

PAXSON COMMUNICATIONS CORP

Form 10-K

March 31, 2003

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2002
- OR
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
(NO FEE REQUIRED)
For the transition period from _____ to _____

Commission File Number 1-13452

PAXSON COMMUNICATIONS CORPORATION

(Exact name of registrant as specified in its charter)

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

Registrant's telephone number, including area code: (561) 659-4122

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

Title of Each Class	Name of Exchange on Which Registered
Class A Common Stock, \$0.001 par value 10 3/4%	American Stock Exchange
Senior Subordinated Notes	American Stock Exchange

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

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

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

Edgar Filing: PAXSON COMMUNICATIONS CORP - Form 10-K

The aggregate market value of common stock held by non-affiliates of the registrant as of March 17, 2003 is \$98,207,000 computed by reference to the closing price for such shares on the American Stock Exchange.

The number of shares outstanding of each of the registrant's classes of common stock, as of March 17, 2003 was: 59,261,670 shares of Class A Common Stock, \$0.001 par value, and 8,311,639 shares of Class B Common Stock, \$0.001 par value.

Documents Incorporated By Reference

Parts of the definitive Proxy Statement for the Registrant's Annual Meeting of Stockholders to be held on May 16, 2003.

TABLE OF CONTENTS

PART I

Item 1. Business

Item 2. Properties

Item 3. Legal Proceedings

Item 4. Submission of Matters to Vote of Security Holders

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

Item 6. Selected Financial Data

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

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Item 8. Financial Statements and Supplementary Financial Data

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

PART III

Item 10. Directors and Executive Officers of the Registrant

Item 11. Executive Compensation

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Item 13. Certain Relationships and Related Transactions

Item 14. Controls and Procedures

PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

SIGNATURES

CERTIFICATIONS

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULE

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

CONSOLIDATED BALANCE SHEETS

CONSOLIDATED STATEMENTS OF OPERATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

VALUATION AND QUALIFYING ACCOUNTS

Waiver Dated as of March 13, 2003.

Agreement Dated December 16, 2002.

Amendment to Employment Agreement.

Subsidiaries of the Company

Consent of PricewaterhouseCoopers LLP

Certification of CEO

Certification of CFO

Table of Contents**TABLE OF CONTENTS**

	Page
Item 1. Business	1
Item 2. Properties	28
Item 3. Legal Proceedings	28
Item 4. Submission of Matters to a Vote of Security Holders	29
Item 5. Market for Registrant's Common Equity and Related Stockholder Matters	30
Item 6. Selected Financial Data	31
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations	32
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	46
Item 8. Financial Statements and Supplementary Data	46
Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	46
Item 10. Directors and Executive Officers of the Registrant	47
Item 11. Executive Compensation	47
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	47
Item 13. Certain Relationships and Related Transactions	47
Item 14. Controls and Procedures	47
Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K	48

Table of Contents

PART I

Item 1. Business

General

We are a network television broadcasting company which owns and operates the largest broadcast television station group in the United States, as measured by the number of television households in the markets our stations serve. We currently own and operate 63 full power broadcast television stations (including three stations we operate under time brokerage agreements), all of which carry PAX TV, including stations reaching all of the top 20 U.S. markets, and 41 of the top 50 U.S. markets. We operate PAX TV, a network that provides family oriented entertainment programming seven days per week between the hours of 5:00 p.m. and 11:30 p.m. (eastern standard time equivalent), Monday through Friday, and 6:00 p.m. and 11 p.m. (eastern standard time equivalent), Saturday and Sunday. PAX TV's programming consists of shows originally developed by us and shows that have appeared previously on other broadcast networks which we have purchased the right to air. PAX TV reaches approximately 88% of prime time television households in the U.S. (approximately 94 million homes) through our broadcast television station group, and pursuant to distribution agreements with cable and satellite systems and affiliates. PAX TV reaches approximately 64% of U.S. television households through our owned and operated broadcast television station group. We have agreements with cable television system owners and satellite television providers to carry PAX TV, through which we reach an additional 17% of U.S. television households in markets not served by our owned and operated stations. We reach an additional 7% of U.S. television households through affiliation agreements with 62 independently owned PAX TV affiliated stations. We have obtained audience ratings and share, market rank and television household data set forth in this report from the most recent information available from Nielsen Media Research. We do not assume responsibility for the accuracy or completeness of this data.

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

Network Spot Advertising. We sell commercial air time to advertisers who want to reach the entire nationwide PAX TV viewing audience with a single advertisement. Most of our network advertising is sold under advance, or upfront, commitments to purchase advertising time which are obtained before the beginning of our PAX TV programming season. The National Broadcasting Company, Inc. (NBC) serves as our exclusive sales representative to sell most of our network advertising. Any remaining inventory which is not sold by NBC is sold by us as direct response advertising. Our network advertising sales represented approximately 33% of our revenue during the year ended December 31, 2002.

Network Long Form Paid Programming. We sell air time for long form paid programming, consisting primarily of infomercials, during broadcasting hours when we are not airing PAX TV. Infomercials are shows produced by others, at no cost to us, principally to promote and sell products or services through viewer direct response. Our network long form paid programming represented approximately 32% of our revenue during the year ended December 31, 2002.

Station Advertising. We sell commercial air time to advertisers who want to reach the viewing audience in specific geographic markets in which our stations operate. These advertisers may be local businesses or regional or national advertisers who want to target their advertising in these markets. NBC provides national advertising sales services for a majority of our stations. In markets in which our stations are operating under joint sales agreements, or JSAs, our JSA partner serves as our exclusive sales representative to sell our local station advertising. For stations for which NBC does not provide national account representation, our JSA partner's national representation firm performs this function. Our local sales forces sell this advertising in markets without JSAs. Our station advertising sales represented approximately 35% of our revenue during the year ended December 31, 2002 (including 15% of our revenue during such year which was derived from local and national long form paid programming).

Table of Contents

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

Business Strategy

The principal components of our strategy are set forth below:

Provide Quality Family Programming. We believe there is significant demand, including from adult demographic groups which are attractive to advertisers, for quality family oriented programming which is free of excessive violence, explicit sexual themes and foul language. We are attracting viewers and establishing a nationally recognized brand by offering quality family programming. As our PAX TV brand recognition grows, we believe that PAX TV will increasingly be a destination channel to which viewers turn regularly for family programming. We have developed original entertainment programming for PAX TV at lower costs than those typically incurred by other broadcast networks for original entertainment programming by employing cost efficient development, financing and production techniques.

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

Improve Local Television Station Operations by Implementing Joint Sales Agreements. In order to improve the operations of our local stations, we have entered into JSAs with respect to 52 of our stations, including JSAs between 44 of our stations and NBC owned stations or independently owned NBC affiliated stations. Substantially all of those stations are currently operating under the terms of the JSAs. Generally, JSAs are for ten-year terms. Substantially all JSA partners have the right to terminate the JSA upon a sale by the JSA partner of its station that is the subject of the JSA. Each JSA typically provides the following:

The JSA partner serves as our exclusive sales representative to sell our station advertising, enabling our station to benefit from the strength of the JSA partner's sales organization and existing advertiser relationships;

We integrate and co-locate many of our station operations with those of the JSA partner, reducing our costs through operating efficiencies and economies of scale, including the elimination of redundant owned and leased facilities and staffing; and

The JSA partner may provide local news and syndicated programming, supplementing and enhancing our station's programming lineup.

Expand and Improve PAX TV Distribution. We intend to continue to expand our television distribution system through the addition of affiliated broadcast television stations and cable systems.

Table of Contents

We intend to expand our distribution to reach as many U.S. television households as possible in a cost efficient manner. We continue to improve the channel positioning of our broadcast television stations on local cable systems across the country, as we believe the ability to view our programming on one of the lower numbered channel positions (generally below channel 21) on a cable system improves the likelihood that viewers will watch our programming.

Develop Our Broadcast Station Group's Digital Television Platform. Our owned and operated station group gives us a significant platform for digital broadcasting. We are continuing the construction of our digital broadcast facilities and intend to explore the most effective use of digital broadcast technology for each of our stations. Upon completion of the construction of our digital facilities, we believe that we will be able to provide a significant broadband platform on which to broadcast digital television, including multiple additional television networks. While future applications of this technology and the time frame within which digital broadcasting will commence are uncertain, we believe that with our existing broadcast stations we are well positioned to take advantage of future digital broadcasting opportunities.

Continue Airing Long-Form Paid Programming. We continue to air a substantial amount of long form paid programming as we believe they provide us with a stable revenue base as we continue to develop the PAX TV network's entertainment programming. In January 2003, we increased our inventory of air time available for long form paid programming by approximately 42% by shifting 26.5 hours per week of non-prime time PAX TV network entertainment programming to long form paid programming. We determined that we could sell this air time for long form paid programming at higher rates than the rates at which we were selling spot advertising time in these time periods. As a result of this change, we expect that the portion of our revenues which is derived from network advertising will decrease and the portion of our revenues which is derived from network and station long form paid programming will increase. This reduction in our network entertainment programming, which consisted principally of syndicated programs, will also enable us to reduce our programming costs. We expect to periodically review and adjust the amount of air time we sell for long form paid programming in order to take advantage of opportunities that may arise for us to increase our advertising revenue.

Distribution

We distribute PAX TV through a television distribution system comprised of our owned and operated broadcast television stations, cable television systems in various markets not served by a PAX TV station, satellite television providers and independently owned PAX TV affiliated broadcast stations. According to Nielsen our programming currently reaches 88% of U.S. television households (approximately 94 million homes).

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

Our Owned and Operated Television Stations. We currently own and operate 63 full power broadcast television stations (including three stations we operate under time brokerage agreements, or TBAs), all of which carry PAX TV, including stations reaching all of the top 20 U.S. markets and 41 of the top 50 U.S. markets. Our owned and operated station group reaches approximately 64% of U.S. prime time television households, according to Nielsen. Our ownership of the stations providing most of our television distribution

Table of Contents

enables us to receive advertising revenue from each station's entire broadcast day and to achieve operating efficiencies typically not enjoyed by network affiliated television stations. As nearly all of our owned and operated stations operate in the ultra high frequency, or UHF, portion of the broadcast spectrum, only half of the number of television households they reach are counted against the national ownership cap under the Communications Act. By exercising our rights under the Communications Act to require cable television system operators to carry the broadcast signals of our owned and operated stations, we reach many more television households in each station's designated market area, or DMA, than we would if our stations were limited to transmitting their broadcast signals over the airwaves.

We operate an additional three stations (WPXL, New Orleans; WPXX, Memphis; and WBNA, Louisville) pursuant to time brokerage agreements, or TBAs, with the station owners. Under these agreements, we provide the station with PAX TV programming and retain the advertising revenues from the sale of advertising time during PAX TV programming hours. We have options to acquire two of these stations (WPXL and WPXX) and a right of first refusal to acquire the third (WBNA). The owners of the two stations for which we have options have the right to require us to purchase these stations at any time after January 1, 2005 through December 31, 2006.

The table below provides information about our owned and operated stations and stations we operate pursuant to TBAs. Upon completion of the pending acquisition and sale transactions noted in the table, we will own and operate 60 stations, all of which will carry PAX TV, including stations reaching all of the top 20 U.S. markets and 40 of the top 50 markets.

Market Name	Market Rank(1)	Station Call Letters	Broadcast Channel	Total Market TV Households(2)	JSA Partner(3)
New York	1	WPXN	31	7,282,320	NBC
Los Angeles	2	KPXN	30	5,318,040	NBC
Chicago	3	WCPX	38	3,351,330	NBC
Philadelphia	4	WPPX	61	2,830,470	NBC
San Francisco	5	KKPX	65	2,436,220	NBC
Boston (3 stations)	6	WBPX	68	2,353,500	
Dallas	7	KPXD	68	2,195,540	NBC
Washington D.C	8	WPXW	66	2,169,230	NBC
Washington D.C	8	WWPX	60	2,169,230	NBC
Atlanta	9	WPXA	14	1,971,180	Gannett Co., Inc.
Detroit	10	WPXD	31	1,899,910	
Houston	11	KPXB	49	1,814,140	Belo Corp.
Seattle	12	KWPX	33	1,659,100	Belo Corp.
Tampa	13	WXPX	66	1,620,110	Media General, Inc.
Minneapolis	14	KPXM	41	1,594,740	Gannett Co., Inc.
Cleveland	15	WVPX	23	1,528,840	Gannett Co., Inc.
Phoenix	16	KPPX	51	1,524,130	Gannett Co., Inc.
Miami	17	WPXM	35	1,486,860	NBC
Denver	18	KPXC	59	1,366,250	Gannett Co., Inc.
Sacramento	19	KSPX	29	1,227,600	Hearst-Argyle Television, Inc.
Orlando	20	WOPX	56	1,224,470	Hearst-Argyle Television, Inc.
Portland, OR	23	KPXG	22	1,061,080	Belo Corp.
Indianapolis	25	WIPX	63	1,019,870	Dispatch Broadcast Group
Hartford	27	WHPX	26	980,410	NBC
Raleigh-Durham	29	WFPX	62	929,460	NBC
Raleigh-Durham	29	WRPX	47	929,460	NBC
Nashville	30	WNPX	28	880,670	
Milwaukee	31	WPXE	55	860,350	Journal Broadcast Group, Inc.
Kansas City	33	KPXE	50	852,510	Scripps Howard Broadcasting Company
Salt Lake City	36	KUPX	16	769,230	
San Antonio	37	KPXL	26	718,730	Clear Channel Broadcasting, Inc.
Grand Rapids	38	WZPX	43	713,800	LIN Television Corp.
West Palm Beach	39	WPXP	67	700,850	Scripps Howard Broadcasting Company
Birmingham	40	WPXH	44	690,030	NBC

Table of Contents

Market Name	Market Rank(1)	Station Call Letters	Broadcast Channel	Total Market TV Households(2)	JSA Partner(3)
Norfolk	41	WPXV	49	677,610	LIN Television Corp.
New Orleans(4)(5)	42	WPXL	49	658,830	Hearst-Argyle Television, Inc.
Memphis(4)(5)	43	WPXX	50	653,840	Raycom America, Inc.
Buffalo	44	WPXJ	51	639,190	Gannett Co., Inc.
Oklahoma City	45	KOPX	62	636,970	The New York Times Company
Greensboro	46	WGPX	16	634,140	Hearst-Argyle Television, Inc.
Providence	48	WPXQ	69	624,020	NBC
Albuquerque (6)	49	KAPX	14	620,230	Hubbard Broadcasting, Inc.
Louisville(4)(7)	50	WBNA	21	612,300	
Jacksonville-Brunswick	51	WPXC	21	587,200	Post-Newsweek Stations, Inc.
Wilkes Barre	53	WQPX	64	580,290	The New York Times Company
Albany	55	WYPX	55	532,520	Hubbard Broadcasting, Inc.
Tulsa	60	KTPX	44	496,880	Scripps Howard Broadcasting Company
Charleston, WV	61	WLPX	29	495,320	
Knoxville	63	WPXK	54	489,710	Raycom America, Inc.
Lexington	65	WUPX	67	454,440	
Roanoke	67	WPXR	38	445,000	Media General, Inc.
Honolulu	71	KPXO	66	401,330	
Des Moines	72	KFPX	39	400,830	The New York Times Company
Portland-Auburn, ME (6)	76	WMPX	23	391,930	Gannett Co., Inc.
Spokane	79	KGPX	34	381,130	KHQ, Incorporated
Syracuse	80	WSPX	56	375,880	Raycom America, Inc.
Shreveport	81	KPXJ	21	372,950	KTBS, Inc.
Cedar Rapids	88	KPXR	48	323,810	
Greenville-N. Bern	103	WEPX	38	266,390	GOCOM Television LLC
Greenville-N. Bern	103	WPXU	35	266,390	GOCOM Television LLC
Wausau(8)	134	WTPX	46	175,790	
St. Croix (6)		WPXO	15		Alpha Broadcasting Corporation

- (1) Market rank is based on the number of television households in the television market or Designated Market Area, or DMA, as used by Nielsen, effective as of September 2002.
- (2) Refers to the number of television households in the DMA as estimated by Nielsen, effective as of September 2002.
- (3) Indicates the company with which we have entered into a JSA for the station.
- (4) Station is independently owned and is operated by us under a time brokerage agreement.
- (5) We have the option to acquire the station and the current owner has the right to require us to purchase the station at anytime after January 1, 2005 through December 31, 2006.
- (6) Station is subject to a pending sale transaction.
- (7) We have a right of first refusal to acquire the station.
- (8) The station has been constructed but is currently off the air.

Cable and Satellite Distribution. In order to increase the distribution of our programming, we have entered into carriage agreements with the nation's largest cable multiple system operators, as well as with other cable system operators and satellite television providers. These cable and satellite system operators carry our programming on a designated channel of their service. These carriage agreements enable us to reach television households in markets not served by our owned or affiliated stations. Our carriage agreements with cable system operators generally

Edgar Filing: PAXSON COMMUNICATIONS CORP - Form 10-K

require us to pay an amount based upon the number of additional television households reached. Our carriage agreements with satellite television providers allow the satellite provider to sell and retain the advertising revenue from a portion of the non-network advertising time during PAX TV programming hours. Some of our carriage agreements with cable operators also provide this form of compensation to the cable operator. We do not pay compensation for reaching households in DMAs already served by our broadcast stations, even though the cable operator may provide our programming to these households because we have exercised our must carry rights under the Communications Act. We believe that the ability to view our programming on one of the lower numbered channel positions (generally below channel 21) on a cable system improves the likelihood that viewers will watch our programming, and we have

Table of Contents

successfully negotiated favorable channel positions with most of the cable system operators and satellite television providers with whom we have carriage agreements. Through cable and satellite distribution, we reach approximately 17% of U.S. prime time television households in DMAs not already served by a PAX TV station.

Our PAX TV Affiliated Stations. To increase the distribution of PAX TV, we have entered into affiliation agreements with stations in markets where we do not otherwise own or operate a broadcast station. These stations include full power and low power television stations. Each affiliation agreement gives the particular station the right to broadcast PAX TV programming, or portions of it, in the station's market. Although the majority of the affiliation agreements provide for the distribution of PAX TV prime time programming, some affiliates do not carry all of our PAX TV programming. In addition, some affiliates do not air PAX TV programming in the exact time patterns that the programming is broadcast on our network because of issues related to their specific markets. Our affiliation agreements provide us with additional distribution of our PAX TV programming without the expense of acquiring a station or paying compensation to cable system operators in the markets reached. Under our affiliation agreements, we are not required to pay cash compensation to the affiliate, and the affiliate is entitled to sell and retain the revenue from all or a portion of the non-network advertising time during the PAX TV programming hours. We have affiliation agreements with respect to 62 television stations which reach approximately 7% of U.S. prime time television households.

Programming

During our PAX TV network hours, which are between 5:00 p.m. and 11:30 p.m., Monday through Friday, and 6:00 p.m. and 11 p.m., Saturday and Sunday, we offer family entertainment programs that are free of excessive violence, explicit sexual themes and foul language. We produce original shows to air during PAX TV's prime time hours. The balance of our PAX TV lineup consists of syndicated programs and a limited amount of entertainment and sports programming on a market-by-market basis. Since our launch, we have sought to develop our original PAX TV programming, as our operating experience with PAX TV has shown that quality original programs can generate higher ratings and deliver a greater return to us, in terms of advertising revenues, than syndicated programs of comparable cost. We are concentrating our programming efforts on creating and promoting existing and new original shows to air during PAX TV's prime time hours.

We have developed original entertainment programming for PAX TV at lower costs than those typically incurred by other broadcast networks for original entertainment programming. We have done this by employing cost efficient development and production techniques, such as the development of program concepts without the use of pilots, and by entering into production arrangements with foreign production companies through which we are able to