt	(10,000)	--
Purchase of treasury stock	(956)	(287)
Other	--	--
Net cash provided by (used in) financing activities	(8,556)	(9,807)
Total increase (decrease) cash and cash equivalents	(7,498)	954

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

Cash and cash equivalents at beginning of year	7,631	133
<hr/>		
Cash and cash equivalents at end of year	\$ 133	\$ 1,087
<hr/>		

NOTES TO CONDENSED FINANCIAL STATEMENTS

Note A - Basis Of Presentation. The Company's investment in subsidiaries is stated at cost plus equity in undistributed earnings of the subsidiaries. Income taxes are computed at the federal statutory rate of 34%.

Note B -No dividends were received from subsidiaries in any period.

Note C - Long-Term Debt. Interactive has a note payable to a subsidiary, with a principal amount of \$8.5 million at December 31, 2004, at a fixed interest rate of 6% per annum, due in 2005. The note is convertible, at the subsidiary's option, into common stock of Lynch Corporation (1 share) and Interactive (2 shares) with a combined exercise price of \$120 per share.

In 2004, Interactive issued a \$4.5 million 8.5% five-year amortizing subordinated note payable and assumed an additional \$0.5 million note in connection with the acquisition of a 37% interest in KMG. KMG's principal asset consists of a \$6.0 million subordinated note and a 17% equity interest in Lynch Telephone Corporation, an 83% owned subsidiary of the Corporation.

Note D - See notes to consolidated financial statements for additional information.

Note E - Prior reporting periods amounts have been reclassified to conform with current year reporting presentations.

53

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

LYNCH INTERACTIVE CORPORATION  
YEARS ENDED DECEMBER 31, 2002, 2003 AND 2004

COLUMN A DESCRIPTION	COLUMN B BALANCE AT BEGINNING OF PERIOD	COLUMN C - ADDITION CHARGED CHARGED TO COSTS AND EXPENSES	OTHER ACCOUNT DESCRIB
Year ended December 31, 2004 Allowance for uncollectible accounts	\$ 262,000	\$ 222,000	--
Year ended December 31, 2003 Allowance for uncollectible accounts	\$ 316,000	\$ 223,000	--

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

Year ended December 31, 2002			
Allowance for uncollectible accounts	\$ 424,000	\$1,037,000	--

(A) UNCOLLECTIBLE ACCOUNTS WRITTEN OFF ARE NET OF RECOVERIES.

54

### EXHIBIT INDEX

Exhibit No.	Description
2	Separation Agreement(1)
3.1	Amended and Restated Certificate of Incorporation of Registrant (1)
3.2	Amended By-laws of Registrant(2)
4.1	Mortgage, Security Agreement and Financing Statement among Haviland Telephone Company, Inc., the United States of America and the Rural Telephone Bank(1)
4.2	Restated Mortgage, Security Agreement and Financing Statement between Western New Mexico Telephone Company, Inc. and the United States of America(1)
10(a)	Partnership Agreement dated March 11, 1987, between Lombardo Communications, Inc. and Lynch Entertainment Corporation (incorporated by reference to Exhibit 10(e) of the Lynch Corporation ("Lynch")'s Annual Report on Form 10-K for the year ended December 31, 1987).
10(b)	Lynch Corporation 401(k) Savings Plan (incorporated by reference to Exhibit 10(b) to Lynch's Form 10-K for the year ended December 31, 1995).
10(c)	Shareholders Agreement among Capital Communications Company, Inc., Lombardo Communications, Inc. and Lynch Entertainment Corporation II (incorporated by reference to Exhibit 10 of Lynch's Form 8-K, dated March 14, 1994).
10(d) (i)	Loan Agreement, dated as of November 6, 1995, between Lynch PCS Corporation A and Aer Force Communications L.P. (now Fortunet Wireless, L.P.) (plus four similar loan agreements with Fortunet Wireless, L.P.) (incorporated by reference to Exhibit 10(w) to Lynch's Form 10-K for the year ended December 31, 1995).
10(d) (ii)	Amendment No. 1 to the Loan Agreement, dated as of November 6, 1995, referred to in 10(d) (i) incorporated by reference to

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

Exhibit 10(a) to Lynch's Form 10-Q for quarter ended March 31, 1996).

- 10(e) (i) Letter Agreement, dated as of August 12, 1996, between Rivgam Communicators, L.L.P. and Lynch PCS Corporation G (incorporated by reference to Exhibit 10(u)(ii) to Lynch's Form 10-K for the year ended December 31, 1996).
- 10(f) (ii) Letter Agreement dated as of December 16, 1998, between Rivgam Communicators, L.L.P. and Lynch PCS Corporation G (incorporated by reference in Exhibit 10(u)(iv) to Lynch's Form 10-K for the year ended December 31, 1998).
- 10(f) Letter Agreement between Lynch PCS Corporation G and Bal/Rivgam, L.L.C. (incorporated by reference to Exhibit 10(x) to Lynch's Form 10-Q for the Quarter ended September 30, 1997).
- 10(g) Letter Agreement, dated January 20, 1998, between Lynch PCS Corporation G and BCK/Rivgam, L.L.C. (incorporated by reference to Exhibit 10(y) to Lynch's Form 10-K for the year ended December 31, 1997).
- 10(h) 2000 Stock Option Plan (incorporated by reference to the Exhibit to Registrant's Proxy Statement dated April 18, 2000).
- 10(i) Lease Agreement between Lynch and Gabelli Funds, Inc. (incorporated by reference to Exhibit 10(a)(a) to Lynch's Form 10-Q for the Quarter ended March 31, 1998).

55

Exhibit No.      Description  
-----

- 10(j) Letter Agreement dated November 11, 1998, between Registrant and Gabelli & Company, Inc. (incorporated by reference to Exhibit 10(c)(c) to Lynch Form 10-K for the year ended December 31, 1998).
- 10(l) Agreement and Plan of Merger dated as of May 25, 1999, among Central Scott Telephone Company, Brighton Communications Corporation and Brighton Iowa Acquisition Corporation (schedules omitted) (incorporated by reference to Exhibit 10.1 to Lynch's Form 8-K dated July 16, 1999).
- 10(m) Separation and Distribution Agreement, dated as of January 18, 2002, by and among Lynch Interactive Corporation, Morgan Group Holding Co. and The Morgan Group, Inc. (2)
- 10(n) Agreement for Purchase and Sale of Licenses dated August 18, 2003, by and between Sunshine PCS Corporation, Cingular Wireless LLC and for purposes of Articles X and XII, certain stockholders including Lynch Interactive Corporation. (3)
- 10(o) Stock Purchase Agreement by and among Lynch Telephone Corporation XI, Lynch Interactive Corporation, Brighton Communications Corporation, California-Oregon Telecommunications Company



Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

("COTC") and the Shareholders of COTC dated as of March 22, 2004.(3)

- 14.1 Lynch Interactive Corporation Code of Ethics(3)
- 14.2 Lynch Interactive Corporation Conflicts of Interest Policy(3)
- 21 Subsidiaries of Registrant(4)
- 23.1 Consent of Ernst & Young LLP(4)
- 23.2 Consent of Deloitte & Touche LLP(4)
- 23.3 Consents of Siefert & Co., L.L.P. for use of:(4)
  - Report of Siefert & Co., L.L.P. on the financial statements of Cuba City Telephone Exchange Company for the year ended December 31, 2002
  - Report of Siefert & Co., L.L.P. on the financial statements of Belmont Telephone Company for the year ended December 31, 2002
  - Report of Siefert & Co., L.L.P. on the financial statements of Upper Peninsula Telephone Company for the year ended December 31, 2002
- 24 Powers of Attorney(4)
- 31.1 Rule 13a-14(a) Certification of the Chief Executive Officer+
- 31.2 Rule 13a-14(a) Certification of the Chief Financial Officer+
- 32.1 Section 1350 Certification of the Chief Executive Officer+
- 32.2 Section 1350 Certification of the Chief Financial Officer+

56

Exhibit No. Description  
-----

- 99.1 Reports of Independent Auditors(4)
  - Report of Siefert & Co., L.L.P. on the financial statements of Cuba City Telephone Exchange Company for the year ended December 31, 2002
  - Report of Siefert & Co., L.L.P. on the financial statements of Belmont Telephone Company for the year ended December 31, 2002
  - Report of Siefert & Co., L.L.P. on the financial statements of Lynch Michigan Telephone Holding Corporation for the year ended December 31, 2002

+ Filed herewith.

(1) Incorporated by reference to the exhibits to the Registrant's Registration Statement on Form 10A-1.

(2) Incorporated by reference to the exhibits to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2002.

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-K/A

(3) Incorporated by reference to the exhibits to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

(4) Incorporated by reference to the exhibits to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2004.

The Exhibits listed above have been filed separately with the Securities and Exchange Commission in conjunction with this Annual Report on Form 10-K or have been incorporated by reference into this Annual Report on Form 10-K. Lynch Interactive Corporation will furnish to each of its shareholders a copy of any such Exhibit for a fee equal to Lynch Interactive Corporation's cost in furnishing such Exhibit. Requests should be addressed to the Office of the Secretary, Lynch Interactive Corporation, 401 Theodore Fremd Avenue, Rye, New York 10580.

57

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LYNCH INTERACTIVE CORPORATION

By: /s/ Robert E. Dolan

-----  
Robert E. Dolan  
Chief Financial Officer

Dated: September 7, 2005

Signature	Capacity	Date
/s/ Mario J. Gabelli ----- MARIO J. GABELLI	Chairman of the Board of Officer (Principal Executive Officer) Directors and Chief Executive	September 7, 2005
/s/ Morris Berkowitz ----- MORRIS BERKOWITZ	Director	September 7, 2005
/s/ Paul J. Evanson ----- PAUL J. EVANSON	Director	September 7, 2005
/s/ John C. Ferrara -----	Director	September 7, 2005

