

ARBITRON INC
Form 10-Q
November 04, 2004

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2004

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 57th Street
New York, New York 10019
(Address of principal executive offices) (Zip Code)

(212) 887-1300
(Registrant's telephone number, including area code)

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

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

The registrant had 30,987,048 shares of common stock, par value \$0.50 per share, outstanding as of October 29, 2004.

ARBITRON INC.

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PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

ARBITRON INC .
Consolidated Balance Sheets
(In thousands, except par value data)

| | September 30, 2004 | December 31, 2003 |
|--|-------------------------------|------------------------------|
| | (unaudited) | (audited) |
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 68,729 | \$ 68,433 |
| Trade accounts receivable, net of allowance for doubtful accounts of \$1,307 in 2004 and \$1,081 in 2003 | 29,676 | 21,355 |
| Deferred income taxes | 4,417 | 24,183 |
| Prepaid expenses and other current assets | 6,789 | 2,886 |
| | <hr/> | <hr/> |
| Total current assets | 109,611 | 116,857 |
| Investments in affiliate | 6,990 | 10,953 |
| Property and equipment , net | 16,718 | 13,182 |
| Goodwill, net | 38,027 | 32,937 |
| Other intangibles, net | 3,773 | 1,487 |
| Noncurrent deferred tax assets | 2,738 | 6,646 |
| Other noncurrent assets | 1,662 | 2,132 |
| | <hr/> | <hr/> |
| Total assets | \$ 179,519 | \$ 184,194 |
| | <hr/> | <hr/> |
| Liabilities and Stockholders Equity (Deficit) | | |
| Current liabilities | | |
| Accounts payable | \$ 4,602 | \$ 5,326 |
| Accrued expenses and other current liabilities | 24,373 | 28,119 |
| Deferred revenue | 51,725 | 58,398 |
| | <hr/> | <hr/> |
| Total current liabilities | 80,700 | 91,843 |
| Noncurrent liabilities | | |
| Long-term debt | 50,000 | 105,000 |
| Other noncurrent liabilities | 4,472 | 5,424 |
| | <hr/> | <hr/> |
| Total liabilities | 135,172 | 202,267 |
| | <hr/> | <hr/> |

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| | | |
|---|-------------------|-------------------|
| Stockholders' equity (deficit) | | |
| Common stock, \$0.50 par value, authorized 500,000 shares, issued 32,336 shares | 16,168 | 16,168 |
| Additional paid-in capital | 110,614 | 100,024 |
| Accumulated earnings (net distributions to Ceridian in excess of accumulated earnings) prior to spin-off | (242,870) | (242,870) |
| Retained earnings subsequent to spin-off | 163,742 | 112,795 |
| Common stock held in treasury, 1,181 shares in 2004 and 1,626 shares in 2003 | (590) | (813) |
| Accumulated other comprehensive loss, net of tax | (2,717) | (3,377) |
| | <u> </u> | <u> </u> |
| Total stockholders' equity (deficit) | <u>44,347</u> | <u>(18,073)</u> |
| | | |
| Total liabilities and stockholders' equity (deficit) | <u>\$ 179,519</u> | <u>\$ 184,194</u> |

See notes to consolidated financial statements.

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

| | Three Months Ended September 30, | |
|---|---|-------------------|
| | 2004 | 2003 |
| | <u> </u> | <u> </u> |
| Revenue | \$81,965 | \$75,319 |
| Costs and expenses | | |
| Cost of revenue | 23,531 | 23,694 |
| Selling, general and administrative | 14,994 | 14,070 |
| Research and development | 8,604 | 6,294 |
| | <u> </u> | <u> </u> |
| Total costs and expenses | 47,129 | 44,058 |
| | <u> </u> | <u> </u> |
| Operating income | 34,836 | 31,261 |
| Proportionate share of net loss of affiliate | (1,118) | (637) |
| | <u> </u> | <u> </u> |
| Income before interest and income tax expense | 33,718 | 30,624 |
| Interest income | 309 | 174 |
| Interest expense | 1,842 | 2,911 |
| | <u> </u> | <u> </u> |
| Income before income tax expense | 32,185 | 27,887 |
| Income tax expense | 7,957 | 10,876 |
| | <u> </u> | <u> </u> |
| Net income | \$24,228 | \$17,011 |
| | <u> </u> | <u> </u> |
| Net income per weighted average common share | | |
| Basic | \$ 0.78 | \$ 0.56 |
| Diluted | \$ 0.77 | \$ 0.55 |
| Weighted average common shares used in calculations | | |
| Basic | 31,174 | 30,127 |
| Potentially dilutive securities | 388 | 635 |
| | <u> </u> | <u> </u> |
| Diluted | 31,562 | 30,762 |
| | <u> </u> | <u> </u> |

See notes to consolidated financial statements.

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

| | Nine Months Ended September 30, | |
|---|--|-------------------|
| | 2004 | 2003 |
| | <u> </u> | <u> </u> |
| Revenue | \$223,634 | \$208,121 |
| Costs and expenses | | |
| Cost of revenue | 74,789 | 71,933 |
| Selling, general and administrative | 45,285 | 42,160 |
| Research and development | 23,471 | 18,989 |
| | <u> </u> | <u> </u> |
| Total costs and expenses | 143,545 | 133,082 |
| | <u> </u> | <u> </u> |
| Operating income | 80,089 | 75,039 |
| Equity in net income of affiliate | 1,411 | 1,584 |
| | <u> </u> | <u> </u> |
| Income before interest and income tax expense | 81,500 | 76,623 |
| Interest income | 707 | 547 |
| Interest expense | 6,220 | 9,736 |
| | <u> </u> | <u> </u> |
| Income before income tax expense | 75,987 | 67,434 |
| Income tax expense | 25,040 | 26,299 |
| | <u> </u> | <u> </u> |
| Net income | \$ 50,947 | \$ 41,135 |
| | <u> </u> | <u> </u> |
| Net income per weighted average common share | | |
| Basic | \$ 1.64 | \$ 1.38 |
| Diluted | \$ 1.62 | \$ 1.35 |
| Weighted average common shares used in calculations | | |
| Basic | 30,982 | 29,859 |
| Potentially dilutive securities | 539 | 579 |
| | <u> </u> | <u> </u> |
| Diluted | 31,521 | 30,438 |
| | <u> </u> | <u> </u> |

See notes to consolidated financial statements.

ARBITRON INC.
Consolidated Statements of Cash Flows
(In thousands)
(unaudited)

| | Nine Months Ended September 30, | |
|--|--|----------------|
| | 2004 | 2003 |
| Cash flows from operating activities | | |
| Net income | \$ 50,947 | \$ 41,135 |
| Adjustments to reconcile net income to net cash provided by operating activities : | | |
| Depreciation and amortization of property and equipment | 3,216 | 2,856 |
| Other amortization | 996 | 722 |
| Loss on asset disposals | 458 | 102 |
| Asset impairment charges | 328 | 178 |
| Deferred income taxes | 23,109 | 2,011 |
| Equity in net income of affiliate | (1,411) | (1,584) |
| Distributions from affiliate | 5,374 | 5,100 |
| Bad debt expense | 346 | 225 |
| Tax benefit from stock option exercises | 4,297 | 2,791 |
| Other noncash items | 141 | |
| Changes in operating assets and liabilities, excluding effects of business acquisition | | |
| Trade accounts receivable | (7,956) | 6,027 |
| Prepaid expenses and other assets | (1,935) | (2,080) |
| Accounts payable | (739) | (228) |
| Accrued expenses and other current liabilities | (3,782) | 12,730 |
| Deferred revenue | (7,159) | (5,308) |
| Other noncurrent liabilities | 219 | (915) |
| | <u>66,449</u> | <u>63,762</u> |
| Net cash provided by operating activities | | |
| Cash flows from investing activities | | |
| Additions to property and equipment | (7,149) | (3,369) |
| Payment for business acquisition | (8,928) | |
| | <u>(16,077)</u> | <u>(3,369)</u> |
| Net cash used in investing activities | | |
| Cash flows from financing activities | | |
| Proceeds from stock option exercises and stock purchase plan | 14,810 | 12,647 |
| Stock repurchases | (9,927) | |
| Payment of long-term debt | (55,000) | (50,000) |

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| | | |
|--|-------------------|-------------------|
| | <u> </u> | <u> </u> |
| Net cash used in financing activities | (50,117) | (37,353) |
| | <u> </u> | <u> </u> |
| Effect of exchange rate changes on cash and cash equivalents | 41 | 79 |
| | <u> </u> | <u> </u> |
| Net increase in cash and cash equivalents | 296 | 23,119 |
| Cash and cash equivalents at beginning of period | 68,433 | 43,095 |
| | <u> </u> | <u> </u> |
| Cash and cash equivalents at end of period | <u>\$ 68,729</u> | <u>\$ 66,214</u> |

See notes to consolidated financial statements.

ARBITRON INC.

Notes to Consolidated Financial Statements

September 30, 2004

(unaudited)

1. Basis of Presentation and Consolidation

Presentation

The accompanying unaudited consolidated financial statements of Arbitron Inc. (the Company or Arbitron) 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. Certain amounts in the financial statements for prior periods have been reclassified to conform to the current period's presentation. The consolidated balance sheet as of December 31, 2003, was audited 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 Company's Annual Report on Form 10-K for the year ended December 31, 2003.

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., Audience Research Bureau S.A. de C.V., Ceridian Infotech (India) Private Limited, CSW Research Limited and Euro Fieldwork Limited.

2. Pro Forma Disclosures of Stock Based Compensation

The Company applies the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations including Financial Accounting Standards Board (FASB) Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25*, to account for its fixed-plan stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price of the options. Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation* (as amended by SFAS No. 148, *Accounting for Stock-Based Compensation-Transitions and Disclosures*) established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS No. 123.

The following table illustrates the effect on net income if the fair-value-based method had been applied to all outstanding and unvested awards in each period (dollars in thousands, except per share data):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|------------------|--|------------------|
| | 2004 | 2003 | 2004 | 2003 |
| Net income, as reported | \$ 24,228 | \$ 17,011 | \$ 50,947 | \$ 41,135 |
| Less : Stock-based compensation expense determined under fair value method, net of tax | 501 | 843 | 2,110 | 2,391 |
| Pro forma net income | \$ 23,727 | \$ 16,168 | \$ 48,837 | \$ 38,744 |
| Basic net income per weighted average common share, as reported | \$ 0.78 | \$ 0.56 | \$ 1.64 | \$ 1.38 |
| Pro forma basic net income per weighted average common share | \$ 0.76 | \$ 0.54 | \$ 1.58 | \$ 1.30 |
| Diluted net income per weighted average common share, as reported | \$ 0.77 | \$ 0.55 | \$ 1.62 | \$ 1.35 |
| Pro forma diluted net income per weighted average common share | \$ 0.74 | \$ 0.53 | \$ 1.54 | \$ 1.28 |
| Options granted | 366,062 | 10,561 | 472,999 | 576,639 |
| Weighted-average exercise price | \$ 38.24 | \$ 35.30 | \$ 38.00 | \$ 34.71 |
| Weighted-average fair value | \$ 13.85 | \$ 7.93 | \$ 13.04 | \$ 7.54 |
| Weighted-average assumptions : | | | | |
| Expected lives in years | 6.5 | 4.0 | 6.0 | 4.0 |
| Expected volatility | 27.3% | 23.4% | 27.3% | 23.5% |
| Expected dividend rate | | | | |
| Risk-free interest rate | 3.75% | 2.36% | 3.68% | 2.42% |

3. Purchase Acquisition

On March 11, 2004, Arbitron acquired certain assets of Marketing Resources Plus from Interactive Market Systems, Inc., part of the VNU Media Measurement and Information Group, for \$8.9 million in cash. The \$8.9 million purchase price was allocated as follows: \$0.2 million in tangible net assets, \$3.6 million in identifiable intangible assets and \$5.1 million in goodwill.

4. Long-Term Debt

Long-term debt consisted of the following (in thousands):

| | September 30, 2004 | December 31, 2003 |
|-------------------------------------|-----------------------------------|------------------------------|
| Senior fixed rate notes | \$ 50,000 | \$ 50,000 |
| Long-term revolving credit facility | | 55,000 |

\$ 50,000

\$ 105,000

On January 31, 2001, the Company entered into a \$225.0 million five-year revolving credit agreement with a consortium of banks (Credit Facility). In connection with the Company s spin-off of Ceridian Corporation (Ceridian) in March 2001, \$200.0 million 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 0.50% 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 90 days. The agreement contains a commitment fee provision whereby the Company is charged a fee, ranging from 0.375% to 0.550%, that is applied to 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 buy or 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. On September 30, 2004, Arbitron paid the remaining \$25.0 million outstanding under the Credit Facility. The effective interest rate on the Credit Facility borrowings outstanding prior to the payment on September 30, 2004, was 7.02%.

Arbitron's commitment under the Credit Facility, which was \$225.0 million at inception, has been reduced to \$76.2 million as of March 31, 2004, in accordance with the mandatory commitment reduction and excess cash flow provisions. Available borrowings under the Credit Facility were \$76.1 million as of September 30, 2004. There was a letter of credit outstanding in the amount of \$0.1 million on the Credit Facility as of September 30, 2004.

Upon consummation of the spin-off, the Company issued \$50.0 million 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. The fair value of the senior secured notes as of September 30, 2004 and December 31, 2003 was \$54.4 million and \$55.3 million, respectively, and was estimated using a cash flow valuation model and available market data for securities with similar maturity dates.

5. Interest Rate Swap

The Company entered into an interest rate swap agreement effective 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 \$200.0 million at inception and declines each quarter over the life of the contract in proportion to the Company's estimated outstanding balance on the Credit Facility. Under the terms of the contract, the Company paid a fixed rate of 5.02% and received LIBOR, which reset every 90 days. The contract was settled on September 30, 2004 in conjunction with the payment of outstanding debt under the Credit Facility. 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 rate debt and the swap agreement was LIBOR and the instruments had the same renewal dates over the lives of the instruments. The fair value of the cash flow hedge had been recorded as a noncurrent liability, and the offsetting unrealized loss was recorded in accumulated other comprehensive loss. As a result of the swap and debt retirement, the Company realized a loss of \$0.1 million, which was recorded as interest expense in the consolidated statement of income for the three months ended September 30, 2004.

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. Stockholders Equity (Deficit)

Changes in stockholders equity (deficit) for the nine months ended September 30, 2004, were as follows (in thousands):

| | Balance as of December 31, 2003 | Net Income | Common Stock Issued | Common Stock Repur- chased | Tax Benefit from Stock Option Exercises | Other Compre- hensive Income | Balance as of Sept. 30, 2004 |
|--|--|-----------------------|------------------------------------|---|--|---|---|
| Common stock | \$ 16,168 | \$ | \$ | \$ | \$ | \$ | \$ 16,168 |
| Additional paid-in capital | 100,024 | | 16,092 | (9,799) | 4,297 | | 110,614 |
| Accumulated earnings (net distributions to Ceridian in excess of accumulated earnings) prior to spin-off | (242,870) | | | | | | (242,870) |
| Retained earnings subsequent to spin-off | 112,795 | 50,947 | | | | | 163,742 |
| Common stock in treasury | (813) | | 351 | (128) | | | (590) |
| Accumulated other comprehensive income (loss) | (3,377) | | | | | 660 | (2,717) |
| Stockholders equity (deficit) | \$ (18,073) | \$50,947 | \$16,443 | \$(9,927) | \$4,297 | \$ 660 | \$ 44,347 |
| Number of shares outstanding | 30,710 | | 700 | (255) | | | 31,155 |

7. Net Income Per Weighted Average Common Share

The computations of basic and diluted net income per weighted average common share for the three months and nine months ended September 30, 2004, and 2003 are based on Arbitron's weighted average shares of common stock and potentially dilutive securities outstanding, respectively.

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.

8. Comprehensive Income

The Company's comprehensive income comprises of net income, foreign currency translation adjustments, changes in additional minimum pension liability and changes in unrealized losses on the interest rate swap agreement.

The components of comprehensive income were as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|-----------------|--|-----------------|
| | 2004 | 2003 | 2004 | 2003 |
| Net income | \$24,228 | \$17,011 | \$50,947 | \$41,135 |
| Items of other comprehensive income | | | | |
| Foreign currency translation adjustments | (5) | 18 | 53 | 91 |
| Change in unrealized loss on interest rate swap | 292 | 840 | 1,171 | 2,467 |
| Income tax benefit | (134) | (317) | (564) | (934) |
| Comprehensive income | <u>\$24,381</u> | <u>\$17,552</u> | <u>\$51,607</u> | <u>\$42,759</u> |

The components of accumulated other comprehensive loss were as follows (in thousands):

| | September 30, 2004 | December 31, 2003 |
|---|-----------------------------------|----------------------------------|
| Foreign currency translation adjustment | \$ 289 | \$ 236 |
| Unrealized loss on interest rate swap | | (1,171) |
| Additional minimum pension liability | (4,706) | (4,706) |
| Income tax benefit | 1,700 | 2,264 |
| Accumulated other comprehensive loss | <u>\$ (2,717)</u> | <u>\$ (3,377)</u> |

9. Retirement Plans

Arbitron's United States employees participate in a defined benefit pension plan that closed to new participants effective January 1, 1995. Arbitron subsidizes health care benefits for eligible retired employees who participate in the pension plan and were hired before January 1, 1992.

The components of periodic benefit costs for the defined benefit pension plan and postretirement plan were as follows (in thousands):

| Defined Benefit Pension Plan Three Months | Postretirement Plan Three Months |
|--|---|
|--|---|

| | Ended September 30, | | Ended September 30, | |
|------------------------------------|--------------------------------|--------------------------|--------------------------------|--------------------------|
| | 2004 | 2003 | 2004 | 2003 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Service cost | \$ 186 | \$ 140 | \$ 9 | \$ 5 |
| Interest cost | 354 | 326 | 19 | 11 |
| Expected return on plan assets | (368) | (330) | | |
| Amortization of prior service cost | 5 | 5 | | |
| Amortization of net loss | 117 | 107 | 8 | 1 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Net periodic benefit cost | \$ 294 | \$ 248 | \$ 36 | \$ 17 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

In July 2004, Arbitron made a contribution of \$1.1 million to the defined benefit pension plan.

10. Income Taxes

Pursuant to an Internal Revenue Service (IRS) Revenue Procedure issued during the second quarter of 2004, the Company changed its tax method of accounting for advanced customer payments. As a result of the method change, income taxes of approximately \$22.2 million paid in 2003 were applied toward the Company s 2004 tax liability, and the deferred tax assets no longer include a temporary difference for deferred revenue.

Income tax expense was lower in the third quarter of 2004 primarily because reserves for certain tax contingencies were reversed during the third quarter of 2004 due to guidance in a recent IRS notice. Also, the valuation allowance on the deferred tax assets related to state net operating loss carryforwards was reduced due to higher actual and projected taxable income in the applicable states. The net benefit of these changes during the quarter was \$4.2 million. The effective tax rate, exclusive of these discrete events, has been reduced from 39.0% to 38.5% to reflect a reduction in the expected state tax rate.

11. Significant Customers and Concentration of Credit Risk

Arbitron s quantitative radio audience measurement service and related software sales accounted for approximately 86% of its revenue in 2003 and for approximately 89% of its revenue for the nine months ended September 30, 2004, the largest portion of which is provided to radio broadcasters. As a result of the consolidation of United States radio broadcasters in the 1990 s, Arbitron has two customers that individually represent approximately 10% or more of its revenue. For the year 2003, those customers represented approximately 21% and 10% of the Company s revenue. Certain license agreements with Infinity Broadcasting Corp. (Infinity Broadcasting) expired on March 31, 2004. All license agreements with Infinity Broadcasting to provide audience estimates and most ancillary services were renewed on August 17, 2004, and effective April 1, 2004. Certain Arbitron license agreements with Clear Channel Communications, which accounted for approximately 17% of Arbitron s 2003 revenue, expire on December 31, 2004. Arbitron cannot give any assurances that it could replace the revenue that would be lost if a key customer failed to renew all or part of its agreements with Arbitron. The loss of a key customer would materially impact Arbitron s business, financial position and operating results.

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, believes or plans, or comparable terminology, are forward-looking statements based on current expectations about future events, which Arbitron has derived from information currently available to it. 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 all or part of contracts with large customers as they expire;

successfully execute our business strategies, including implementation of our Portable People Meter (PPMSM) services;

effectively manage the impact of consolidation in the radio and advertising agency industries;

keep up with rapidly changing technological needs of our customer base, including creating new proprietary software systems and new customer products and services that meet these needs in a timely manner;

successfully manage the impact on our business of any economic downturn generally and in the advertising market in particular; and

successfully manage the impact on costs of data collection due to privacy concerns and/or government regulations.

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, 2003.

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 is an international media and marketing research firm primarily serving radio, cable television, advertising agencies, advertisers, outdoor and out-of-home media and, through its Scarborough joint venture, broadcast television and print media. Arbitron currently has four main services:

measuring radio audiences in local markets in the United States and Mexico;

measuring national radio audiences and the audience size of network radio programs and commercials;

providing application software used for accessing and analyzing media audience and marketing information data; and

providing consumer, shopping and media usage information services to the radio, cable television, advertising agencies, advertisers, outdoor and out-of-home media, online industries and, through its Scarborough joint venture, broadcast television and print media.

Arbitron's quantitative radio audience measurement business and related software sales accounted for approximately 89% of Arbitron's revenue for the nine months ended September 30, 2004. Consolidation in the radio broadcasting industry has led to Arbitron's dependence on a limited number of key customers. In 2003, Clear Channel Communications, Inc. (Clear Channel Communications) and Infinity Broadcasting Corp. (Infinity Broadcasting) represented approximately 21% and 10%, respectively, of Arbitron's revenue. Arbitron's agreements with these customers are not exclusive and contain no renewal obligations. In August 2004, Arbitron entered into multi-year license agreements with Infinity Broadcasting, effective April 1, 2004, to provide audience estimates, software and other ancillary services to 185 Infinity Broadcasting radio stations in 42 markets. Infinity Broadcasting did not renew its corporate contract for the Scarborough service. Certain Arbitron license agreements with Clear Channel Communications, which accounted for approximately 17% of Arbitron's 2003 revenue, expire on December 31, 2004.

Arbitron cannot give any assurances that it could replace the revenue that would be lost if a key customer failed to renew all or part of its agreements with Arbitron. The loss of a key customer would materially impact Arbitron's business, financial position and operating results.

Due to the slow economic growth of the radio industry as well as the high penetration of current services in the core radio station business, Arbitron expects that its annual organic rate of revenue growth will be slower than historical trends.

Arbitron entered into an agreement on May 31, 2000, with Nielsen Media Research, Inc. (Nielsen Media Research), a provider of U.S. television and cable audience measurement services, under which Arbitron granted Nielsen Media Research an option to join Arbitron in the potential commercial deployment of the Portable People Meter (Portable People Meter or PPM) in the United States. In the event Nielsen Media Research exercises the option, the parties would form a joint venture to commercially deploy and operate the business of utilizing the Portable People Meter for the collection of listening and viewing audience data. In 2003, Arbitron worked with Nielsen Media Research on response rate issues and a variety of engineering tests. In 2004, Arbitron reported on the positive outcomes of three collaborative tests of the PPM that were conducted with Nielsen Media Research. Arbitron continues to work with Nielsen Media Research to resolve outstanding issues and to negotiate business terms for a potential Portable People Meter joint venture.

In the third quarter of 2004, Arbitron began recruiting consumers to participate in another market demonstration to be conducted in Houston, Texas in 2005 and 2006 to confirm the results of previous tests and demonstrate enhancements to the Portable People Meter system that have been made since it was tested in Philadelphia. In addition, Arbitron is participating in a Portable People Meter business impact study that will be led by the Radio Advertising Bureau to research the impact on the radio industry of a move from diaries to the Portable People Meter for radio audience measurement. The study should be completed early in 2005.

Separate from the proposed joint venture with Nielsen Media Research, Arbitron began testing additional marketing research applications of the Portable People Meter technology in 2003. One application that Arbitron began testing was the use of the Portable People Meter as the media collection tool for a national marketing-oriented panel designed to correlate advertising with shopping behavior and sales. The objective is to provide multimedia exposure data combined with sales data from a single source to produce a measure of advertising effectiveness for advertisers, agencies and broadcasters.

On September 29, 2004, Arbitron announced that Arbitron and VNU, Inc. have agreed to jointly explore the development of a new national marketing research service which collects multi-media and purchase information from a common sample of consumers. Procter & Gamble will collaborate to ensure that the service properly addresses the needs of marketers. This would be a new type of service for which market acceptance is not yet known.

On July 21, 2004, BBM Canada (BBM), the Canadian industry cooperative for audience ratings, announced the adoption of the Portable People Meter as the official ratings system for buying and selling commercial airtime on French-language television in Quebec and Montreal. The PPM-based television ratings service was introduced in September 2004.

The continuing development and anticipated rollout of PPM services will require significant capital resources and will increase Arbitron's operating costs over the next several years. In the event Arbitron decides to commercialize either a PPM ratings service or a PPM marketing application service, there could be significant start-up expenses that could adversely affect Arbitron's financial position and operating results.

Arbitron uses listener diaries to gather radio listening data from sample households in the United States local markets for which it currently provides radio ratings. A representative sample of the population in each local market is randomly selected for each survey and is recruited by telephone. It is increasingly difficult and more costly to obtain consent from the phone sample to participate in the surveys and to get a usable diary returned to Arbitron. Arbitron must achieve response rates sufficient to maintain confidence in its ratings, the support of the industry and accreditation by the Media Rating Council. Response rates are a quality measure of survey performance and an important factor impacting costs associated with data collection. Response rates have continued to decline over the past few years. If response rates continue to decline further, Arbitron's radio audience measurement business could be adversely affected. Arbitron commits extensive efforts and resources to address the decline of response rates.

Additional initiatives in 20 low-response-rate markets have had a positive impact on response rates in those markets, which have increased from the Spring 2003 survey to the Spring 2004 survey.

On March 11, 2004, Arbitron acquired certain assets of Marketing Resources Plus (MRP) from Interactive Market Systems, Inc., part of the VNU Media Measurement and Information Group, for \$8.9 million in cash. MRP is a provider of media buying software systems to local and regional advertising agencies for broadcast and print media. MRP develops, markets and supports a suite of software services used by approximately 800 advertisers and advertising agencies across the United States.

On September 9, 2004, the Company announced that its Board of Directors authorized a repurchase program under which the Company could purchase up to \$25.0 million of its outstanding common stock. The Company expects that the shares may be purchased from time to time in either open market or private transactions at then prevailing market prices through December 31, 2004. As of September 30, 2004, the Company had repurchased an aggregate of 255,000 shares under the program for an aggregate purchase price of \$9.9 million.

Critical Accounting Policies and Estimates

Critical accounting policies and estimates are those that are both important to the presentation of the Company's financial condition and results of operations and require management's most difficult, complex or subjective judgments. The Company's most critical accounting policy relates to the capitalization and recovery of software development costs.

The Company capitalizes software development costs with respect to major internal use software initiatives or enhancements. The costs are capitalized from the time that the preliminary project stage is completed and

management considers it probable that the software will be used to perform the function intended until the time the software is placed in service for its intended 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 management's assessments change. As of September 30, 2004, the Company's capitalized software developed for internal use had a carrying amount of \$5.5 million, including \$5.1 million of Portable People Meter software.

The Company accounted for the acquisition of certain assets of MRP using the criteria for the measurement and recognition of goodwill and other acquired intangible assets as outlined by Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations* and SFAS No. 142, *Goodwill and Other Intangible Assets*. Arbitron used an independent appraisal firm to value the assets. The \$8.9 million purchase price was allocated as follows: \$0.2 million in tangible net assets, \$3.6 million in identifiable intangible assets and \$5.1 million in goodwill.

Results of Operations**Comparison of the Three Months Ended September 30, 2004, to the Three Months Ended September 30, 2003**

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 | | Increase (Decrease) | | Percentage of Revenue | |
|---|-----------------------|----------|------------------------|---------|--------------------------|--------|
| | September 30, 2004 | 2003 | Dollar | Percent | 2004 | 2003 |
| Revenue | \$81,965 | \$75,319 | \$ 6,646 | 8.8% | 100.0% | 100.0% |
| Costs and expenses | | | | | | |
| Cost of revenue | 23,531 | 23,694 | (163) | (0.7%) | 28.7% | 31.5% |
| Selling, general and administrative | 14,994 | 14,070 | 924 | 6.6% | 18.3% | 18.7% |
| Research and development | 8,604 | 6,294 | 2,310 | 36.7% | 10.5% | 8.3% |
| Total costs and expenses | 47,129 | 44,058 | 3,071 | 7.0% | 57.5% | 58.5% |
| Operating income | 34,836 | 31,261 | 3,575 | 11.4% | 42.5% | 41.5% |
| Proportionate share of net loss of affiliate | (1,118) | (637) | (481) | (75.5%) | (1.4%) | (0.8)% |
| Income before interest and income tax expense | 33,718 | 30,624 | 3,094 | 10.1% | 41.1% | 40.7% |
| Interest income | 309 | 174 | 135 | 77.6% | 0.4% | 0.2% |
| Interest expense | 1,842 | 2,911 | (1,069) | (36.7%) | 2.2% | 3.9% |
| Income before income tax expense | 32,185 | 27,887 | 4,298 | 15.4% | 39.3% | 37.0% |
| Income tax expense | 7,957 | 10,876 | (2,919) | (26.8%) | 9.7% | 14.4% |
| Net income | \$24,228 | \$17,011 | \$ 7,217 | 42.4% | 29.6% | 22.6% |
| Net income per weighted average common share | | | | | | |
| Basic | \$ 0.78 | \$ 0.56 | \$ 0.22 | 39.3% | | |

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| | | | | |
|--------------------------------|-------------------|-------------------|-------------------|-------|
| Diluted | \$ 0.77 | \$ 0.55 | \$ 0.22 | 40.0% |
| Other data: | | | | |
| EBIT | \$33,718 | \$30,624 | \$ 3,094 | 10.1% |
| EBITDA | \$35,161 | \$31,819 | \$ 3,342 | 10.5% |
| EBIT and EBITDA Reconciliation | | | | |
| Net income | \$24,228 | \$17,011 | \$ 7,217 | |
| Income tax expense | 7,957 | 10,876 | (2,919) | |
| Interest income | 309 | 174 | 135 | |
| Interest expense | 1,842 | 2,911 | (1,069) | |
| | <u> </u> | <u> </u> | <u> </u> | |
| EBIT | 33,718 | 30,624 | 3,094 | |
| Depreciation and amortization | 1,443 | 1,195 | 248 | |
| | <u> </u> | <u> </u> | <u> </u> | |
| EBITDA | <u>\$35,161</u> | <u>\$31,819</u> | <u>\$ 3,342</u> | |

Revenue. Revenue increased 8.8% to \$82.0 million for the three months ended September 30, 2004, from \$75.3 million for the same period in 2003. Approximately \$4.8 million of the increase was due to increases in the ratings and qualitative subscriber base, analytical software applications and escalations in multiyear customer contracts and contract renewals. The MRP acquisition accounted for \$1.8 million of the total increase.

Cost of Revenue. Cost of revenue decreased slightly to \$23.5 million for the three months ended September 30, 2004, from \$23.7 million for the three months ended September 30, 2003 and decreased as a percentage of revenue to 28.7% in 2004 from 31.5% in 2003. The \$0.2 million decrease was primarily due to lower U.S. Media Services costs (Arbitron's core quantitative, qualitative and software application services) of \$0.7 million, which were mainly due to the start-up costs incurred in 2003 for the Houston calling center. The decrease in U.S. Media Services costs was partially offset by the MRP acquisition (\$0.2 million) and increased CSW Research Limited costs (\$0.2 million).

Selling, General and Administrative. Selling, general and administrative expenses increased 6.6% to \$15.0 million during the three months ended September 30, 2004, from \$14.1 million for the same period in 2003, but decreased as a percentage of revenue to 18.3% in 2004 from 18.7% in 2003. The \$0.9 million increase was primarily attributed to the MRP acquisition (\$1.2 million), which was partially offset by lower commissions (\$0.4 million).

Research and Development. Research and development increased 36.7% to \$8.6 million during the three months ended September 30, 2004, from \$6.3 million for the same period in 2003, and increased as a percentage of revenue to 10.5% in 2004 from 8.3% in 2003. The \$2.3 million increase was due to the MRP acquisition (\$0.5 million) and PPM research and development (\$2.5 million), which was partially offset by lower U.S. Media Services research and development expenses (\$0.6 million).

Operating Income. Operating income increased 11.4% to \$34.8 million for the three months ended September 30, 2004, from \$31.3 million for the same period in 2003. Operating margin increased to 42.5% in 2004 from 41.5% in 2003. The increase in operating margin was primarily attributed to revenue growth and reductions in cost of revenue, which was partially offset by increased research and development expenses.

Proportionate Share of Net Loss of Affiliate. Proportionate share of net loss of affiliate increased 75.5% to \$1.1 million for the three months ended September 30, 2004, from \$0.6 million for the same period in 2003. The increase in losses of \$0.5 million was partly attributed to Infinity Broadcasting not renewing its Scarborough contracts.

Interest Expense. Interest expense decreased 36.7% to \$1.8 million for the three months ended September 30, 2004, from \$2.9 million for the same period in 2003. The decrease was primarily attributed to a \$60.1 million decline in the average outstanding debt under the Credit Facility in the three months ended September 30, 2004, compared to the three months ended September 30, 2003.

Income Tax Expense. Income tax expense was lower in the third quarter of 2004 primarily because reserves for certain tax contingencies were reversed during the third quarter of 2004 due to guidance in a recent Internal Revenue Service notice. Also, the valuation allowance on the deferred tax assets related to state net operating loss carryforwards was reduced due to higher actual and projected taxable income in the applicable states. The net benefit of these changes during the quarter was \$4.2 million. The effective tax rate, exclusive of these discrete events, has been reduced from 39.0% to 38.5% to reflect a reduction in the expected state tax rate. Arbitron's effective tax rate was 38.5% and 39.0% for the three months ended September 30, 2004, and 2003, respectively.

Net Income. Net income increased 42.4% to \$24.2 million for the three months ended September 30, 2004, from \$17.0 million for the same period in 2003. Tax changes amounting to \$4.2 million accounted for 24.7%, and the lower interest expense accounted for 6.3% of the 42.4% increase.

EBIT and EBITDA. Earnings before interest and income taxes (EBIT) increased 10.1% to \$33.7 million, and earnings before interest, income taxes, depreciation and amortization (EBITDA) increased 10.5% to \$35.2 million for the three months ended September 30, 2004, from \$30.6 million and \$31.8 million, respectively, for the same period in 2003. Arbitron has presented EBIT and EBITDA as supplemental information that management of Arbitron believes may be useful to investors to evaluate Arbitron's results because they exclude certain items that are not directly related to the Company's core operating performance. EBIT is calculated by adding back net interest expense and income tax expense to net income. EBITDA is calculated by adding back net interest expense, income taxes, depreciation and amortization to net income. EBIT and EBITDA should not be considered substitutes either for net income, as indicators of Arbitron's operating performance, or for cash flow, as measures of Arbitron's liquidity. In addition, because EBIT and EBITDA may not be calculated identically by all companies, the presentation here may not be comparable to other similarly titled measures of other companies.

Comparison of the Nine Months Ended September 30, 2004 to the Nine Months Ended September 30, 2003

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)

| | Nine Months Ended September 30, | | Increase (Decrease) | | Percentage of Revenue | |
|---|------------------------------------|-----------|------------------------|---------|--------------------------|--------|
| | 2004 | 2003 | Dollar | Percent | 2004 | 2003 |
| Revenue | \$223,634 | \$208,121 | \$15,513 | 7.5% | 100.0% | 100.0% |
| Costs and expenses | | | | | | |
| Cost of revenue | 74,789 | 71,933 | 2,856 | 4.0% | 33.4% | 34.6% |
| Selling, general and administrative | 45,285 | 42,160 | 3,125 | 7.4% | 20.2% | 20.3% |
| Research and development | 23,471 | 18,989 | 4,482 | 23.6% | 10.5% | 9.1% |
| Total costs and expenses | 143,545 | 133,082 | 10,463 | 7.9% | 64.1% | 64.0% |
| Operating income | 80,089 | 75,039 | 5,050 | 6.7% | 35.9% | 36.0% |
| Equity in net income of affiliate | 1,411 | 1,584 | (173) | (10.9%) | 0.6% | 0.8% |
| Income before interest and income tax expense | 81,500 | 76,623 | 4,877 | 6.4% | 36.5% | 36.8% |
| Interest income | 707 | 547 | 160 | 29.3% | 0.3% | 0.3% |
| Interest expense | 6,220 | 9,736 | (3,516) | (36.1%) | 2.8% | 4.7% |
| Income before income tax expense | 75,987 | 67,434 | 8,553 | 12.7% | 34.0% | 32.4% |
| Income tax expense | 25,040 | 26,299 | (1,259) | (4.8%) | 11.2% | 12.6% |
| Net income | \$ 50,947 | \$ 41,135 | \$ 9,812 | 23.9% | 22.8% | 19.8% |
| Net income per weighted average common share | | | | | | |
| Basic | \$ 1.64 | \$ 1.38 | \$ 0.26 | 18.8% | | |
| Diluted | \$ 1.62 | \$ 1.35 | \$ 0.27 | 20.0% | | |
| Other data: | | | | | | |
| EBIT | \$ 81,500 | \$ 76,623 | \$ 4,877 | 6.4% | | |

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| | | | | |
|--------------------------------|-------------------|-------------------|-------------------|------|
| EBITDA | \$ 85,712 | \$ 80,201 | \$ 5,511 | 6.9% |
| EBIT and EBITDA Reconciliation | | | | |
| Net income | \$ 50,947 | \$ 41,135 | \$ 9,812 | |
| Income tax expense | 25,040 | 26,299 | (1,259) | |
| Interest income | 707 | 547 | 160 | |
| Interest expense | 6,220 | 9,736 | (3,516) | |
| | <u> </u> | <u> </u> | <u> </u> | |
| EBIT | 81,500 | 76,623 | 4,877 | |
| Depreciation and amortization | 4,212 | 3,578 | 634 | |
| | <u> </u> | <u> </u> | <u> </u> | |
| EBITDA | \$ 85,712 | \$ 80,201 | \$ 5,511 | |
| | <u> </u> | <u> </u> | <u> </u> | |

Revenue. Revenue increased 7.5% to \$223.6 million for the nine months ended September 30, 2004, from \$208.1 million for the same period in 2003. Approximately \$12.1 million of the increase was due to increases in the ratings and qualitative subscriber base, analytical software applications and escalations in multiyear customer contracts and contract renewals. The MRP acquisition accounted for \$4.1 million of the total increase. Due to the slow economic growth of the radio industry as well as the high penetration of current services in the core radio station business, Arbitron expects that its annual organic rate of revenue growth will be slower than historical trends.

Cost of Revenue. Cost of revenue increased 4.0% to \$74.8 million for the nine months ended September 30, 2004, from \$71.9 million for the same period in 2003, but decreased as a percentage of revenue to 33.4% in 2004 from 34.6% in 2003. The \$2.9 million increase was primarily due to U.S. Media Services computer center costs (\$0.4 million), increases in royalties (\$0.8 million), PPM (\$0.9 million), human resources costs (\$0.5 million), CSW Research Limited (\$0.4 million) and the MRP acquisition (\$0.4 million).

Selling, General and Administrative. Selling, general and administrative expenses increased 7.4% to \$45.3 million for the nine months ended September 30, 2004, from \$42.2 million for the same period in 2003, but decreased as a percentage of revenue to 20.2% in 2004 from 20.3% in 2003. The \$3.1 million increase was primarily attributed to the MRP acquisition (\$2.5 million) and the write-off of assets with the discontinuance of the MeasureCast service (\$0.5 million).

Research and Development. Research and development increased 23.6% to \$23.5 million during the nine months ended September 30, 2004, from \$19.0 million for the same period in 2003 and increased as a percentage of revenue to 10.5% in 2004 from 9.1% in 2003. The \$4.5 million increase was due to PPM research and development (\$3.2 million) and the MRP acquisition (\$1.2 million).

Operating Income. Operating income increased 6.7% to \$80.1 million for the nine months ended September 30, 2004, from \$75.0 million for the same period in 2003. Operating margin was virtually unchanged as revenue growth and lower cost of revenue were offset by increased research and development expenses.

Interest Expense. Interest expense decreased 36.1% to \$6.2 million for the nine months ended September 30, 2004, from \$9.7 million for the same period in 2003. The decrease was primarily attributed to a \$63.2 million decline in the average outstanding debt under the Credit Facility in the nine months ended September 30, 2004, compared to the nine months ended September 30, 2003.

Income Tax Expense. Income tax expense was lower in the third quarter of 2004 primarily because reserves for certain tax contingencies were reversed during the third quarter of 2004 due to guidance in a recent Internal Revenue Service notice. Also, the valuation allowance on the deferred tax assets related to state net operating loss carryforwards was reduced due to higher actual and projected taxable income in the applicable states. The net benefit of these changes during the quarter and nine month period was \$4.2 million. The effective tax rate, exclusive of these discrete events, has been reduced from 39.0% to 38.5% to reflect a reduction in the expected state tax rate. Arbitron's effective tax rate was 38.5% for the nine months ended September 30, 2004, and 39.0% for the nine months ended September 30, 2003.

Net Income. Net income increased 23.9% to \$50.9 million for the nine months ended September 30, 2004, from \$41.1 million for the same period in 2003. Tax changes amounting to \$4.2 million accounted for 10.2%, and the lower interest expense accounted for 8.5% of the 23.9% increase.

EBIT and EBITDA. EBIT increased 6.4% to \$81.5 million and EBITDA increased 6.9% to \$85.7 million for the nine months ended September 30, 2004, from \$76.6 million and \$80.2 million, respectively, for the same period in 2003. Arbitron has presented EBIT and EBITDA as supplemental information that management of Arbitron believes

may be useful to investors to evaluate Arbitron's results because they exclude certain items that are not directly related to the Company's core operating performance. EBIT is calculated by adding back net interest expense and income tax expense to net income. EBITDA is calculated by adding back net interest expense, income taxes, depreciation and amortization to net income. EBIT and EBITDA should not be considered substitutes either for net income, as indicators of Arbitron's operating performance, or for cash flow, as measures of Arbitron's liquidity. In addition, because EBIT and EBITDA may not be calculated identically by all companies, the presentation here may not be comparable to other similarly titled measures of other companies.

Liquidity and Capital Resources

Working capital was \$28.9 million and \$25.0 million as of September 30, 2004, and December 31, 2003, respectively. As of September 30, 2004, the Company had \$68.7 million in available cash and cash equivalents. In addition, the Company had \$76.1 million in available borrowings under its Credit Facility. Management expects that the cash position as of September 30, 2004, cash flow generated from operations, as well as available borrowings from its Credit Facility will be sufficient to support the Company's operations for the foreseeable future.

Net cash provided by operating activities was \$66.4 million and \$63.8 million for the nine months ended September 30, 2004, and 2003, respectively, an increase of \$2.7 million. The increase was mainly attributable to the following: a decrease in deferred income taxes (\$21.1 million); higher net income in 2004 (\$9.8 million); higher distributions from affiliate (\$0.3 million); higher tax benefit from stock option exercises (\$1.5 million); and increased other noncurrent liabilities (\$1.1 million). These increases were partially offset by decreases in accrued expenses and other liabilities (\$16.5 million) and a decrease in net account receivable collections (\$14.0 million). The decrease in deferred income taxes is due primarily to a new Internal Revenue Service (IRS) procedure related to advance customer payments. As a result of the new procedure, income taxes of approximately \$22.2 million paid in 2003 were applied toward the Company's 2004 tax liability. The decrease in accrued expenses and other liabilities of \$16.5 million was also primarily caused by a change in accrued income taxes resulting from the new IRS Procedure related to advance customer payments.

Net cash used in investing activities was \$16.1 million and \$3.4 million for the nine months ended September 30, 2004, and 2003, respectively, an increase of \$12.7 million. The increase is attributed to the \$8.9 million MRP acquisition in March 2004 and increased spending on PPM software and other fixed assets.

Net cash used in financing activities was \$50.1 million and \$37.4 million for the nine months ended September 30, 2004, and 2003, respectively, an increase of \$12.8 million. The increase is primarily attributed to stock repurchases of \$9.9 million in September of 2004 and increased payments of long-term debt of \$5.0 million, which were partially offset by additional cash proceeds from stock option exercises and stock purchase plans.

Arbitron's commitment under its revolving Credit Facility, which was \$225.0 million at inception, was \$76.2 million on September 30, 2004. The commitment is reduced annually in accordance with mandatory commitment reduction and excess cash flow provisions. On January 31, 2008, Arbitron's senior secured notes in the amount of \$50.0 million mature.

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 buy and 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 has met all covenants since the inception of the borrowings.

On September 9, 2004, the Company announced that its Board of Directors authorized a repurchase program under which the Company could purchase up to \$25.0 million of its outstanding common stock. The Company expects that the shares may be purchased from time to time in either open-market or private transactions at then prevailing market prices through December 31, 2004. As of September 30, 2004, the Company had repurchased an aggregate of 255,000

shares under the program for an aggregate purchase price of \$9.9 million. The Company has not determined whether a similar repurchase program will be instituted in 2005.

In 2003, Clear Channel Communications and Infinity Broadcasting represented approximately 21% and 10%, respectively, of Arbitron's revenue. Arbitron's agreements with these customers are not exclusive and contain no renewal obligations. Certain license agreements with Clear Channel Communications that accounted for approximately 17% of Arbitron's revenue expire on December 31, 2004. In August 2004, Arbitron entered into multi-year license agreements with Infinity Broadcasting, effective April 1, 2004, to provide audience estimates, software and other ancillary services to 185 Infinity Broadcasting radio stations in 42 markets. Infinity Broadcasting

did not renew its corporate contract for the Scarborough service. Arbitron cannot give any assurances that it will retain current customers or that it will be able to replace the revenue that is lost when a key customer fails to renew its agreement with Arbitron.

In 2004, Arbitron is focusing on a demonstration to be conducted in Houston, Texas, in 2005 and 2006 to confirm the results of previous tests and demonstrate enhancements to the Portable People Meter system that have been made since it was tested in Philadelphia. Arbitron continues to work with Nielsen Media Research to resolve outstanding issues and to negotiate business terms for a potential Portable People Meter joint venture.

Separate from the proposed joint venture with Nielsen Media Research, Arbitron began testing additional marketing research applications of the Portable People Meter technology in 2003. One application that Arbitron began testing was the use of the Portable People Meter as the media collection tool for a national marketing-oriented panel designed to correlate advertising with shopping behavior and sales. The objective is to provide multimedia exposure data combined with sales data from a single source to produce a measure of advertising effectiveness for advertisers, agencies and broadcasters. On September 29, 2004, Arbitron announced that Arbitron and VNU, Inc. signed an agreement to explore the development of a new national marketing research service. Procter & Gamble will collaborate to ensure that the service properly addresses the needs of marketers. This would be a new type of service for which market acceptance is not yet known.

The continuing development and anticipated rollout of PPM services will require significant capital resources and will increase our operating costs over the next several years. In the event Arbitron decides to commercialize either a PPM ratings service or a PPM marketing application service there could be significant start-up expenses that could adversely affect Arbitron's financial position and operating results.

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 294 United States local markets. All markets are measured at least twice per year (April-May-June for the Spring Survey and October-November-December for the Fall Survey). In addition, all major markets are measured two additional times per year (January-February-March for the Winter Survey and July-August-September for the 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 provided 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 DISCLOSURES ABOUT MARKET RISK

Interest Risk

The Company currently has no exposure to market risk with respect to changes in interest rates, because the Company's only outstanding debt is on senior notes that bear interest at a fixed rate of 9.96%. The Company does not use derivatives for speculative or trading purposes.

Because the Company currently has no outstanding floating rate debt, 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 value of the Company's senior notes.

Foreign Currency Risk

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

ITEM 4. CONTROLS AND PROCEDURES

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's President and Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15 of the rules promulgated under the Securities Exchange Act of 1934, as amended) as of the end of the most recently completed fiscal quarter. Based upon that evaluation, the Company's President and Chief Executive Officer and the Company's Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic Securities and Exchange Commission filings. There has been no change in the Company's internal control over financial reporting during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

On September 9, 2004, the Company announced that its Board of Directors authorized a repurchase program under which the Company could purchase up to \$25.0 million of its outstanding common stock. The Company expects that the shares may be purchased from time to time in either open market or private transactions at then prevailing market prices through December 31, 2004. The following table outlines the stock repurchase activity during the three months ended September 30, 2004.

Arbitron Purchases of Equity Securities

| Period | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of a publicly announced program | Maximum dollar value of shares that may yet be purchased under the program |
|------------------|---|-------------------------------------|---|---|
| July 1 - 31 | | \$ | | \$ |
| August 1 - 31 | | \$ | | \$ |
| September 1 - 30 | 255,000 | \$38.88 | 255,000 | \$15,073,156 |
| Total | 255,000 | \$38.88 | 255,000 | \$15,073,156 |

ITEM 6. EXHIBITS

| Exhibit No. | Description |
|--------------------|--|
| Exhibit 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |

Exhibit 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.1 Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURE

Pursuant to 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.

ARBITRON INC.

By: /s/ WILLIAM J. WALSH

William J. Walsh
Executive Vice President of Finance and Planning and
Chief Financial Officer (on behalf of the registrant and as
the registrant's principal accounting officer)

Date: November 4, 2004