

ARBITRON INC  
Form 10-Q  
May 08, 2002

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

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FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

**For the quarterly period ended March 31, 2002**

Or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 1-1969

**ARBITRON INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**52-0278528**

(I.R.S. Employer Identification No.)

**142 West 57<sup>th</sup> Street  
New York, New York 10019**

(Address of principal executive offices) (Zip Code)

**(212) 887-1300**

(Registrant's telephone number, including area code)

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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  No

The registrant had 29,276,630 shares of common stock, par value \$0.50 per share, outstanding as of April 23, 2002.

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ARBITRON INC.

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**PART I FINANCIAL INFORMATION**  
**ITEM 1. FINANCIAL STATEMENTS**

**ARBITRON INC.**  
Consolidated Balance Sheets  
(In thousands)

|   | March 31,<br>2002 | December 31,<br>2001 |
|---|-------------------|----------------------|
|   | (unaudited)       | (audited)            |
| <b>Assets</b>   |                   |                      |
| Current assets  |                   |                      |
| Cash and cash equivalents   | \$ 15,524         | \$ 21,043            |
| Trade accounts receivable, net of allowance for doubtful<br>accounts of \$1,088 in 2002 and \$995 in 2001   | 15,486            | 19,393               |
| Deferred income taxes   | 16,796            | 24,644               |
| Prepaid expenses and other current assets   | 2,609             | 2,578                |
| <b>Total current assets</b>   | <b>50,415</b>     | <b>67,658</b>        |
| Investments in affiliates   | 7,277             | 9,722                |
| Property and equipment, net   | 10,455            | 8,850                |
| Goodwill, net   | 32,937            | 28,937               |
| Other intangibles, net  | 2,671             | 2,961                |
| Deferred income taxes   | 3,064             | 3,698                |
| Other noncurrent assets   | 4,787             | 5,015                |
| <b>Total assets</b>   | <b>\$ 111,606</b> | <b>\$ 126,841</b>    |
| <b>Liabilities and Stockholders Equity (Deficit)</b>  |                   |                      |
| Current liabilities   |                   |                      |
| Accounts payable  | \$ 3,472          | \$ 5,245             |
| Accrued expenses and other current liabilities  | 10,310            | 15,597               |
| Due to owners of acquired business  | 10,811            | 10,621               |
| Deferred revenue  | 40,233            | 52,993               |
| <b>Total current liabilities</b>  | <b>64,826</b>     | <b>84,456</b>        |
| Noncurrent liabilities  |                   |                      |
| Long-term debt  | 195,000           | 205,000              |
| Other noncurrent liabilities  | 4,968             | 6,494                |
| <b>Total liabilities</b>  | <b>264,794</b>    | <b>295,950</b>       |
| Stockholders equity (deficit)   |                   |                      |
| Common stock, \$0.50 par value, authorized 500,000 shares,<br>issued 32,336 shares                          | 16,168            | 16,166               |
| Additional paid-in capital  | 60,044            | 59,349               |
| Accumulated earnings (net distributions to Ceridian in excess of<br>accumulated earnings) prior to spin-off | (260,146)         | (260,146)            |
| Retained earnings subsequent to spin-off  | 34,409            | 20,167               |
| Common stock held in treasury, 3,095 shares   | (1,548)           | (1,565)              |
| Accumulated other comprehensive loss  | (2,115)           | (3,080)              |
| <b>Total stockholders equity (deficit)</b>  | <b>(153,188)</b>  | <b>(169,109)</b>     |

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|  |            |            |
|--|------------|------------|
| Total liabilities and stockholders' equity (deficit) | \$ 111,606 | \$ 126,841 |
|--|------------|------------|

See notes to consolidated financial statements.

**ARBITRON INC.**  
Consolidated Statements of Income  
(In thousands, except per share data)  
(unaudited)

|   | Three Months Ended<br>March 31, |           |
|---|---------------------------------|-----------|
|   | 2002                            | 2001      |
| Revenue   | \$ 65,902                       | \$ 60,190 |
| Costs and expenses  |                                 |           |
| Cost of revenue   | 18,863                          | 15,873    |
| Selling, general and administrative   | 12,677                          | 11,214    |
| Research and development  | 5,512                           | 4,696     |
| Total costs and expenses  | 37,052                          | 31,783    |
| Operating income  | 28,850                          | 28,407    |
| Proportionate share of net loss of affiliate  | (1,245)                         | (1,123)   |
| Income before interest and income tax expense   | 27,605                          | 27,284    |
| Interest income   | 138                             | 19        |
| Interest expense  | 4,586                           | 386       |
| Income before income tax expense  | 23,157                          | 26,917    |
| Income tax expense  | 8,915                           | 10,622    |
| Net income  | \$ 14,242                       | \$ 16,295 |
| Net income and pro forma net income per<br>weighted average common share              |                                 |           |
| Basic   | \$ 0.49                         | \$ 0.56   |
| Diluted   | \$ 0.48                         | \$ 0.56   |
| Weighted average and pro forma weighted average<br>common shares used in calculations |                                 |           |
| Basic   | 29,215                          | 29,158    |
| Potentially dilutive securities   | 634                             | 153       |
| Diluted   | 29,849                          | 29,311    |

See notes to consolidated financial statements.

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**ARBITRON INC.**  
 Consolidated Statements of Cash Flows  
 (Dollars in thousands)  
 (unaudited)

|   | Three Months Ended<br>March 31, |                  |
|---|---------------------------------|------------------|
|   | 2002                            | 2001             |
| <b>Cash flows from operating activities</b>                                       |                                 |                  |
| Net income  | \$ 14,242                       | \$ 16,295        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |                  |
| Depreciation and amortization of property and equipment                           | 693                             | 476              |
| Other amortization  | 290                             | 599              |
| Deferred income taxes   | 7,871                           | 10,622           |
| Proportionate share of net loss of affiliate                                      | 1,245                           | 1,123            |
| Distributions from affiliate  | 1,200                           | 1,101            |
| Bad debt expense  | 96                              | 38               |
| Tax benefit from stock option exercises   | 225                             |                  |
| Changes in operating assets and liabilities                                       |                                 |                  |
| Trade accounts receivable   | 3,785                           | 1,669            |
| Prepaid expenses and other assets   | 193                             | (688)            |
| Accounts payable  | (1,764)                         | (4,804)          |
| Accrued expenses and other current liabilities                                    | (5,084)                         | (2,770)          |
| Deferred revenue  | (12,753)                        | (11,796)         |
| Other noncurrent liabilities  | 90                              | (73)             |
|   | <u>10,329</u>                   | <u>11,792</u>    |
| <b>Cash flows from investing activities</b>                                       |                                 |                  |
| Additions to property and equipment   | (2,302)                         | (1,461)          |
| Payment for business acquisition  | (4,000)                         |                  |
| Proceeds from disposals of property and equipment                                 |                                 | 40               |
|   | <u>(6,302)</u>                  | <u>(1,421)</u>   |
| <b>Cash flows from financing activities</b>                                       |                                 |                  |
| Proceeds from stock option exercises and stock purchase plan                      | 489                             |                  |
| Proceeds from issuance of long-term debt  |                                 | 250,000          |
| Repayment of long-term debt   | (10,000)                        |                  |
| Payment of deferred financing costs   |                                 | (2,983)          |
| Net cash distributions to Ceridian  |                                 | (235,958)        |
|   | <u>(9,511)</u>                  | <u>11,059</u>    |
| Effect of exchange rate changes on cash   | (35)                            | 30               |
| Net increase (decrease) in cash and cash equivalents                              | (5,519)                         | 21,460           |
| Cash and cash equivalents at beginning of period                                  | 21,043                          | 3,540            |
| Cash and cash equivalents at end of period  | <u>\$ 15,524</u>                | <u>\$ 25,000</u> |

See notes to consolidated financial statements.





**ARBITRON INC.**

Notes to Consolidated Financial Statements

March 31, 2002

(Dollars in thousands, except per share data)  
(unaudited)

**1. Basis of Presentation and Consolidation**

***Presentation***

Arbitron Inc. was formerly known as Ceridian Corporation. Prior to March 31, 2001, Ceridian was a publicly traded company, the principal lines of business of which were the human resource service businesses, the Comdata business, which provided transaction processing and regulatory compliance services for the transportation industry, and the radio audience measurement business.

On March 30, 2001, Ceridian effected a reverse spin-off, which we refer to as the spin-off. In connection with the spin-off, the assets and liabilities associated with the human resource service businesses and Comdata subsidiaries were transferred to New Ceridian. The radio audience measurement business stayed with Ceridian. Ceridian then distributed the stock of New Ceridian to its existing stockholders. As a result, New Ceridian is now a separate publicly traded corporation. In connection with the spin-off, Ceridian changed its name to Arbitron Inc. and effected a one-for-five reverse stock split, and New Ceridian changed its name to Ceridian Corporation. Because of the relative significance of the businesses transferred to New Ceridian, New Ceridian was considered the accounting successor to Ceridian for financial reporting purposes.

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( the U.S. ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. In the opinion of management, all adjustments considered for fair presentation have been included. The consolidated balance sheet at December 31, 2001 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Arbitron Inc. annual report on Form 10-K for the year ended December 31, 2001.

***Consolidation***

The consolidated financial statements of Arbitron reflect the consolidated financial position, results of operations and cash flows of Arbitron Inc. and its subsidiaries: Arbitron Holdings Inc., Ceridian Infotech (India) Private Limited, CSW Research Limited and Euro Fieldwork Limited. In periods ended prior to March 31, 2001, the Company's financial statements reflected the combined financial position and results of operations of Arbitron (The Arbitron Company which was a division of Ceridian and CSW Research Limited, Euro Fieldwork Limited and Ceridian Infotech (India) Private Limited, each of which was a wholly owned subsidiary of Ceridian).

**2. Goodwill and Other Intangible Assets**

Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, was adopted on January 1, 2002, with the exception of a provision for acquisitions occurring after June 30, 2001, which was adopted on July 1, 2001. Under SFAS No. 142, the Company is no longer amortizing goodwill, rather goodwill is measured for impairment on an annual basis under the guidance set forth in the standard. Additionally, SFAS No. 142 requires disclosure of pro forma net income and earnings per share for prior periods as if the standard was in effect for all periods presented.

**ARBITRON INC.**  
Notes to Consolidated Financial Statements    Continued  
March 31, 2002  
(Dollars in thousands, except per share data)  
(unaudited)

Intangible assets with finite lives are being amortized to expense over their estimated useful lives. As of March 31, 2002, the Company has no other intangible assets with indefinite useful lives.

The following unaudited information presents the results of operations of the Company as if SFAS No. 142 had been adopted on January 1, 2001.

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>March 31,</b>          |             |
|   | <b>2002</b>               | <b>2001</b> |
| Net income, as reported   | \$ 14,242                 | \$ 16,295   |
| Goodwill amortization, net of tax                                     |                           | 426         |
| Net income, as adjusted   | \$ 14,242                 | \$ 16,721   |
| Net income and pro forma net income per weighted average common share |                           |             |
| Basic   | \$ 0.49                   | \$ 0.57     |
| Diluted   | \$ 0.48                   | \$ 0.57     |

**3. Purchase Acquisition**

On July 2, 2001, the Company acquired all of the assets and assumed certain liabilities of the radio network audience measurement service business of Statistical Research, Inc. ( SRI ), known as Radio s All Dimension Audience Research ( RADAR ). The RADAR service measures national radio audiences and the audience size of network radio programs and commercials. The primary reason for the acquisition was to gain entry into the network radio measurement business. Arbitron plans to provide larger sample sizes to customers by combining Arbitron s existing diary sampling process with the RADAR network commercial clearance system.

The aggregate consideration payable by the Company is approximately \$25,000. The Company paid \$10,275 in 2001 and during the three months ended March 31, 2002 paid contingent consideration of \$4,000 earned pursuant to the acquisition agreement. The last installment of \$11,000 is due on July 2, 2002. In connection with the acquisition, the Company also entered into several operational agreements with SRI, including a software development agreement pursuant to which SRI adapted RADAR to the Company s diary based ratings measurement method.

The following unaudited pro forma information presents the results of operations of the Company as if the RADAR acquisition had occurred as of January 1, 2001.

|  | <b>Three Months Ended</b> |             |
|--|---------------------------|-------------|
|  | <b>March 31,</b>          |             |
|  | <b>2002</b>               | <b>2001</b> |
| Pro forma revenue  | \$ 65,902                 | \$ 62,631   |
| Pro forma net income   | \$ 14,242                 | \$ 16,560   |
| Pro forma diluted net income per weighted average common share | \$ 0.48                   | \$ 0.56     |

**ARBITRON INC.**

Notes to Consolidated Financial Statements Continued

March 31, 2002

(Dollars in thousands, except per share data)

(unaudited)

**4. Long-term Debt**

Long-term debt consists of the following:

|                                     | March 31,<br>2002 | December 31,<br>2001 |
|-------------------------------------|-------------------|----------------------|
| Senior fixed rate notes             | \$ 50,000         | \$ 50,000            |
| Long-term revolving credit facility | 145,000           | 155,000              |
|                                     | <u>\$ 195,000</u> | <u>\$ 205,000</u>    |

On January 31, 2001, the Company entered into a \$225,000 five-year revolving credit agreement with a consortium of banks ( Credit Facility ). On March 29, 2001, in connection with the spin-off, \$200,000 was drawn on the Credit Facility and distributed to Ceridian.

The Credit Facility has two borrowing options, a Eurodollar rate option or a base rate option, as defined in the agreement. Under the Eurodollar option, the Company may elect interest periods of one, two, three or six months at the inception date and each renewal date. Borrowings under the Eurodollar option bear interest at the London Interbank Offered Rate (LIBOR) plus a margin of 2.00% to 2.75%. Borrowings under the base rate option bear interest at the higher of the lead lender's prime rate or the Federal Funds rate plus 50 basis points, plus a margin of .50% to 1.25%. The specific margins, under both options, are determined based on the Company's ratio of indebtedness to earnings before interest, taxes, depreciation and amortization (leverage ratio), and are adjusted every ninety days. The agreement contains a commitment fee provision whereby the Company is charged a fee, ranging from .375% to .550%, based on the unused portion of the facility. Under the terms of the Credit Facility, the Company is required to maintain certain other financial ratios, in addition to the leverage ratio, and meet other financial conditions. The agreement limits, among other things, the Company's ability to sell assets, incur additional indebtedness, grant or incur liens on its assets, repay indebtedness other than the Credit Facility, make investments or acquisitions, repurchase or redeem capital stock and engage in certain mergers or consolidations. The agreement prohibits the payment of cash dividends through the year ending December 31, 2002. The interest rate on the credit facility borrowings outstanding as of March 31, 2002 was 7.40%.

Arbitron's commitment under its revolving credit facility, which was \$225.0 million at inception, was reduced to \$185.2 million on April 1, 2002 in accordance with the mandatory commitment reduction and excess cash flow provisions. Available borrowings under the credit facility were \$40.2 million as of April 1, 2002.

Upon consummation of the spin-off, the Company issued \$50,000 of senior secured notes due January 31, 2008, and distributed the proceeds to Ceridian. The notes bear interest at a fixed rate of 9.96%. The senior secured notes agreement contains covenants similar to the Credit Facility. The agreement also contains a make-whole provision that applies in the event of early prepayment of principal.

**5. Interest Rate Swap**

The Company entered into an interest rate swap agreement effective on March 29, 2001 to hedge its exposure to fluctuations in interest rates relating to its outstanding variable rate debt. The contract's notional amount was \$200,000 at inception and declines each quarter over the life of the contract in proportion to the Company's estimated outstanding balance on its revolving credit agreement. Under the terms of the contract, the Company pays a fixed rate of 5.02% and receives LIBOR, which resets every 90 days. The contract matures on March 31, 2005. The interest rate swap agreement was designated as a cash flow hedge, and was designed to be entirely effective by matching the terms of the swap agreement with the debt. The base rate for both the variable

**ARBITRON INC.**

Notes to Consolidated Financial Statements-Continued

March 31, 2002

(Dollars in thousands, except per share data)

(unaudited)

rate debt and the swap is LIBOR and the instruments have the same renewal dates over the lives of the instruments. The fair value of the cash flow hedge was recorded as a non-current liability and the offsetting unrealized loss was recorded in accumulated other comprehensive loss as of December 31, 2001 and March 31, 2002.

The Company's risk-management objective for entering into the interest rate swap was to mitigate its exposure to interest rate risk. The Company's initial strategy was to lock into a fixed rate of interest with a pay-fixed, receive-variable interest rate swap, thereby hedging exposure to the variability in future cash flows.

**6. Net Income and Pro Forma Net Income per Weighted Average Common Share**

The computations of basic and diluted net income per common share for the three month period ended March 31, 2002 are based on Arbitron's weighted average shares of common stock and potentially dilutive securities outstanding, respectively. For the three month period ended March 31, 2001, the pro forma net income per weighted average common share computations are based entirely upon Ceridian's weighted average number of shares of Ceridian common stock and potentially dilutive securities outstanding.

Potentially dilutive securities are calculated in accordance with the treasury stock method, which assumes that the proceeds from the exercise of all stock options are used to repurchase the Company's common stock at the average market price for the period.

In November 2000, Ceridian's board of directors approved a one-for-five reverse stock split for Arbitron common stock, which was effective immediately after the spin-off. Pro forma net income per common share and weighted average common shares outstanding included in the accompanying consolidated financial statements and related notes have been adjusted to reflect this reverse stock split.

**7. Comprehensive Income**

The Company's comprehensive income is comprised of net income, foreign currency translation adjustments and changes in unrealized gains and losses on interest rate swap agreements.

The components of comprehensive income are as follows:

|  | <b>Three Months Ended</b> |                   |
|--|---------------------------|-------------------|
|  | <b>March 31,</b>          |                   |
|  | <b>2002</b>               | <b>2001</b>       |
|  | <u>          </u>         | <u>          </u> |
| Net income   | \$ 14,242                 | \$ 16,295         |
| Items of other comprehensive income                      |                           |                   |
| Change in foreign currency translation adjustment        | (40)                      | 50                |
| Unrealized gain (loss) on interest rate swap, net of tax | 1,005                     | (288)             |
|  | <u>          </u>         | <u>          </u> |
| Comprehensive income                                     | <u>\$ 15,207</u>          | <u>\$ 16,057</u>  |
|  | <u>          </u>         | <u>          </u> |

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion should be read in conjunction with Arbitron's consolidated financial statements and the notes related to those consolidated financial statements contained elsewhere in this Form 10-Q.

**Forward-Looking Statements**

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The statements regarding Arbitron in this document that are not historical in nature, particularly those that utilize terminology such as may, will, should, likely, expects, anticipates, estimates, believes or plans, or comparable terminology, are forward-looking statements. These forward-looking statements involve known and unknown risks and uncertainties that may cause our results to be materially different from results implied in such forward-looking statements. These risks and uncertainties include whether we will be able to:

renew contracts with large customers as they expire;

successfully execute our business strategies, including timely implementation of our Portable People Meter service, as well as expansion of international operations;

effectively manage the impact of further consolidation in the radio industry;

keep up with rapidly changing technological needs of our customer base, including creating new products and services that meet these needs; and

realize the benefits we expect to achieve resulting from Ceridian's completion of the reverse spin-off.

Additional important factors known to Arbitron that could cause forward-looking statements to turn out to be incorrect are identified and discussed from time to time in Arbitron's filings with the Securities and Exchange Commission, including in particular the risk factors discussed under the caption ITEM 1. BUSINESS - Business Risks in Arbitron's Annual Report on Form 10-K for the year ended December 31, 2001.

The forward-looking statements contained in this document speak only as of the date hereof, and Arbitron undertakes no obligation to correct or update any forward-looking statements, whether as a result of new information, future events or otherwise.

**Overview**

Arbitron Inc. was formerly known as Ceridian. Prior to March 31, 2001, Ceridian was a publicly traded company, the principal lines of business of which were the human resource service businesses, the Comdata business, which provided transaction processing and regulatory compliance services for the transportation industry, and the radio audience measurement business.

On March 30, 2001, Ceridian effected a reverse spin-off, which we refer to as the spin-off. In connection with the spin-off, the assets and liabilities associated with the human resource service businesses and Comdata subsidiaries were transferred to New Ceridian. The radio audience measurement business stayed with Ceridian. Ceridian then distributed the stock of New Ceridian to its existing stockholders. As a result, New Ceridian is now a separate publicly traded corporation. In connection with the spin-off, Ceridian changed its name to Arbitron Inc. and effected a one-for-five reverse stock split, and New Ceridian changed its name to Ceridian Corporation. Because of the relative significance of the businesses transferred to New Ceridian, New Ceridian was considered the accounting successor to Ceridian for financial reporting purposes.

The terms Arbitron or the Company as used in this document shall include Arbitron Inc. and its subsidiaries.

The consolidated financial statements of Arbitron reflect the consolidated financial position, results of operations and cash flows of Arbitron Inc. and its subsidiaries: Arbitron Holdings Inc., Ceridian Infotech (India) Private Limited, CSW Research Limited and Euro Fieldwork Limited. In periods ended prior to March 31, 2001, the Company's financial statements reflected the combined financial position and results of operations of Arbitron (The Arbitron Company which was a division of Ceridian and CSW Research Limited, Euro Fieldwork Limited and Ceridian Infotech (India) Private Limited, each of which was a wholly owned subsidiary of Ceridian).

Arbitron's radio audience measurement business has generally accounted for a majority of its revenue. In recent years, significant consolidation of radio station ownership has tended to intensify competition within the radio industry and between radio and other forms of media for advertising dollars. At the same time, audiences have become more fragmented as a result of the greatly increased programming choices and entertainment and media options. Consequently, the increased competition together with the desire for more complex information have driven demand by radio broadcasters, advertising agencies and advertisers for Arbitron's audience measurement information. In addition, although radio industry consolidation has led to the increased concentration of Arbitron's customer base, it has also contributed to an increase in the number of stations subscribing for the ratings service as well as increases in sales of Arbitron's analytical software applications and other services.

Contracts with Infinity Broadcasting, which collectively accounted for nine percent of Arbitron's revenue in 2001, expired at the end of 2001 and renewal negotiations with Infinity Broadcasting commenced during the fourth quarter of 2001. In April 2002, Arbitron signed a contract extension with Infinity Broadcasting, which gives their stations access to our Winter 2002 quarterly radio ratings until the release of the Spring 2002 radio survey as well as access to additional services currently provided. Negotiations for a long-term renewal of the Infinity Broadcasting contract continue. Arbitron cannot give any assurances that it will renew Infinity Broadcasting or attract new customers that could replace the revenue that could be lost if a key customer failed to renew its agreement with Arbitron. The loss of a key customer would materially harm Arbitron's business and operating results.

#### **Critical Accounting Policies**

Critical accounting policies are those that are both important to the presentation of our financial condition and results of operations and require management's most difficult, complex or subjective judgments. The Company's most critical accounting policies relate to revenue recognition, the capitalization of software development costs and impairments of assets.

Arbitron recognizes revenue for products and services over the term of the license agreement as products and services are delivered. Direct costs associated with data collection and diary processing are expensed as incurred.

The Company capitalizes software development costs with respect to major product initiatives or enhancements, which are incurred during the period from the time of technological feasibility until the time that the software is ready for use. To the extent that software is being developed for use by customers or to support data collection activities, the Company also considers the recovery of such costs through future revenue streams in its decision to capitalize software development costs. Once the software is placed in service, the capitalized costs are generally amortized over periods of three to five years. If events or changes in circumstances indicate that the carrying value of software may not be recovered, a recoverability analysis is performed based on estimated undiscounted cash flows to be generated from the software in the future. If the analysis indicates that the carrying value is not recoverable from future cash flows, the software cost is written down to estimated fair value and an impairment loss is recognized. The Company's estimates are subject to revision as market conditions and the Company's assessments of them change.

In 2002, and annually thereafter, the Company will assess the fair value of goodwill. To the extent that information indicates that the carrying value of the assets exceeds their estimated fair values, the Company will recognize an impairment charge. The Company's estimates of fair value will be subject to revision as market conditions and the Company's assessments of them change.

**New Accounting Pronouncements**

Statement of Financial Accounting Standards (SFAS) No. 142 was adopted on January 1, 2002, with the exception of a provision for acquisitions occurring after June 30, 2001 which was adopted on July 1, 2001. Under SFAS No. 142, the Company's goodwill is no longer amortized to expense, rather goodwill will be measured for impairment on an annual basis under the guidance set forth in the standard. Additionally, SFAS No. 142 requires disclosure of pro forma net income and earnings per share for prior periods as if the standard was in effect for all periods presented. For the year ending December 31, 2002, the Company expects a reduction in amortization expense that will increase net income by approximately \$1.7 million. If the Company had adopted the provisions of SFAS No. 142 on January 1, 2001, net income and diluted net income per weighted average share would have been \$16,721 and \$.57, respectively, for the three months ended March 31, 2001.

**Results of Operations****Comparison of the Three Months Ended March 31, 2002 to the Three Months Ended March 31, 2001**

The following table sets forth information with respect to the consolidated statements of income of Arbitron:

**Consolidated Statements of Income**  
(Dollars in thousands, except per share amounts)

|   | Three Months Ended<br>March 31, |          | Increase<br>(Decrease) |         | Percentage of<br>Revenue |        |
|---|---------------------------------|----------|------------------------|---------|--------------------------|--------|
|   | 2002                            | 2001     | Dollar                 | Percent | 2002                     | 2001   |
| Revenue   | \$65,902                        | \$60,190 | \$ 5,712               | 9.5%    | 100.0%                   | 100.0% |
| Costs and expenses  |                                 |          |                        |         |                          |        |
| Cost of revenue   | 18,863                          | 15,873   | 2,990                  | 18.8%   | 28.6%                    | 26.4%  |
| Selling, general and administrative                                   | 12,677                          | 11,214   | 1,463                  | 13.0%   | 19.2%                    | 18.6%  |
| Research and development  | 5,512                           | 4,696    | 816                    | 17.4%   | 8.4%                     | 7.8%   |
| Total costs and expenses  | 37,052                          | 31,783   | 5,269                  | 16.6%   | 56.2%                    | 52.8%  |
| Operating income  | 28,850                          | 28,407   | 443                    | 1.6%    | 43.8%                    | 47.2%  |
| Proportionate share of net loss of affiliate                          | (1,245)                         | (1,123)  | (122)                  | 10.9%   | (1.9%)                   | (1.9%) |
| Income before interest and income tax expense                         | 27,605                          | 27,284   | 321                    | 1.2%    | 41.9%                    | 45.3%  |
| Interest income   | 138                             | 19       | 119                    | 100%    | 0.2%                     | 0.0%   |
| Interest expense  | 4,586                           | 386      | 4,200                  | 100%    | 7.0%                     | 0.6%   |
| Income before income tax expense                                      | 23,157                          | 26,917   | (3,760)                | (14.0%) | 35.1%                    | 44.7%  |
| Income tax expense  | 8,915                           | 10,622   | (1,707)                | (16.1%) | 13.5%                    | 17.6%  |
| Net income  | \$14,242                        | \$16,295 | \$(2,053)              | (12.6%) | 21.6%                    | 27.1%  |
| Net income and pro forma net income per weighted average common share |                                 |          |                        |         |                          |        |
| Basic   | \$ 0.49                         | \$ 0.56  | \$ (0.07)              | (12.5%) |                          |        |
| Diluted   | \$ 0.48                         | \$ 0.56  | \$ (0.08)              | (14.3%) |                          |        |
| Other data  |                                 |          |                        |         |                          |        |
| EBITDA  | \$28,588                        | \$28,359 | \$ 229                 | 0.8%    | 43.4%                    | 47.1%  |

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**Revenue.** Revenue increased 9.5% from \$60.2 million for the three months ended March 31, 2001 to \$65.9 million for the same period in 2002. RADAR accounted for \$2.2 million, or 3.7% of the increase. Increases in the ratings subscriber base, analytical software applications and escalations in multi-year customer contracts and contract renewals accounted for the remainder of the difference.



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**Cost of Revenue.** Cost of revenue increased 18.8% from \$15.9 million for the three months ended March 31, 2001 to \$18.9 million for the same period in 2002, and increased as a percentage of revenue from 26.4% in 2001 to 28.6% in 2002. RADAR accounted for \$0.9 million of the increase. Increases in computer center costs, royalties and data collection costs accounted for \$2.1 million of the increase.

**Selling, General and Administrative.** Selling, general and administrative expenses increased 13.0% from \$11.2 million for the three months ended March 31, 2001 to \$12.7 million for the same period in 2002 and increased as a percentage of revenue from 18.6% in 2001 to 19.2% in 2002. RADAR accounted for \$0.3 million of the dollar increase. Certain variable costs, including marketing communications costs and selling and administrative expenses, increased by \$1.6 million from 2001 to 2002. These increases were partially offset by the elimination of goodwill amortization, in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, which was \$0.4 million in 2001.

**Research and Development.** Research and development increased 17.4% from \$4.7 million during the three months ended March 31, 2001 to \$5.5 million for the same period in 2002 and increased as a percentage of revenue from 7.8% in 2001 to 8.4% in 2002. RADAR accounted for \$0.5 million of the dollar increase. The remaining \$0.3 million dollar increase is attributable to a \$1.4 million increase in product development and enhancement costs in the core services, which was offset by a \$1.1 million decrease in spending on new product development related to the Portable People Meter (PPM) and the Webcast RatingsSM service.

**Operating Income.** Operating income increased 1.6% from \$28.4 million for the three months ended March 31, 2001 to \$28.9 million for the same period in 2002. Operating margin decreased from 47.2% in 2001 to 43.8% in 2002. The decline in the operating margin is attributed primarily to increases in cost of revenue and research and development costs as a percentage of revenue.

**Proportionate Share of Net Loss of Affiliate.** Proportionate share of net loss of affiliate increased 10.9% from \$1.1 million for the three months ended March 31, 2001 to \$1.2 million for the same period in 2002.

**Interest Expense.** Interest expense increased from \$0.4 million for the three months ended March 31, 2001 to \$4.6 million for the same period in 2002. For the three months ended March 31, 2002, the Company's long-term debt incurred in connection with the spin-off was outstanding for the entire period, whereas in 2001, the debt was outstanding for only part of the period. Also, for the three months ended March 31, 2002, the Company incurred \$0.2 million of interest expense on the deferred acquisition payment to the former owners of RADAR. The Company did not have deferred acquisition payments during three months ended March 31, 2001.

**Income Tax Expense.** Arbitron's effective tax rate was 39.5% and 38.5% for the three months ended March 31, 2001 and 2002, respectively. The 1.0% decrease in the Company's effective income tax rate resulted from the discontinuance of goodwill amortization in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, and a change in certain state tax apportionment factors following the spin-off from Ceridian.

**Net Income.** Net income decreased 12.6% from \$16.3 million for the three months ended March 31, 2001 to \$14.2 million for the same period in 2002. The decrease was primarily attributed to interest expense incurred on long-term debt outstanding since the spin-off.

**EBITDA.** EBITDA increased from \$28.4 million for the three months ended March 31, 2001 to \$28.6 million for the same period in 2002.

## Liquidity and Capital Resources

Prior to the spin-off, Arbitron participated in Ceridian's centralized cash management system to finance its operations. Cash deposits from the majority of Arbitron's operations were transferred to Ceridian on a daily basis and Ceridian funded Arbitron's cash disbursements from the centralized cash management system. Accordingly, Arbitron's net change in cash in periods prior to and containing the spin-off is not indicative of its liquidity or cash flow as a stand-alone company.

As of March 31, 2002, the Company had \$15.5 million in available cash and cash equivalents. In addition, the Company had \$40.2 million in available borrowings under its bank credit facility. Although Arbitron has a limited history as a stand-alone company, management expects that cash flow generated from operations, as well as available borrowings from its bank credit facility, if necessary, will be sufficient to support the Company's operations, including research and development costs, for the foreseeable future.

Net cash provided by operating activities was \$10.3 million and \$11.8 million for the three month periods ended March 31, 2002 and 2001, respectively, a decrease of \$1.5 million. The decrease is mainly attributed to lower net income for the three months ended March 31, 2002. The \$2.1 million decrease in net income is primarily attributed to interest expense on debt incurred in connection with the spin-off.

Net cash used in investing activities was \$6.3 million and \$1.4 million for the three month periods ended March 31, 2002 and 2001, respectively, an increase of \$4.9 million. The increase is primarily attributed to a \$4.0 million contingent consideration payment to the former owners of RADAR during the three months ended March 31, 2002. There were no business acquisition payments during the same period in 2001. The remaining \$0.9 million increase resulted from an increase in property and equipment additions. The increase in property and equipment additions is largely related to hardware and internally developed software related to PPM.

Net cash provided by (used in) financing activities was (\$9.5) million and \$11.1 million for the three month periods ended March 31, 2002 and 2001, respectively, a decrease of \$20.6 million. The decrease is partly attributed to a discretionary debt repayment of \$10.0 million during the three months ended March 31, 2002. The Company had no debt, and therefore no debt repayments during the three months ended March 31, 2001. During the three months ended March 31, 2001, the Company had proceeds of \$250.0 million from the debt issuance and distributed cash of \$236.0 million to Ceridian and paid financing costs of \$3.0 million, resulting in \$11.0 million of cash provided by investing activities after payment of debt issue costs.

Arbitron's commitment under its revolving credit facility, which was \$225.0 million at inception, was reduced to \$185.2 million on April 1, 2002 in accordance with the mandatory commitment reduction and excess cash flow provisions. Available borrowings under the credit facility were \$40.2 million as of April 1, 2002.

Arbitron's credit facility and senior secured notes ( borrowings ) contain non-investment grade financial terms, covenants and operating restrictions that increase the cost of financing and restrict financial flexibility. Under the terms of the borrowings, Arbitron is required to maintain certain leverage and coverage ratios and meet other financial conditions. The agreements limit, among other things, Arbitron's ability to sell assets, incur additional indebtedness, grant or incur liens on its assets, repay senior indebtedness, pay cash dividends, make certain investments or acquisitions, repurchase or redeem capital stock and engage in certain mergers or consolidations. Although Arbitron does not believe that the terms of its borrowings limit the operation of its business in any material respect, the terms may restrict or prohibit Arbitron's ability to raise additional capital when needed or could prevent Arbitron from making acquisitions or investing in other growth initiatives. Arbitron holds a derivative instrument as a hedge of its variable interest rate debt as indicated below under Item 3, Quantitative and Qualitative Disclosures About Market Risk.

In 2001, Clear Channel Communications, Inc. and Infinity Broadcasting Corp. represented approximately 23.0% and 11.0%, respectively, of Arbitron's revenue. Arbitron's agreements with these customers are not exclusive and contain no renewal obligations. Contracts with Infinity Broadcasting, which collectively accounted for nine

percent of Arbitron's revenue in 2001, expired at the end of 2001 and renewal negotiations with Infinity Broadcasting commenced during the fourth quarter of 2001. In April 2002, Arbitron signed a contract extension with Infinity Broadcasting, which gives their stations access to our Winter 2002 quarterly radio ratings until the release of the Spring 2002 radio survey as well as access to additional services currently provided. Negotiations for a long-term contract continue. Arbitron cannot give any assurances that it will renew Infinity Broadcasting or attract new customers that could replace the revenue that would be lost if a key customer failed to renew its agreement with Arbitron. The loss of a key customer would adversely affect Arbitron's results of operations and liquidity.

The continuing development and anticipated rollout of the Portable People Meter service will require significant capital resources and would increase our operating costs over the next several years. The introduction of the Portable People Meter could be delayed if Arbitron cannot form a joint venture. In that event, Arbitron would need to revise its plans and assumptions relating to the timing of the Portable People Meter rollout.

### **Seasonality**

Arbitron recognizes revenue for products and services over the terms of license agreements as products and services are delivered, and expenses are recognized as incurred. Arbitron gathers radio-listening data in approximately 283 United States local markets. All markets are measured at least twice per year (April, May, June, Spring Survey, and October, November, December, Fall Survey). In addition, major markets are measured two additional times per year (January, February, March, Winter Survey, and July, August, September Summer Survey). Arbitron's revenue is generally higher in the first and third quarters as the result of the delivery of the Fall Survey and Spring Survey, respectively, to all markets compared to revenue in the second and fourth quarters when delivery of the Winter Survey and Summer Survey, respectively, is only delivered to major markets. Arbitron's expenses are generally higher in the second and fourth quarters as the Spring Survey and Fall Survey are being conducted.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE OF MARKET RISK**

#### ***Interest Risk***

The Company currently has no exposure to market risk with respect to changes in interest rates because the variable portion of the Company's long-term obligations is fully hedged with a derivative instrument. The Company does not use derivatives for speculative or trading purposes.

The Company has two long-term obligations: senior notes that bear interest at a fixed rate of 9.96%, and a revolving credit facility which bears interest at LIBOR plus a margin of 2.00% to 2.75%. The variable portion of the interest rate, LIBOR, is hedged with an interest rate swap which has a fixed rate of 5.02%.

Due to the variable rate debt being fully hedged, a hypothetical market interest rate change of 1% would have no effect on the Company's results of operations. However, changes in market interest rates would impact the fair values of the Company's long-term obligations.

#### ***Foreign Currency Risk***

Arbitron's foreign operations are not significant at this time, and, therefore, Arbitron's exposure to foreign currency risk is minimal.

**PART II OTHER INFORMATION**

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

(a) Exhibits

None

(b) Reports on Form 8-K

Arbitron filed a Current Report on Form 8-K on January 25, 2002 reporting 2001 fourth quarter and year end financial results.

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SIGNATURE

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

ARBITRON INC.

By: /s/ WILLIAM J. WALSH

William J. Walsh

Executive Vice President of Finance and  
Planning and Chief Financial Officer

Date: May 8, 2002

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