PAXSON COMMUNICATIONS CORP
Form 10-K
March 31, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)

For the transition period from to

Commission File Number 1-13452

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

| | |
|---|---|
| DELAWARE | 59-3212788 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

601 CLEARWATER PARK ROAD, WEST PALM BEACH, FLORIDA 33401
(Address of principal executive offices) (Zip Code)

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

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

| TITLE OF EACH CLASS | NAME OF EXCHANGE ON WHICH REGISTERED |
|---|---|
| Class A Common Stock, $0.001 par value | American Stock Exchange |

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

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

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

The aggregate market value of common stock held by non-affiliates of the registrant as of March 19, 2004 is $169,948,000 computed by reference to the closing price for such shares on the American Stock Exchange.

The number of shares outstanding of each of the registrant's classes of common stock, as of March 19, 2004 was: 63,473,488 shares of Class A Common Stock, $0.001 par value, and 8,311,639 shares of Class B Common Stock, $0.001 par value.

DOCUMENTS INCORPORATED BY REFERENCE

Parts of the definitive Proxy Statement for the Registrant's Annual Meeting of Stockholders to be held on May 21, 2004.

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PART I

ITEM 1. BUSINESS

GENERAL

We are a network television broadcasting company which owns and operates the largest broadcast television station group in the United States, as measured by the number of television households in the markets our stations serve. We currently own and operate 61 broadcast television stations (including three stations we operate under time brokerage agreements), all of which carry PAX TV, including stations reaching all of the top 20 U.S. markets and 40 of the top 50

U.S. markets. We operate PAX TV, a network that provides programming seven days per week, 24 hours per day, and reaches approximately 96 million homes, or 89% of prime time television households in the U.S., through our broadcast television station group, and pursuant to distribution arrangements with cable and satellite distribution systems and our broadcast station affiliates. PAX TV's entertainment programming principally consists of shows originally developed by us and shows that have appeared previously on other broadcast networks which we have purchased the right to air. The balance of PAX TV's programming consists of long form paid programming (principally infomercials) and public interest programming. We have obtained audience ratings and share, market rank and television household data set forth in this report from the most recent information available from Nielsen Media Research. We do not assume responsibility for the accuracy or completeness of this data.

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

- Network Spot Advertising. We sell commercial air time to advertisers who want to reach the entire nationwide PAX TV viewing audience with a single advertisement. Most of our network spot advertising is sold under advance, or "upfront," commitments to purchase advertising time which are obtained before the beginning of our PAX TV entertainment programming season. Network spot advertising rates are significantly affected by audience ratings and our ability to reach audience demographics that are desirable to advertisers. Higher ratings generally will enable us to charge higher rates to advertisers. Our network spot advertising revenue represented approximately 21% of our revenue during the year ended December 31, 2003.

- Network Long Form Paid Programming. We sell air time for long form paid programming, consisting primarily of infomercials, during broadcasting hours when we are not airing PAX TV entertainment programming or public interest programming. Our network long form paid programming represented approximately 41% of our revenue during the year ended December 31, 2003.

- Station Advertising. We sell commercial air time to advertisers who want to reach the viewing audience in specific geographic markets in which we own and operate our television stations. These advertisers may be local businesses or regional or national advertisers who want to target their advertising in these markets. Station advertising rates are affected by ratings and local market conditions. Our station advertising sales represented approximately 38% of our revenue during the year ended December 31, 2003 (including 21% of our revenue during such year which was derived from local and national long form paid programming).

Beginning in January 2003, we modified our programming schedule by replacing entertainment programming during the hours of 1 p.m. to 5 p.m. and 11:30 p.m. to midnight, Monday through Friday, and 5 p.m. to 6 p.m. and 11 p.m. to midnight, Saturday and Sunday, with long form paid programming. As a result, the percentage of our revenues derived from long form paid programming has increased from 47% in the year ended December 31, 2002, to 62% in the year ended December 31, 2003. We expect to continue to derive more than half of our revenues from long form paid programming for the foreseeable future.

Commencing in the fourth quarter of 1999, we began entering into joint sales agreements, or JSAs, with owners of broadcast stations in markets served by our stations. After implementation of a JSA, we no longer employ our own on-site station sales staff. The JSA partner provides station spot and long form advertising sales management and representation for our stations and in about half our stations we integrate and co-locate our station operations with those of our JSA partners. To date, we have entered into JSAs for 47 of our 61 owned and operated television stations.

Our primary operating expenses include selling, general and administrative expenses, depreciation and amortization expenses, programming expenses, employee compensation and costs associated with cable and satellite distribution, ratings services and promotional advertising. Programming amortization is a significant expense and is affected by several factors, including the mix of syndicated versus lower cost original programming as well as the frequency with which programs are aired.



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

EXPLORATION OF STRATEGIC ALTERNATIVES

We believe that absent significant improvement in our ratings and revenues, our business operations are unlikely to provide sufficient cash flow to support our debt service and preferred stock dividend requirements. In September 2002, we engaged Bear, Stearns & Co. Inc. and in August 2003 we engaged Citigroup Global Markets Inc. to act as our financial advisors to assess our business plan, capital structure and future capital needs, and to explore strategic alternatives for our company. These strategic alternatives may include the sale of all or part of our assets, finding a strategic partner for our company who would provide the financial resources to enable us to redeem, restructure or refinance our debt and preferred stock, or finding a third party to acquire our company through a merger or other business combination or through a purchase of our equity securities.

BUSINESS STRATEGY

Our principal business objective is to maximize our cash flow through maintaining an efficient operating structure while we explore strategic alternatives for our business. To materially increase our revenues, we believe we would need to significantly improve the audience ratings of our entertainment programming, which in turn would require us to invest substantial resources in the acquisition and development of additional entertainment programming. We have pursued a strategy of reducing our programming and other operating expenses in order to improve our cash flow, conserve our financial resources and maintain our liquidity while we explore strategic alternatives to address the issues facing our business, and are therefore not currently investing substantial additional amounts in new entertainment programming. In January 2003, we significantly reduced the amount of entertainment programming aired on PAX TV, and replaced it with long form paid programming, consisting principally of infomercials.

OPERATING STRATEGY

While we explore strategic alternatives as discussed above, the principal components of our operating strategy are:

- Provide Quality Entertainment Programming. We believe there is significant demand, including from adult demographic groups which are attractive to advertisers, for quality entertainment programming which is free of excessive violence, explicit sexual themes and foul language. We seek to attract viewers and establish a nationally recognized brand by offering quality entertainment programming. We have developed original entertainment programming for PAX TV at lower costs than those typically incurred by other broadcast networks for original entertainment programming by employing cost efficient development, financing and production techniques.

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

o Improve Local Television Station Operations through Joint Sales Agreements. We have sought to improve the operations of our local stations by entering into JSAs with respect to 47 of our stations, including JSAs between 42 of our stations and stations owned by National Broadcasting Company, Inc., or NBC, or independently owned NBC affiliated stations. Substantially all of those stations are currently operating under the terms of the JSAs. Generally, JSAs are for ten-year terms. Substantially all JSA partners have the right to terminate the JSA upon a sale by the JSA partner of its station that is the subject of the JSA. Each JSA typically provides for the JSA partner to serve as



our exclusive sales representative to sell our station advertising, enabling our station to benefit from the strength of the JSA partner's sales organization and existing advertiser relationships. In about half of our JSA arrangements, we have co-located many of our station operations with those of the JSA partner, seeking to reduce our costs through operating efficiencies and economies of scale, including the elimination of redundant owned and leased facilities and staffing. Our JSA partner may provide local news and syndicated programming, supplementing and enhancing our station's programming lineup.

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

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

- Continue Airing Long Form Paid Programming. We air a substantial amount of long form paid programming as we believe this provides us with a stable revenue base as we continue to develop the PAX TV network's entertainment programming. In January 2003, we increased our inventory of air time available for long form paid programming by approximately 42% by shifting 26.5 hours per week of non-prime time PAX TV network entertainment programming to long form paid programming. We determined that we could sell this air time for long form paid programming at higher rates than the rates at which we were selling spot advertising time in these time periods. The portion of our revenues which is derived from network advertising decreased from 33% for the year ended December 31, 2002 to 21% for the year ended December 31, 2003 and the portion of our revenues which is derived from network and station long form paid programming increased from 47% for the year ended December 31, 2002 to 62% for the year ended December 31, 2003. This reduction in our network entertainment programming, which consisted principally of syndicated programs, also has enabled us to reduce our programming costs. We expect to periodically review and adjust the amount of air time we sell for long form paid programming in order to take advantage of opportunities that may arise for us to increase our advertising revenue.

DISTRIBUTION

We distribute PAX TV through a television distribution system comprised of our owned and operated broadcast television stations, cable television systems in various markets not served by a PAX TV station, satellite television providers and independently owned PAX TV affiliated broadcast stations. According to Nielsen our programming currently reaches 89% of U.S. television households (approximately 96 million homes).

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

Our Owned and Operated Television Stations. We currently own and operate 61 broadcast television stations (including three stations we operate under time brokerage agreements, or TBAs), all of which carry PAX TV, including stations reaching all of the top 20 U.S. markets and 40 of the top 50 U.S. markets. Our owned and operated station group reaches approximately 64% of U.S. prime time television households, according to Nielsen. Our ownership of the stations providing most of our television distribution enables us to receive advertising revenue from each station's entire broadcast day and to achieve operating efficiencies typically not enjoyed by network affiliated television stations. As nearly all of our owned and operated stations operate in the "ultra high frequency," or UHF, portion of the broadcast spectrum, only half of the number of television households they reach are counted against the national ownership cap under the Communications Act. By exercising our rights under the Communications Act to require cable television system operators to carry the broadcast signals of our owned and operated stations, we reach many more television households in each station's designated market area, or DMA, than we would if our stations were limited to transmitting their broadcast signals over the airwaves.

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

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

| Market Name | Market Rank(1) | Station Call Letters | Broadcast Channel | Total Market TV Households(2) | JSA Partne |
|---|---|---|---|---|---|
| New York . . . . . . . . . . | 1 | WPXN | 31 | 7,376,330 | NBC |
| Los Angeles . . . . . . . . . | 2 | KPXN | 30 | 5,402,260 | NBC |
| Chicago . . . . . . . . . . . | 3 | WCPX | 38 | 3,399,460 | NBC |
| Philadelphia . . . . . . . . | 4 | WPPX | 61 | 2,874,330 | NBC |
| San Francisco . . . . . . . . | 5 | KKPX | 65 | 2,440,920 | NBC |
| Boston (3 stations) . . . . . | 6 | WBPX | 68 | 2,391,830 | -- |
| Dallas . . . . . . . . . . . | 7 | KPXD | 68 | 2,255,970 | NBC |
| Washington D.C . . . . . . . | 8 | WPXW | 66 | 2,224,070 | NBC |
| Washington D.C . . . . . . . | 8 | WWPX | 60 | 2,224,070 | NBC |
| Atlanta . . . . . . . . . . . | 9 | WPXA | 14 | 2,035,060 | Gannett |
| Detroit . . . . . . . . . . . | 10 | WPXD | 31 | 1,923,230 | -- |
| Houston . . . . . . . . . . . | 11 | KPXB | 49 | 1,848,770 | Belo Co |
| Seattle . . . . . . . . . . . | 12 | KWPX | 33 | 1,685,480 | Belo Co |
| Tampa . . . . . . . . . . . . | 13 | WXPX | 66 | 1,644,270 | Media G |
| Minneapolis . . . . . . . . . | 14 | KPXM | 41 | 1,635,650 | Gannett |
| Phoenix . . . . . . . . . . . | 15 | KPPX | 51 | 1,561,760 | Gannett |
| Cleveland . . . . . . . . . . | 16 | WVPX | 23 | 1,542,970 | Gannett |
| Miami . . . . . . . . . . . . | 17 | WPXM | 35 | 1,510,740 | NBC |
| Denver . . . . . . . . . . . | 18 | KPXC | 59 | 1,399,100 | Gannett |
| Sacramento . . . . . . . . . | 19 | KSPX | 29 | 1,278,430 | Hearst- |
| Orlando . . . . . . . . . . . | 20 | WOPX | 56 | 1,263,900 | Hearst- |
| Portland, OR . . . . . . . . | 24 | KPXG | 22 | 1,073,210 | Belo Co |
| Indianapolis . . . . . . . . | 25 | WIPX | 63 | 1,038,370 | Dispatc |
| Hartford . . . . . . . . . . | 27 | WHPX | 26 | 1,001,320 | NBC |

| | | | | |
|---|---|---|---|---|
| Raleigh-Durham . . . . . . . 29 | WFPX | 62 | 947,750 | NBC |
| Raleigh-Durham . . . . . . . 29 | WRPX | 47 | 947,750 | NBC |
| Nashville . . . . . . . . . 30 | WNPX | 28 | 904,380 | -- |
| Kansas City . . . . . . . . 31 | KPXE | 50 | 875,090 | Scripps |
| Milwaukee . . . . . . . . . 33 | WPXE | 55 | 871,490 | Journal |
| Salt Lake City . . . . . . . 36 | KUPX | 16 | 786,030 | -- |
| San Antonio . . . . . . . . 37 | KPXL | 26 | 736,240 | Clear C |
| Grand Rapids . . . . . . . . 38 | WZPX | 43 | 724,290 | LIN Tel |



| | | | | |
|---|---|---|---|---|
| West Palm Beach . . . . . . .39 | WPXP | 67 | 709,290 | Scripps |
| Birmingham . . . . . . . . . 40 | WPXH | 44 | 697,570 | NBC |
| Norfolk . . . . . . . . . . 41 | WPXV | 49 | 693,660 | LIN Tel |
| New Orleans(4) (5) . . . . . 42 | WPXL | 49 | 665,190 | Hearst- |
| Memphis(4) (5) . . . . . . . 43 | WPXX | 50 | 662,280 | Raycom |
| Buffalo . . . . . . . . . . 44 | WPXJ | 51 | 647,920 | Gannett |
| Oklahoma City . . . . . . . 45 | KOPX | 62 | 647,390 | The New |
| Greensboro . . . . . . . . . 46 | WGPX | 16 | 645,430 | Hearst- |
| Providence . . . . . . . . . 48 | WPXQ | 69 | 635,610 | NBC |
| Louisville(4) (6) . . . . . 50 | WBNA | 21 | 624,470 | -- |
| Jacksonville-Brunswick . . . 52 | WPXC | 21 | 598,070 | Post-Ne |
| Wilkes Barre . . . . . . . . 53 | WQPX | 64 | 590,100 | The New |
| Albany . . . . . . . . . . . 55 | WYPX | 55 | 542,670 | Hubbard |
| Tulsa . . . . . . . . . . . 60 | KTPX | 44 | 505,000 | Scripps |
| Knoxville . . . . . . . . . 61 | WPXK | 54 | 499,040 | Raycom |
| Charleston, WV . . . . . . . 63 | WLPX | 29 | 495,190 | -- |
| Lexington . . . . . . . . . 65 | WUPX | 67 | 466,980 | -- |
| Roanoke . . . . . . . . . . 66 | WPXR | 38 | 450,090 | Media G |
| Honolulu . . . . . . . . . . 72 | KPXO | 66 | 412,190 | -- |
| Des Moines . . . . . . . . . 73 | KFPX | 39 | 404,580 | The New |
| Syracuse . . . . . . . . . . 79 | WSPX | 56 | 384,290 | Raycom |
| Spokane . . . . . . . . . . 80 | KGPX | 34 | 381,820 | KHQ, In |
| Shreveport(7) . . . . . . . 81 | KPXJ | 21 | 379,880 | KTBS, I |
| Cedar Rapids . . . . . . . . 88 | KPXR | 48 | 328,060 | -- |
| Greenville-N. Bern . . . . 103 | WEPX | 38 | 270,560 | -- |
| Greenville-N. Bern . . . . .103 | WPXU | 35 | 270,560 | -- |
| Wausau . . . . . . . . . . 134 | WTPX | 46 | 178,910 | -- |

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(1) Market rank is based on the number of television households in the television market or Designated Market Area, or "DMA," as used by Nielsen, effective as of September 2003.

(2) Refers to the number of television households in the DMA as estimated by Nielsen, effective as of September 2003.

(3) Indicates the company with which we have entered into a JSA for the station.

(4) Station is independently owned and is operated by us under a time brokerage agreement.

(5) We have the option to acquire the station and the current owner has the right to require us to purchase the station at anytime after

January 1, 2005 through December 31, 2006.

(6) We have a right of first refusal to acquire the station.

(7) Station is subject to a pending sale transaction.

Cable and Satellite Distribution. In order to increase the distribution of our programming, we have entered into carriage agreements with the nation's largest cable multiple system operators, as well as with other cable system operators and satellite television providers. These cable and satellite system operators carry our programming on a designated channel of their service. These carriage agreements enable us to reach television households in markets not served by our owned or affiliated stations. Our carriage agreements with cable system operators generally required us to pay an amount based upon television households reached. Our carriage agreements with satellite television providers allow the satellite provider to sell and retain the advertising revenue from a portion of the non-network advertising time during PAX TV programming hours. Some of our carriage agreements with cable operators also provide this form of compensation to the cable operator. We do not pay compensation for reaching households in DMAs already served by our broadcast stations, even though the cable operator may provide our programming to these households because we have exercised our "must carry" rights under the Communications Act. We believe that the ability to view our programming on one of the lower numbered channel positions



(generally below channel 21) on a cable system improves the likelihood that viewers will watch our programming, and we have successfully negotiated favorable channel positions with most of the cable system operators and satellite television providers with whom we have carriage agreements. Through cable and satellite distribution, we reach approximately 17% of U.S. prime time television households in DMAs not already served by a PAX TV station.

Our PAX TV Affiliated Stations. To increase the distribution of PAX TV, we have entered into affiliation agreements with stations in markets where we do not otherwise own or operate a broadcast station. These stations include full power and low power television stations. Each affiliation agreement gives the particular station the right to broadcast PAX TV programming, or portions of it, in the station's market. Although the majority of the affiliation agreements provide for the distribution of PAX TV prime time entertainment programming, some affiliates do not carry all of our PAX TV prime time entertainment programming. In addition, some affiliates do not air PAX TV programming in the exact time patterns that the programming is broadcast on our network because of issues related to their specific markets. Our affiliation agreements provide us with additional distribution of our PAX TV programming without the expense of acquiring a station or paying compensation to cable system operators in the markets reached. Under our affiliation agreements, we are not required to pay cash compensation to the affiliate, and the affiliate is entitled to sell and retain the revenue from all or a portion of the non-network advertising time during the PAX TV programming hours. We have affiliation agreements with respect to 54 television stations which reach approximately 8% of U.S. prime time television households.

PROGRAMMING

We operate PAX TV, a network that provides programming seven days per week, 24 hours per day. During our PAX TV entertainment programming hours, which are between 5:00 p.m. and 11:30 p.m., local time, Monday through Friday, and 6:00 p.m. and 11:00 p.m., Saturday and Sunday, we offer entertainment programs that are free of excessive violence, explicit sexual themes and foul language. We produce original shows to air primarily during PAX TV's prime time hours. The balance of our PAX TV entertainment lineup consists of syndicated programs and a limited amount of entertainment and sports programming on a market-by-market basis.

Since our launch, we have sought to develop our original PAX TV programming, as our operating experience with PAX TV has shown that quality original programs can generate higher ratings and deliver a greater return to us, in terms of advertising revenues, than syndicated programs of comparable cost. In March 2004 we entered into an agreement with NBC under which NBC will consult with us on the development, production and programming of scripted and unscripted television series, games shows and specials. We have developed original entertainment programming for PAX TV at lower costs than those typically incurred by other broadcast networks for original entertainment programming. We have done this by employing cost efficient development and production techniques, such as the development of program concepts without the use of pilots, and by entering into production arrangements with foreign production companies through which we are able to share production costs, gain access to lower cost production labor and participate in tax incentives. In addition, we attempt to pre-sell the foreign and other distribution rights to our original PAX TV programming and thereby recover a significant portion of the program's production costs, while retaining all of the domestic rights. Our agreements for syndicated programming generally entitle us to exclusive nationwide distribution rights over our entire television distribution system for a fixed cost, without regard to the number of households that receive our programming.

During hours when we are not broadcasting entertainment programming, our stations broadcast long form paid programming, consisting primarily of infomercials, which are shows produced at no cost to us to market and sell products and services through viewer direct response, and paid religious programming. Pursuant to an agreement with The Christian Network, Inc., or CNI, our broadcast stations carry CNI's programming between the hours of 1:00 a.m. and 6:00 a.m., seven days per week. For additional details on our relationship with CNI, see "Certain Relationships and Related Transactions."

Under many of our JSAs, the JSA partner provides our station with evening local news broadcasts, which we believe enhances our station's appeal to viewers and advertisers. This news programming may be a rebroadcast of the JSA partner's news in a different time slot or a news broadcast produced for PAX TV.

RATINGS

The advertising revenues from our PAX TV entertainment programming are largely dependent upon the popularity of our programming, in terms of audience ratings, and the attractiveness of our PAX TV viewing audience to advertisers. Higher ratings generally will enable us to charge higher rates to advertisers. Nielsen, one of the leading providers of national audience measuring services, has grouped all television stations in the country into approximately 210 DMAs that

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are ranked in size according to the number of television households, and periodically publishes data on estimated audiences for the television stations in the various DMAs. The estimates are expressed in terms of the percentage of the total potential audience in the market viewing a station (the station's "Rating") and of the percentage of the audience actually watching television (the station's "Share"). Nielsen provides this data on the basis of total television households and selected demographic groupings in the DMA.

Some viewer demographic groups are more attractive to advertisers than others, such as adults of working age who typically have greater purchasing power than other viewer demographic groups. Many products and services are targeted to consumers with specific demographic characteristics, and a viewer demographic group containing a concentration of these types of consumers generally will be more attractive to advertisers. Based on our experiences with PAX TV, advertisers often will pay higher rates to advertise during programming that reaches demographic groups that are targeted by that advertiser. A significant component of our entertainment programming strategy is to develop and air programming that will increase PAX TV's ratings among certain demographic groups, including the group consisting of women from ages 25-54.

ADVERTISING

We offer advertisers the opportunity to reach PAX TV's nationwide viewing audience with a single commercial, which we refer to as network advertising, and to target specific geographical markets airing our programming, which we refer to as local and national advertising.

We sell commercial air time to advertisers who want to reach the entire nationwide PAX TV viewing audience with a single advertisement. Most of our network spot advertising is sold under advance, or "upfront," commitments to purchase advertising time, which are obtained before the beginning of our PAX TV entertainment programming season. NBC serves as our exclusive sales representative to sell most of our network spot advertising. Network spot advertising represented approximately 33% of our revenue during the year ended December 31, 2002 and 21% of our revenue during the year ended December 31, 2003. The central programming signal through which we supply our programming to our stations and to cable and satellite viewers includes advertising, generally of a direct response nature, which reaches our cable and satellite viewers (during both PAX TV entertainment programming and other viewing hours) in markets not served by our stations during time that is otherwise allocated to station spot advertising, and which reaches viewers in local markets during unsold station spot advertising time. We include the revenue from this advertising in our network advertising revenues.

We also sell commercial air time to local and national advertisers who want to reach our viewing audience in specific geographic markets in which we operate. These advertisers may be local businesses or regional or national advertisers who want to target their advertising in these markets. NBC provides national advertising sales services for a majority of our stations. In markets in which our stations are operating under JSAs, our JSA partner serves as our exclusive sales representative to sell our local station advertising. For stations for which NBC does not provide national account representation, our JSA partner performs this function. Our local sales force sells this advertising in markets without JSAs. Our station advertising represented approximately 35% of our revenue during the year ended December 31, 2002 and 38% of our revenue during the year ended December 31, 2003 (including 15% and 21%, respectively, of our revenue during such year which was derived from local and national long form paid programming).

Our advertising rates are typically negotiated and based upon:

- economic and market conditions;
- the size of the market in which a station operates;
- a program's popularity among the viewers that an advertiser wishes to attract;
- the number of advertisers competing for a time slot;
- the availability of alternative advertising media in the market area;

- the demographic composition of the market served by the station;
- development of projects, features and programs that tie advertiser messages to programming; and
- quarterly "sweeps" performance ratings which measure household tuning and demographic audience estimates in all 210 Nielsen TV markets.



We also sell long form paid programming, consisting primarily of infomercials. This programming may appear on our entire PAX TV network or it may be aired only in specific markets. Network and regional paid programming time is sold by our national long form sales team. Local paid programming may be sold by our national sales team or by the local sales team at each station.

NBC RELATIONSHIP

On September 15, 1999, we entered into an investment agreement with NBC under which wholly-owned subsidiaries of NBC purchased shares of our Series B preferred stock and warrants to purchase shares of our common stock for an aggregate purchase price of $415 million. At the same time, a wholly-owned subsidiary of NBC entered into an agreement with Mr. Paxson and entities controlled by Mr. Paxson, under which the NBC subsidiary was granted the right to purchase all, but not less than all, of the 8,311,639 shares of our Class B common stock beneficially owned by Mr. Paxson.

Series B Preferred Stock. Under the investment agreement, a wholly-owned subsidiary of NBC acquired $415 million aggregate liquidation preference of our Series B preferred stock. This security accrues cumulative dividends at an annual rate of 8% and is convertible, subject to adjustment under the terms of the Series B preferred stock, into 31,896,032 shares of our Class A common stock at an initial conversion price of $13.01 per share ($17.48 per share as of December 31, 2003). On September 15, 2004, the rate at which dividends accrue on the Series B preferred stock will be adjusted to a market rate, determined by a nationally recognized independent investment firm chosen by us, at which the Series B preferred stock would trade at its liquidation preference. The shares of Series B preferred stock are exchangeable, in whole or in part, at the option of the holders, into convertible debentures ranking on a parity with our other subordinated indebtedness subject, with respect to any exchange before January 1, 2007, to the exchange being permitted under the terms of our debt and preferred stock instruments. The maturity date of the convertible debentures into which the shares of Series B preferred stock are exchangeable is December 31, 2009.

Warrant A and Warrant B. A wholly-owned subsidiary of NBC also acquired a warrant ("Warrant A") to purchase up to 13,065,507 shares of Class A common stock at an exercise price of $12.60 per share, and a warrant ("Warrant B") to purchase from us up to 18,966,620 shares of Class A common stock at an exercise price equal to the average of the closing sale prices of the Class A common stock for the 45 consecutive trading days ending on the trading day immediately preceding the warrant exercise date, provided that the average price shall not be more than 17.5% higher or 17.5% lower than the six month trailing average closing sale price. The warrants are exercisable until September 2009, subject to various conditions and limitations. In addition:

- Warrant B may not be exercised before the exercise in full of Warrant A; and
- Warrant B may not be exercised to the extent that, after giving effect to the exercise, Mr. Paxson would no longer constitute our "single

majority stockholder" unless Warrant B is exercised in full and at the same time NBC exercises its right to purchase all the shares of our Class B common stock held by Mr. Paxson.

Right to Purchase Class B Common Stock. Concurrently with entering into the Investment Agreement and issuing the Series B preferred stock and Warrants A and B to subsidiaries of NBC, a wholly-owned subsidiary of NBC entered into an agreement with Mr. Paxson and entities controlled by Mr. Paxson, under which the NBC subsidiary was granted the right to purchase all, but not less than all, of the 8,311,639 shares of our Class B common stock beneficially owned by Mr. Paxson. This right is exercisable through September 15, 2009, and may not be exercised before the exercise in full of Warrant A and Warrant B.

These shares of Class B common stock are entitled to ten votes per share on all matters submitted to a vote of our stockholders and are convertible into an equal number of shares of Class A common stock. The purchase price per share of Class B common stock is equal to the higher of:

- the average of the closing sale prices of the Class A common stock for the 45 consecutive trading days ending on the trading day immediately preceding the exercise of NBC's call right, provided that the average price shall not be more than 17.5% higher or 17.5% lower than the six month trailing average closing sale prices; and

- $20.00 per share.

The owners of the shares that are subject to the call right have agreed not to transfer those shares before September 15, 2005, and not to convert those shares into any of our other securities, including shares of Class A common stock. NBC's exercise of the call right is subject to compliance with applicable provisions of the Communications Act and the rules and regulations of the FCC.



Optional Redemption by NBC. On November 13, 2003, NBC notified us that it was exercising its right under its investment agreement with us to demand that we redeem or arrange for a third party to acquire (the "Redemption"), by payment in cash, all 41,500 outstanding shares of our Series B Convertible Exchangeable Preferred Stock held by NBC. The aggregate redemption price payable in respect of the 41,500 preferred shares, including accrued dividends thereon, was approximately $557.5 million as of December 31, 2003.

We will have up to one year after November 13, 2003 to consummate the Redemption. If at any time during the one year redemption period, the terms of our outstanding debt and preferred stock do not prohibit the Redemption and we have sufficient funds on hand to consummate the Redemption, we must consummate the Redemption at that time. NBC may not exercise Warrant A and Warrant B (which represent the right to purchase an aggregate of 32,032,127 shares of our Class A common stock) or its right to purchase shares of Class B common stock beneficially owned by Lowell W. Paxson, our Chairman of the Board and Chief Executive Officer, during the one year redemption period.

If we do not effect the Redemption within one year after November 13, 2003, NBC will again be permitted to exercise Warrant A and Warrant B and its right to acquire Mr. Paxson's Class B common stock, and generally will be permitted to transfer, without restriction, any of our securities acquired by it, its right to acquire Mr. Paxson's Class B common stock, the contractual rights with respect to the NBC investment agreement and its other rights under the related transaction agreements, provided that Warrant A, Warrant B and the right to acquire Mr. Paxson's Class B common stock will expire, to the extent unexercised, 30 days after any such transfer. If NBC transfers any of our securities or its right to acquire Mr. Paxson's Class B common stock, the transferee will remain subject to the terms and conditions of such securities, including those limitations on exercise described above.

Default Redemption by NBC. NBC also has the right to require that we redeem any Series B preferred stock and Class A common stock issued upon conversion of the Series B preferred stock then held by NBC upon the occurrence of various events of default (a "Default Redemption"). If NBC exercises this right, we will have up to 180 days to consummate the redemption. If at any time during the 180 day redemption period, the terms of our outstanding debt and preferred stock do not prohibit the redemption and we have sufficient funds on hand to consummate the redemption, we must consummate the redemption at that time. NBC may not exercise Warrant A, Warrant B or its right to purchase shares of Class B common stock beneficially owned by Mr. Paxson during the 180 day redemption period.

Should we fail to effect a Default Redemption within 180 days after NBC has exercised its right to require us to redeem its securities, NBC will have 180 days within which to exercise Warrant A and Warrant B and its right to acquire Mr. Paxson's Class B common stock, and generally will be permitted to transfer, without restriction, any of our securities acquired by it, its right to acquire Mr. Paxson's Class B common stock, the contractual rights described below, and its other rights under the related transaction agreements, provided that Warrant A, Warrant B and the right to acquire Mr. Paxson's Class B common stock shall expire, to the extent unexercised, 30 days after any such transfer. If NBC does not effect any of these transactions within the 180 day period, we will have the right, for 30 days, to redeem NBC's securities. If we do not effect a redemption during this period, NBC will have the right to require us to effect, at our option, either a public sale or a liquidation of our company and may participate as a bidder in any such transaction. If the highest bid in any public sale of our company would be insufficient to pay NBC the redemption price of its securities, NBC will have a right of first refusal to purchase our company for the highest bid amount. If the highest bid in any public sale would be sufficient to pay NBC the redemption price of its securities, the investment agreement requires us to accept the bid. NBC will not be permitted to exercise Warrant A, Warrant B or its right to acquire Mr. Paxson's Class B common stock during the public sale or liquidation process.

Inability to Effect a Redemption Requested by NBC. Our ability to effect any redemption is restricted by the terms of our outstanding debt and preferred stock. Were NBC to exercise its right to demand that we redeem its Series B preferred stock, in order to be able to do so we would need not only to raise sufficient cash to fund payment of the redemption price, but also to obtain the consents of the holders of our outstanding debt and preferred stock or repay, redeem or refinance these securities in a manner that obviated the need to obtain the consents of the holders. Alternatively, we would need to identify a third party willing to purchase NBC's Series B preferred stock directly from NBC or to enter into a merger, acquisition or other transaction with us as a result of which NBC's Series B preferred stock would be redeemed or acquired.

Optional Redemption by the Company. Beginning on September 15, 2004, we have the right, at any time, to redeem any or all of our outstanding Series B preferred stock at a redemption price per share equal to the higher of (i) the liquidation preference of $10,000 per share plus accrued and unpaid dividends, and (ii) the product of 80% of the average of the closing sale prices of the Class A common stock for the ten consecutive trading days ending on the trading day immediately preceding our notice to NBC exercising the optional redemption, and the number of shares of Class A common stock into which a share of Series B preferred stock is convertible (approximately 768.58 shares of Class A common stock as of December 31, 2003).

If we elect to redeem a portion of our outstanding Series B preferred stock, we are required to declare and pay, in full, all of the accumulated and unpaid dividends on the Series B preferred stock. As of December 31, 2003, accumulated and unpaid dividends on the Series B preferred stock aggregated approximately $142.5 million.

Consent Rights. The investment agreement also provides that we must obtain the consent of NBC for various actions, including:

- approval of annual budgets;
- expenditures materially in excess of budgeted amounts;
- material acquisitions of programming;
- material amendments to our certificate of incorporation or bylaws;
- material asset sales or purchases, including, in some cases, sales of our television stations;
- business combinations where we would not be the surviving corporation or as a result of which we would experience a change of control;
- issuances or sales of any capital stock, with some exceptions;
- certain affiliate transactions;
- stock splits or recombinations;
- any increase in the size of our board of directors other than any increase resulting from provisions of our outstanding preferred stock of up to two additional directors; and
- joint sales, joint services, time brokerage, local marketing or similar agreements as a result of which our stations with national household coverage of 20% or more would be subject to those agreements.

Miscellaneous Rights. In connection with its investment in us, we also granted NBC various rights with respect to our broadcast television operations, including:

- the right to require the conversion of our television stations to NBC network affiliates, subject to various conditions;
- a right of first refusal on proposed sales of television stations; and
- the right to require our television stations to carry NBC network programming that is preempted by NBC network affiliates.

Stockholders Agreement. We also entered into a stockholders agreement with NBC, Mr. Paxson and entities controlled by Mr. Paxson under which we are permitted (but not required) to nominate persons named by NBC for election to our board of directors upon request by NBC if NBC determines that its nominees are permitted under the Communications Act and FCC rules to serve on our board. Mr. Paxson and his affiliates agreed to vote their shares of common stock in favor of the election of those persons as our directors. As part of the outcome of the proceedings that we initiated, which are described below, the FCC determined in 2002 that any NBC nominated director must not be an NBC employee and must be a person who would reasonably be expected to act independently on all matters. The stockholders agreement further provides that we will not, without the prior written consent of NBC, enter into certain agreements or adopt certain plans which would be breached or violated upon the acquisition of our securities by NBC or its affiliates or would otherwise restrict or impede the ability of NBC or its affiliates to acquire additional shares of our capital stock.

Registration Rights. We also granted NBC demand and piggyback registration rights with respect to the shares of Class A common stock issuable upon:

- conversion of the Series B preferred stock;
- conversion of the debentures for which the Series B preferred stock is exchangeable;
- exercise of the warrants; or



- conversion of the Class B common stock.

Operational Arrangements. In connection with these transactions, we entered into a number of business arrangements with NBC. As part of these arrangements and our relationship with NBC:

- NBC provides network advertising sales, marketing and network research services for PAX TV;
- NBC provides national advertising sales services for a majority of our stations; and
- NBC has provided some of its programming, including movies and sporting events, for broadcast on PAX TV.

We have entered into JSAs with NBC with respect to 14 of our stations serving 12 markets also served by an NBC owned and operated station, and with 28 independently owned NBC affiliated stations serving our markets. Under the JSAs, the NBC stations sell all non-network advertising of our stations and receive commission compensation for those sales, and each of our stations may carry one hour per day of NBC syndicated programming, subject to compliance with our entertainment programming content standards.

Arbitration and FCC Proceedings. In December 2001, we commenced a binding arbitration proceeding against NBC in which we asserted that NBC breached its agreements with us and breached its fiduciary duty to us and to our shareholders. We asserted that NBC's proposed acquisition of Telemundo Communications Group, Inc. ("Telemundo Group") (which was completed in April 2002) violates the terms of the agreements governing the investment and partnership between us and NBC. In September 2002, the arbitrator ruled against us on all of our claims, denying us any of the relief we had sought with respect to what we believed to be NBC's wrongful actions. Accordingly, the provisions of our agreements with NBC remain in effect without change.

We also made two filings with the FCC, one of which requested a declaratory ruling as to whether conduct by NBC, including NBC's influence and apparent control over certain members of our board of directors selected by NBC (all of whom have since resigned from our board), caused NBC to have an attributable interest in us in violation of FCC rules or infringed upon our rights as an FCC license holder. The second FCC filing sought to deny FCC approval of NBC's acquisition of the Telemundo Group's television stations. In an opinion and order adopted April 9, 2002, the FCC granted approval of NBC's applications for consent to the transfer to NBC of control of the Telemundo Group television stations, denied our petition to deny these applications, and granted in part and denied in part our request for a declaratory ruling. The FCC found that the placement of NBC employees on our board and the subsequent actions of these persons in their capacity as our directors, including a finding that one such director was protecting NBC's interests and not acting as an independent member of our board, resulted in NBC having an attributable interest in us in violation of the FCC's multiple ownership rules. The FCC determined that admonishment was the appropriate remedy and further inquiry was not necessary. The FCC further indicated that should NBC choose to exercise its rights to nominate new members of our board of directors, the FCC would require that such persons not be NBC employees or agents but persons who would reasonably be expected to act independently in all future matters concerning our company.

COMPETITION

We compete for audience and advertisers and our television stations are located in highly competitive markets and face strong competition on all levels.

Audience. Television stations compete for audience share principally on the basis of program popularity, as measured and reported by Nielsen Media Research, the primary audience measurement service used for buying and selling advertising time. Audience size, as reflected by Nielsen ratings, has a direct effect on advertising rates. Our PAX TV programming competes for audience share in all of our markets with the programming offered by other broadcast networks, local and national cable networks and non-network affiliated television stations. We believe our stations also compete for audience share in their respective markets on the basis of their channel positions on the cable systems which carry our programming, and that the ability to view our programming on the lower numbered channel positions (generally below channel 21) generally improves the likelihood that viewers will watch our programming.

Our stations also compete for audience share with other forms of entertainment programming, including home entertainment systems and direct broadcasting satellite video distribution services which transmit programming directly to homes equipped with special receiving antennas and tuners. Further advances in technology may increase competition for household audiences.

Advertising. PAX TV competes for advertising revenues principally with other broadcast and cable television networks and to some degree with other nationally distributed advertising media, such as print publications. During the annual "up front" process, broadcast and cable networks and nationally syndicated program suppliers seek to obtain advance

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commitments from advertisers to purchase commercial air time, and competition occurs principally on the basis of the advertisers' perception of the anticipated popularity (i.e., ratings) of programming for the upcoming broadcast season, the demographic groups to which the programming is expected to appeal, and the anticipated economics of supply and demand for advertising time during the course of the new season, also known as the "scatter" market.

Our television stations also compete for advertising revenues with other television stations in their respective markets, as well as with other advertising media, such as newspapers, radio stations, magazines, outdoor advertising, transit advertising, yellow page directories, direct mail and local cable systems. Competition for advertising dollars at the television station level occurs primarily within individual markets. Some national advertisers may be more interested in buying groups or markets, either on a regional basis that align to products' distribution patterns, or among larger markets, such as the top 50, as those markets represent approximately two-thirds of the nation's television households. We believe owning and operating stations located primarily in the top 50 markets is more attractive to national advertisers with broad-based distribution of products and services. Generally, a television station in one market does not compete with stations in other market areas.

FEDERAL REGULATION OF BROADCASTING

The FCC regulates television broadcast stations under the Communications Act. The following is a brief summary of certain provisions of the Communications Act and the rules of the FCC.

License Issuance and Renewal. The Communications Act provides that a broadcast station license may be granted to an applicant if the public interest, convenience and necessity will be served thereby, subject to certain limitations. Television broadcast licenses generally are granted and renewed for a period of eight years. Interested parties including members of the public may file petitions to deny a license renewal application but competing applications for the license will not be accepted unless the current licensee's renewal application is denied. The FCC is required to grant a license renewal application if it finds that the licensee (1) has served the public interest, convenience and necessity; (2) has committed no serious violations of the Communications Act or the FCC's rules; and (3) has committed no other violations of the Communications Act or the FCC's rules which would constitute a pattern of abuse. Our licenses are subject to renewal at various times between 2004 and 2007.

General Ownership Matters. The Communications Act requires the prior approval of the FCC for the assignment of a broadcast license or the transfer of control of a corporation or other entity holding a license. In determining whether to approve such an assignment or transfer of control, the FCC considers, among other things, the financial and legal qualifications of the prospective assignee or transferee, including compliance with rules limiting the common ownership of certain attributable interests in broadcast, cable and newspaper properties.

The FCC's multiple ownership rules may limit the acquisitions and investments that we may make or the investments that others may make in us. The FCC generally applies its ownership limits to attributable interests held by an individual, corporation, partnership or other association or entity. In the case of corporations holding or controlling broadcast licenses, the interests of officers, directors and those who, directly or indirectly, have the right to vote five percent or more of the corporation's stock are generally attributable. The FCC treats all partnership and limited liability company interests as attributable, except for those interests that are insulated under FCC rules and policies. For insurance companies, certain regulated investment companies and bank trust departments that hold stock for investment purposes only, stock interests become attributable with the ownership of 20% or more of the voting stock of the corporation holding or controlling broadcast licenses.

Under the FCC's "single majority shareholder" exception, the FCC generally does not treat any minority voting shareholder as attributable if one person or entity (such as Mr. Paxson in the case of our company) holds more than 50% of the combined voting power of the common stock of a company holding or controlling broadcast licenses. The FCC currently is considering whether to retain, modify, or eliminate this exception in a pending rulemaking proceeding. We cannot predict at this time the rules that the FCC may adopt or how the new rules might affect the single majority shareholder exception as it applies to the ownership of television stations.

The FCC treats as attributable debt and equity interests that, when combined, exceed 33% of a station licensee's total assets, which is defined as the total amount of debt and equity capital, if the party holding the equity and debt interests (1) supplies more than 15% of the station's total weekly programming or (2) has an attributable interest in another media entity, whether television, radio or newspaper, in the same market. Non-voting equity, loans, and insulated interests count toward the 33% equity/debt threshold. Non-conforming interests acquired before November 7, 1996, are permanently



grandfathered for purposes of the equity/debt rules and thus do not constitute attributable ownership interests.

Television National Ownership Rule. On June 2, 2003, the FCC adopted new rules governing, among other things, national and local ownership of television broadcast stations and cross-ownership of television broadcast stations with radio broadcast stations and newspapers serving the same market. The new rules would change the regulatory framework within which television broadcasters hold, acquire and transfer broadcast stations. Numerous parties have asked the FCC to reconsider portions of its decision and other parties have sought judicial review. On September 3, 2003, the U. S. Court of Appeals for the Third Circuit issued an order staying the effectiveness of the new media ownership rules pending its review of the FCC's action. Argument on the merits of the underlying appeal of the FCC's order was held on February 11, 2004. Further, legislation regarding indecent broadcasts has recently been passed by the House of Representatives. The bill on indecent broadcasts that has been introduced in the Senate would also result in the suspension of the effectiveness of the FCC's newly adopted ownership rule changes for a period of one year, with the prior rules remaining in effect during the one year period. The legislation would require the United States General Accounting Office to conduct a study during that one year period to determine whether any relationship exists between the horizontal and vertical consolidation of media companies and the number of violations (and complaints regarding violations) of indecency prohibitions under applicable laws and regulations.

Among other things, the FCC's new rules would have increased the percentage of the nation's television households that may be served by television broadcast stations in which the same person or entity has an attributable interest from 35% to 45% of national television households. The Consolidated Appropriations Act of 2004, which became law on January 23, 2004, directed the FCC to increase this percentage to 39% of national television households and allows an entity that acquires licensees in excess of 39% two years to come into compliance with the new cap. The enactment of the 39% cap mooted the FCC's proposed 45% cap. The Third Circuit has not ruled on whether the Consolidated Appropriations Act of 2004 mooted any other issues before it. This act also provides that the FCC shall conduct a quadrennial, rather than biennial, review of its ownership rules. The new rules also relax FCC restrictions on local television ownership and on cross-ownership of television stations with radio stations or newspapers in the same market. In general, these new rules would reduce the regulatory barriers to the acquisition of an interest in our television stations by various industry participants who already own television stations, radio stations, or newspapers.

In assessing compliance with the national ownership caps, the FCC counts each UHF station as serving only half of the television households in its market. This "UHF Discount" is intended to take into account that UHF stations historically have provided less effective coverage of their markets than VHF stations. All of our television stations are UHF stations and, without the UHF Discount, we would not meet the old 35% national coverage cap, the 45% cap that was proposed by the FCC or the 39% cap that is now in effect under the recently enacted Consolidated Appropriations Act of 2004. In its June 2, 2003 decision, the FCC concluded that the future transition to digital television may eliminate the need for a UHF Discount. For that reason, the FCC provided that the UHF Discount will "sunset"--i.e., expire--for the top four broadcast networks (ABC, NBC, CBS, and Fox) on a market-by-market basis as the digital transition is completed, unless otherwise extended by the FCC. The FCC also announced, however, that it will examine in a future review (as noted above, the FCC is required to conduct such reviews on a quadrennial basis under the Consolidated Appropriations Act of 2004) whether to include in this sunset provision the UHF television stations owned by other networks and group owners, which would include our television stations.

Since the FCC's adoption of the new rules, in addition to the legislation enacting the 39% cap, separate legislation has been introduced in Congress to prohibit the application of the UHF Discount to UHF stations sold after June 2, 2003, to sunset the UHF Discount in 2008 for all UHF stations, to prohibit the cross ownership of newspapers and television stations in the same market and to nullify in their entirety the rule changes adopted by the FCC. Further, several parties have filed petitions urging the FCC to eliminate the UHF Discount altogether. On February 19, 2004, the FCC announced that it is seeking public comment regarding the effect of the Consolidated Appropriations Act of 2004 on the FCC's authority to modify or eliminate the UHF Discount.

Television Duopoly Rule. The FCC's television duopoly rule permits a party to own two television stations without regard to signal contour overlap if each station is located in a separate designated market area, or DMA. A party may own two television stations in the same DMA so long as (1) at least eight independently owned and operating full-power commercial and non-commercial television stations remain in the market at the time of acquisition and (2) at least one of the two stations is not among the four top-ranked stations in the market based on audience share. Without regard to the number of independently owned television stations or "media voices," the FCC permits television duopolies within the same DMA so long as the stations' Grade B service contours do not overlap. Satellite stations that are authorized to rebroadcast the programming of a "parent" station located in the same DMA are also exempt from the duopoly rule. On April 2, 2002, the U.S. Court of Appeals for the District of Columbia Circuit reversed the FCC's decision establishing an eight "media voice" standard for same-market television duopolies. The court remanded the proceeding to the FCC to consider whether it should include in its definition of "media voices" other media (i.e., newspapers, radio, and cable). The court also suggested that, on remand, the FCC may decide to adjust the numerical limit of eight.



On June 2, 2003 the FCC adopted new rules governing, among other things, the number of television stations a party may own in the same DMA. Under the new rules, a party would be permitted to have an attributable interest in up to two television stations in the same DMA, provided there were between five and 17 television stations in the DMA and provided that only one of the duopoly stations was among the top four television stations in the market in terms of audience share. Duopolies would not be permitted in markets with fewer than five television stations. In markets with 18 or more television stations, a party would be permitted to own up to three television stations in a DMA, only one of which may be among the top four in terms of audience share. The new rules would also eliminate the contour overlap rule for television. The "media voice" test would be eliminated and the number of television stations in a market would be calculated by counting all full-power commercial and noncommercial television stations located within a given DMA. Neither cable channels, Class A television stations, low power television stations, television translator stations nor dark or non-operational stations would be included in the count. Satellite television stations would also be excluded from the count, if the parent and satellite station were located within the same DMA.

The effectiveness of these new rules has been stayed by the order of the U.S. Court of Appeals for the Third Circuit described above.

Television/Newspaper Radio/Television Cross Ownership. On June 2, 2003, the FCC removed the newspaper-broadcast and radio-television cross-ownership prohibitions and replaced them with a new set of "cross-media limits." The FCC continued, however, to prohibit common ownership of daily newspapers and broadcast stations, and television/radio combinations in markets with three or fewer television stations. In markets having between four and eight television stations, the new rules would limit ownership to one of the following combinations: (1) a daily newspaper, one television station and up to half of the radio station limit for the market; (2) a daily newspaper, no television station and up to the radio station limit for the market; or (3) two television stations (if allowable under the new rules), no daily newspaper, and up to the radio station limit for the market. In markets having nine or more television stations the cross-media limits would be eliminated completely and only the new local television and local radio ownership rules would apply. Under the new rules, noncommercial television stations would be included in the station count.

The effectiveness of these new rules has been stayed by the order of the U.S. Court of Appeals for the Third Circuit described above.

Television Time Brokerage and Joint Sales Agreements. Over the past few years, a number of television stations, including certain of our television stations, have entered into agreements commonly referred to as time brokerage agreements and joint sales agreements. Under these agreements, separately owned and licensed stations agree to function cooperatively subject to the requirements of antitrust laws and compliance with the FCC's rules and policies, including the requirement that each party maintain independent control over the programming and operations of its own station. The FCC's attribution and television duopoly rules apply to time brokerage agreements in which one station brokers more than 15% of the broadcast time per week of another station in the same DMA with an overlapping Grade B contour.

A joint sales agreement, or "JSA," is an arrangement by which a brokering station provides advertising sales services, but not programming, for another station in the market. In its June 2, 2003 decision, the FCC stated that it intends in the future to begin a rule making proceeding to consider whether to treat a television licensee's JSA to sell the advertising time of another television station in the same market as the equivalent of ownership of that station for purposes of the FCC's local television ownership rules. The FCC may adopt rules affecting these arrangements that could adversely affect our current station operations under existing JSAs. We cannot predict what rules the FCC will adopt or what effect any new rules are likely to have.

Alien Ownership. Under the Communications Act, no FCC broadcast license may be held by a corporation of which more than one-fifth of its capital stock is owned or voted by aliens or their representatives or by a foreign government or its representative, or by any corporation organized under the laws of a foreign country (collectively "Aliens"). Furthermore, the Communications Act provides that no FCC broadcast license may be granted to any corporation controlled by any other corporation of which more than one-fourth of its capital stock is owned of record or voted by Aliens if the FCC should find that the public interest would be served by the refusal of the license.

Dual Network Rule. FCC rules permit the combination of television broadcast networks, except for a combination of any two of the four major networks (ABC, CBS, Fox or NBC). The FCC retained the current rule in its June 2, 2003 report and order.



Programming and Operation. The Communications Act requires broadcasters to present programming that responds to community problems, needs and interests and to maintain records demonstrating its responsiveness. Stations also must follow rules that regulate, among other things, obscene and indecent broadcasts, sponsorship identification, the advertising of contests and lotteries and technical operations, including limits on radio frequency radiation.

The FCC's rules limit the amount of advertising in television programming designed for children 12 years of age and under. The FCC effectively requires that television broadcast stations air specified amounts of programming during specified time periods that serve the educational and informational needs of children 16 years of age and under.

The Communications Act and FCC rules also regulate the broadcasting of political advertisements by television stations. Stations must provide "reasonable access" for the purchase of time by legally qualified candidates for federal office and "equal opportunities" for the purchase of equivalent amounts of comparable broadcast time by opposing candidates for the same elective office. Before primary and general elections, legally qualified candidates for elective office may be charged no more than the station's "lowest unit charge" for the same class of advertisement, length of advertisement and daypart.

In March 2002, Congress enacted the Bipartisan Campaign Reform Act of 2002 ("BCRA") (also known as the McCain-Feingold campaign finance bill). In December 2003, the U.S. Supreme Court upheld the BCRA, including provisions which affect broadcasters. The BCRA modifies the regulation of certain aspects of political campaign fundraising and expenditures, and imposes new restrictions on the broadcast of "issue advertisements." In addition, Congress previously has considered and may in the future consider amending the political advertising laws by changing the statutory definition of "lowest unit charge" in a manner which would require television stations to sell time to federal political candidates at lower rates. We are unable to predict whether additional changes to the political broadcasting laws will be enacted, or what effect, if any, these changes might have upon our business.

Equal Employment Opportunity Requirements. Existing FCC rules require all broadcast station employment units with five or more full-time employees to comply with certain general and specific recruitment, outreach, and reporting requirements. All broadcast licensees must refrain from engaging in employment discrimination based on race, color, religion, national origin or sex (with a limited exception for religious broadcasters). The FCC is considering applying these rules to part-time positions.

Cable "Must Carry"/Retransmission Consent Regulations. Under the Communications Act, every local commercial television broadcast station must elect once every three years to require a cable system to carry the station subject to certain exceptions, or to negotiate for retransmission consent to carry the station. A station's "must carry" rights are not absolute, and their exercise depends on variables such as the number of activated channels on a cable system, the location and size of a cable system, the amount of duplicative programming on the station, and the quality of the station's signal at the cable system's headend. Alternatively, if a broadcaster chooses to exercise retransmission consent rights, it can prohibit cable systems from carrying its signal or grant the cable system consent to retransmit the broadcast signal for a fee or other consideration. Our television stations have generally elected the "must carry" alternative. Our elections of retransmission or "must carry" status will continue until the next election period, which commences on January 1, 2006.

In an ongoing rulemaking proceeding, the FCC is considering rules to govern the obligations of cable television systems to carry the analog and digital television signals of local television stations or to obtain retransmission consent to carry those signals during and following the transition from analog to digital broadcasting. In an initial order in the proceeding, the FCC tentatively concluded that broadcasters would not be entitled to mandatory carriage of both their analog and digital signals and that broadcasters with multiple digital video programming streams would be required to designate a single, primary video stream eligible for mandatory carriage. Alternatively, television licensees may negotiate with cable television systems for carriage of their digital signal in addition to their analog signal under retransmission consent.

Under retransmission consent agreements, some of our television stations are also carried as distant signals on cable systems that are located outside of those stations' markets. Cable systems generally must remit a compulsory license royalty fee to the United States Copyright Office to carry television stations in distant markets. We have filed a request with the Copyright Office to change our stations' status under the compulsory license from "independent" to "network" signals. If the Copyright Office grants our request, certain cable systems may transmit our stations at reduced royalty rates.



We cannot determine when the Copyright Office will act on this request, or whether we will receive a favorable ruling.

Satellite Carriage of Television Broadcast Signals. Under the Satellite Home Viewer Improvement Act of 1999, which we refer to as SHVIA, a satellite carrier must obtain retransmission consent before carrying a television station, and a satellite carrier delivering the signal of any local television station is required to carry all television stations licensed to the carried station's DMA. The SHVIA will expire at the end of 2004. Legislation introduced in January 2004 proposes to extend the SHVIA for an additional five years. The FCC rules implementing SHVIA are similar to the must-carry and retransmission consent rules that apply to cable television systems. Our PAX TV signal currently is carried on satellite systems under agreements we negotiated with the satellite television providers, which allow the satellite provider to sell and retain the advertising revenues from a portion of the non-network advertising time during PAX TV programming hours and which require the carriage of some of our television stations in certain circumstances.

Digital Television Service. The FCC has adopted rules for the implementation of digital television, or DTV, service, a technology which is intended to improve the quality of television broadcast signals. The FCC allotted a second channel for DTV operations to each broadcaster who held a license or a construction permit for a full service television station on April 3, 1997. Each such licensee and permittee must return one of its two channels at the end of the DTV transition period currently scheduled to end on December 31, 2006. The transition period could be extended in certain areas depending generally on the level of DTV market penetration or if the FCC or Congress changes the schedule. Except for certain stations operating analog facilities in the 700 MHz spectrum band that have been allotted a digital channel in the 700 MHz spectrum band, the FCC has established a schedule by which broadcasters must begin DTV service absent extenuating circumstances that may affect individual stations.

Under the FCC's digital television transition rules a station will be in compliance with its build-out requirement, without constructing the full authorized facilities, so long as, by May 1, 2002, it constructed digital facilities capable of serving its community of license with a signal of requisite strength. The date by which digital facilities replicating a station's analog service area must be constructed will be set by the FCC at a later date. The FCC, by order released September 17, 2001, authorized analog stations operating in the 700 MHz spectrum band that have entered into voluntary agreements with future users of the 700 MHz spectrum resulting in the surrender of the analog 700 MHz channel to continue broadcasting their analog signal on the channel assigned for digital service and to delay the institution of digital service until December 31, 2005, or later than December 31, 2005 if it can be demonstrated that less than 70% of the television households in the station's market are capable of receiving digital broadcast signals. Broadcasters given a digital channel allocation within the 700 MHz band may forego the use of that channel for digital service until December 31, 2005, or later than December 31, 2005, if it can be demonstrated that less than 70% of the television households in the station's market are capable of receiving digital broadcast signals. Broadcasters left with a single-channel allotment as a result of clearing the 700 MHz spectrum band will retain the interference protection associated with their digital television channel allotment for a period of 31 months after beginning to transmit in digital.

The FCC has adopted rules permitting DTV licensees to offer "ancillary or supplementary services" on their DTV channels, so long as such services are consistent with the FCC's DTV standards, do not derogate required DTV services, and are regulated in the same manner as similar non-DTV services. The FCC's rules require that DTV licensees pay a fee (based on revenues) for any subscription-based services that are provided. The FCC has commenced a proceeding to consider additional public interest obligations for television stations as they transition to digital broadcast television operation. The FCC is considering various proposals that would require DTV stations to use digital technology to increase program diversity, political discourse, access for disabled viewers and emergency warnings and relief. If these proposals are adopted, our stations may be required to increase their current level of public interest programming, which generally does not generate as much revenue from commercial advertisers.

Proposed Changes. Congress and the FCC have under consideration, and may in the future adopt, new laws, regulations and policies regarding a wide variety of matters that could, directly or indirectly, affect our operation, ownership and profitability of our company and our television broadcast stations. We cannot predict what other matters may be considered in the future, nor can we judge in advance what effect, if any, the implementation of any of these proposals or changes might have on our business.

EMPLOYEES

As of December 31, 2003, we had 461 full-time employees and 39 part-time employees. None of our employees are



represented by labor unions. We consider our relations with our employees to be good.

SEASONALITY

Seasonal revenue fluctuations are common within the television broadcasting industry and result primarily from fluctuations in advertising expenditures. We believe that generally television advertisers spend relatively more for spot advertising in the second and fourth calendar quarters of each year, spend relatively less for spot advertising during the first calendar quarter and spend the least for spot advertising in the third calendar quarter. We believe that generally television advertisers spend relatively more for long form paid programming in the first and fourth calendar quarters of each year, spend relatively less for long form paid programming in the second calendar quarter and spend the least for long form paid programming in the third calendar quarter.

TRADEMARKS AND SERVICE MARKS

We have 19 registered trademarks and service marks (13 in the United States and 6 in Mexico) and pending applications for registration of another 38 trademarks and service marks (30 in the United States, 3 in Canada and 5 in Mexico). We do not own any patents or have any pending patent applications.

AVAILABLE INFORMATION

Our internet website address is "www.pax.tv". We make available free of charge through our internet website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. Prior to March 3, 2003, we made these reports and amendments available through a third party provider which, under certain circumstances, charged a fee for access to those reports and amendments.

FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS AND UNCERTAINTIES

This Report contains "forward-looking statements" that reflect our current views with respect to future events. All statements in this Report other than those that are simply statements of historical facts are generally forward-looking statements. These statements are based on our current assumptions and analysis, which we believe to be reasonable, but are subject to numerous risks and uncertainties that could cause actual results to differ materially from our expectations. All forward-looking statements in this Report are made only as of the date of this Report, and we do not undertake to update these forward-looking statements, even though circumstances may change in the future.

Among the significant risks and uncertainties which could cause actual results to differ from those anticipated in our forward-looking statements or could otherwise adversely affect our business or financial condition are those described below.

We have a high level of indebtedness and are subject to restrictions imposed by the terms of our indebtedness and preferred stock.

We are highly leveraged. As of December 31, 2003 we had total indebtedness of $925.6 million, approximately $336.1 million of which would have been senior secured indebtedness, and redeemable preferred stock with an aggregate redemption value of approximately $1.1 billion (approximately $968.2 million of which would have been exchangeable, under certain circumstances, into senior subordinated indebtedness). We may incur limited amounts of additional indebtedness to finance capital expenditures and for certain other corporate purposes. Our ability to incur indebtedness will be subject to restrictions in the terms of the indentures governing our senior secured notes and our senior subordinated notes, as well as the terms of our outstanding preferred stock. The level of our indebtedness and redeemable preferred stock has important consequences to us, including that most of our cash flow from operations must be dedicated to debt service and will not be available for other purposes. Many of our competitors currently operate on a less leveraged basis and may have significantly greater operating and financing flexibility than us. The indentures and the preferred stock contain covenants that restrict, among other things, our ability to incur additional indebtedness, incur liens, make investments, pay dividends or make other restricted payments, consummate asset sales, consolidate with any other person or sell, assign, transfer, lease, convey or otherwise dispose of all or substantially all of our assets. Currently, these covenants prevent us from incurring additional indebtedness other than limited amounts of certain types of permitted indebtedness (e.g., purchase money indebtedness), although certain refinancings of existing debt are permitted. These restrictions could limit our ability to obtain future financing, make acquisitions or needed capital expenditures, withstand a future downturn in our business or the economy in general, conduct operations or otherwise take



advantage of business opportunities that may arise. If we were unable to service our indebtedness or satisfy our dividend or redemption obligations with respect to our outstanding preferred stock, we would be forced to adopt an alternative strategy that may include actions such as reducing or delaying capital expenditures, selling assets, restructuring or refinancing our indebtedness or seeking additional equity capital. There is no assurance that any of these strategies could be effected on satisfactory terms, if at all.

We have a history of operating losses and negative cash flow and we may not become profitable in the future.

We have incurred losses from continuing operations in each fiscal year since our inception. As a result of these net losses, for the years ended December 31, 2003, 2002 and 2001, our earnings were insufficient to cover our combined fixed charges and preferred stock dividend requirements by approximately $139.8 million, $255.5 million and $342.2 million, respectively. We expect to continue to experience net losses in the foreseeable future, principally due to interest charges on outstanding debt (and the debentures into which our outstanding preferred stock can be exchanged, if issued), dividends on outstanding preferred stock, and non-cash charges for depreciation and amortization expense related to fixed assets. Future net losses could be greater than those we have experienced in the past.

Our cash flow from operations has been insufficient to cover our operating expenses, debt service requirements and other cash commitments in each of our last five fiscal years. We have financed our operating cash requirements, as well as our capital needs, during these periods with the proceeds of asset sales and financing activities, including the issuance of preferred stock and additional borrowings. We may not be able to generate sufficient operating cash flow in the future to pay our debt service and preferred stock dividend requirements and may not be able to obtain sufficient additional financing to meet such requirements on terms acceptable to us, or at all.

We believe that absent significant improvement in our ratings and revenues, our business operations are unlikely to provide sufficient cash flow to support our debt service and preferred stock dividend requirements. We have engaged Bear, Stearns & Co. Inc. and Citigroup Global Markets Inc. to act as our financial advisors to assess our business plan, capital structure and future capital needs, and to explore strategic alternatives for our company. These strategic alternatives may include the sale of all or part of our assets, finding a strategic partner for our company who would provide the financial resources to enable us to redeem, restructure or refinance our debt and preferred stock, or finding a third party to acquire our company through a merger or other business combination or through a purchase of our equity securities. See "Forward-Looking Statements and Associated Risks and Uncertainties--The outcome of our exploration of strategic alternatives is uncertain."

PAX TV may not be successful as a broadcast television network.

We launched our PAX TV entertainment programming on August 31, 1998, and are now in our sixth network broadcasting season. Our own experiences, as well as the experiences of other new broadcast television networks during the past decade, indicate that it requires a substantial period of time and the commitment of significant financial, managerial and other resources to gain market acceptance of a new television network by viewing audiences and advertisers to a sufficient degree that the new network can attain profitability. Although we believe that our approach is unique among broadcast television networks, in that we own and operate stations reaching most of the television households that can receive PAX TV, our business model is unproven and to date has not been successful. In January 2003, we significantly reduced the number of entertainment programming hours per week on PAX TV and began airing long form paid programming during these hours. PAX TV may not gain sufficient market acceptance to be profitable or otherwise be successful.

If the audience ratings of our entertainment programming were to continue to decline, or the rates at which we are able to sell long form paid programming were to decline, our advertising revenue could decrease.

Advertising revenues constitute substantially all of our operating revenues. Our ability to generate advertising revenues depends upon our ability to sell our inventory of air time for long form paid programming at acceptable rates and, with respect to entertainment programming, to provide programming which attracts sufficient numbers of viewers in desirable demographic groups to generate audience ratings that advertisers will find attractive. Long form paid programming rates are dependent upon a number of factors, including our available inventory of air time, the viewing public's interest in the products and services being marketed through long form paid programming, and economic conditions generally. Our revenues from the sale of air time for long form paid programming may decline. Our entertainment programming has not attracted sufficient targeted viewership or achieved sufficiently favorable ratings to enable us to generate enough



advertising revenues to be profitable. Our ratings have declined since we increased the amount of long form paid programming on PAX TV in January 2003. Our ratings may continue to decline, which would adversely affect that portion of our advertising revenues derived from the sale of commercial spots during our entertainment programming. We incur production, talent and other ancillary costs to produce original entertainment programs. Our original entertainment programming may not generate advertising revenues in excess of our programming and other costs.

We may lose a portion of the PAX TV network's distribution platform.

A number of our carriage agreements in markets where we do not own a television station place restrictions on the type of programming that we may broadcast on the local cable system. In certain cases, local cable operators have notified us that we are exceeding the number of hours of infomercial programming that we may broadcast on the operator's system. We are currently in discussions with these local cable operators to remove the restrictions. If we are unsuccessful in negotiating the elimination of these restrictions, we may be required to distribute additional entertainment programming over these cable systems in order to remain in compliance with our carriage agreements, or face the possibility of termination of these carriage agreements. We believe that we have the ability to provide additional entertainment programming to these systems at a negligible cost. Our revenues could decrease, however, if we were required to replace infomercials with additional entertainment programming.

The results of operations of our stations which operate under joint sales agreements substantially depend on the performance of our JSA partners.

The performance of our stations operating under JSAs depends to a substantial degree on the performance of our JSA partners, over which we have no control. In addition, if we elect to terminate a JSA in a particular market, we may incur significant costs to transfer the JSA to another broadcast television station operator or to resume operating the station ourselves.

If advertisers have to pay higher residual payments to the members of the actors' guilds that they use in spot advertisements on our network, advertisers may reduce or discontinue their advertising on our network.

Approximately 33% of our 2002 revenues and 21% of our 2003 revenues were derived from network commercial spot advertisements aired on PAX TV. We believe substantially all of our network spot advertisements were produced by advertisers or their advertising agencies using performers who are members of the Screen Actors Guild and the American Federation of Television and Radio Artists. When commercials are aired on broadcast and cable television networks, the performers are entitled to residual payments from the advertisers, which are determined under collective bargaining agreements between the guilds and the advertising community. Under the current guild agreements, the residual payments required to be paid by advertisers in connection with advertisements aired on cable networks are substantially lower than the residuals required to be paid in connection with advertising aired on broadcast networks. To date, we believe that a substantial portion of the network spot advertising time on PAX TV was purchased by advertisers under the assumption that the residual payment obligations incurred in connection with airing these spots were to be calculated under the rates applicable to cable networks, not those applicable to other broadcast networks. The current guild agreements include provisions establishing residual rates that are applicable to network advertisements aired on PAX TV and that are substantially lower than the rates applicable to broadcast networks but still higher, in most circumstances, than the rates applicable to cable networks. As a result of this development, some advertisers have informed us that our network advertising spots are no longer as attractive as those of cable networks because of the relatively higher residual payments applicable to PAX TV. Because of these higher residual payments, some advertisers may be unwilling to purchase advertising time on PAX TV unless we lower our rates or otherwise provide financial compensation to them. We are unable to predict the magnitude of the effect of this development on our network spot advertising revenues.

Change of Control.

In the event of a "change of control" (as defined in the indentures governing our outstanding senior secured notes and senior subordinated notes), we will be required to offer to purchase all of the outstanding notes at a price equal to 101% (or 100% in the case of the senior secured notes, with respect to any change of control occurring on or after January 15, 2006) of the principal amount or accreted value, as the case may be, thereof. In the event of a "change of control" (as defined with respect to our outstanding preferred stock), we will be required to offer to purchase all of the shares of these preferred stocks then outstanding at 101% (100% for the Series A preferred stock) of the then effective liquidation preference thereof, plus accumulated and unpaid dividends. Generally, under these instruments a change of control will be



deemed to have occurred if any person, other than Mr.Paxson and his affiliates or, with respect to the senior secured notes and senior subordinated notes, NBC and its affiliates, acquires control of a majority of the voting power of our outstanding capital stock or acquires more than one-third of the outstanding voting power and possesses voting power in excess of that possessed by Mr. Paxson and his affiliates (or, with respect to the senior secured notes and senior subordinated notes, NBC and its affiliates), or there is a merger and we are not the surviving corporation and our stockholders do not own at least a majority of the outstanding common stock of the surviving corporation. Our repurchase of our outstanding senior subordinated notes or the redemption of any of our preferred stock upon a change of control could also cause a default under the senior secured notes indenture. We can provide no assurance that in the event of a change of control, we will have access to sufficient funds or will be contractually permitted under the terms of our outstanding debt to repay our outstanding senior secured notes and senior subordinated notes or pay the required purchase price for any shares of preferred stock tendered by holders. Were this to occur, we could be required to seek third party financing to the extent we did not have sufficient available funds to meet our purchase obligations, and we can provide no assurance that we would be able to obtain this financing on favorable terms or at all.

NBC's exercise of its rights to exert significant influence upon our operations could adversely affect our business.

As a result of our agreements with NBC, NBC is in a position to exert significant influence over our management and policies and to prevent us from taking actions which our management may otherwise desire to take. NBC may have interests that differ from those of our other stockholders and debtholders. We must obtain NBC's consent for:

- approval of annual budgets;
- expenditures materially in excess of budgeted amounts;
- material acquisitions of programming;
- material amendments to our certificate of incorporation or bylaws;
- material asset sales or purchases, including sales of our television stations which are located in the top twenty DMAs;
- business combinations where we would not be the surviving corporation or as a result of which we would experience a change of control;
- issuances or sales of any capital stock, with some exceptions;
- stock splits or recombinations;
- any increase in the size of our board of directors other than an increase resulting from provisions of our outstanding preferred stock of up to two additional directors; and
- joint sales, joint services, time brokerage, local marketing or similar agreements as a result of which our stations with national household coverage of 20% or more would be subject to those agreements.

We may not be able to redeem our securities held by NBC that NBC has demanded that we redeem and this could have adverse consequences for us.

On November 13, 2003, NBC exercised its right to demand that we redeem, or arrange for a third party to acquire, all of the shares of our Series B preferred stock held by NBC, at a price equal to the aggregate liquidation preference thereof plus accrued and unpaid dividends, which as of December 31, 2003, totaled $557.5 million. Should we fail to effect a redemption within one year after November 13, 2003, NBC will be permitted to transfer, without restriction, any of our securities acquired by it, its right to acquire Mr. Paxson's Class B common stock, its contractual rights with respect to our business, and its other rights under the related transaction agreements. Our ability to effect any redemption is restricted by the terms of our outstanding debt and preferred stock. Further, we do not currently have sufficient funds to pay the redemption price for these securities. In order to comply with NBC's redemption demand, we expect that we will need to repay, refinance or otherwise restructure the majority of our outstanding indebtedness and preferred stock and raise sufficient liquidity to enable us to pay the required redemption price. Alternatively we may find a third party willing to purchase those securities at the required redemption price. If we were unable to complete a redemption, we would be unable to prevent NBC from transferring its interest in our company to a third party selected by NBC in its discretion, which could have a material adverse effect upon us.



NBC's demand for redemption may have an adverse effect upon our operating relationships with NBC.

We have significant operating relationships with NBC which have been developed since NBC's investment in us in September 1999. NBC serves as our exclusive sales representative to sell most of our PAX TV network advertising and is the exclusive national sales representative for most of our stations. We have entered into JSAs with stations owned by or affiliated with NBC with respect to 42 of our television stations. Each JSA typically provides for our JSA partner to serve as our exclusive sales representative to sell our local station advertising and for many of our station's operations to be integrated and co-located with those of the JSA partner. If NBC ceases to hold an investment in our securities, NBC and the NBC affiliates will have the ability to elect to terminate the agreements under which these operating relationships have been implemented. Should NBC or the NBC affiliates elect to terminate these agreements, we could be required to incur significant costs to resume performing the advertising sales and other operating functions currently performed by NBC and our JSA partners, including the expense of re-establishing office and studio facilities separate from those of the JSA partners, or to transfer performance of these functions to another broadcast television station operator. Our network and station revenues could also be adversely affected by the disruption of our advertising sales efforts that could result from the unwinding of the JSAs. The unwinding or termination of some or all of our JSAs could have a materially adverse effect upon us. We are unable to predict the effect, if any, that NBC's demand that we redeem our securities held by it may have upon our current operating relationships with NBC. We would expect, however, that NBC would seek to terminate these relationships if it were to cease holding an investment in our securities.

The adjustment to the dividend rate on our Series B preferred stock that will occur in September 2004 could have adverse consequences for our business.

On September 15, 2004, the rate at which dividends accrue on our Series B preferred stock, all of which is held by NBC, will be adjusted to a market rate, determined by a nationally recognized independent investment banking firm chosen by us, at which the Series B preferred stock would trade at its liquidation preference. As described in greater detail above under "Forward-Looking Statements and Associated Risks and Uncertainties--We have a high level of indebtedness and are subject to restrictions imposed by the terms of our indebtedness and preferred stock," a material increase in the dividend rate on our Series B preferred stock resulting from this adjustment process could have material adverse consequences for us.

The outcome of our exploration of strategic alternatives is uncertain.

We have engaged Bear, Stearns & Co. Inc. and Citigroup Global Markets Inc. to act as our financial advisors and explore strategic alternatives for our company. These strategic alternatives may include the sale of all or part of our assets, finding a strategic partner for our company who would provide the financial resources to enable us to redeem, restructure or refinance our debt and preferred stock, or finding a third party to acquire our company through a merger or other business combination or acquisition of our equity securities. Our ability to pursue strategic alternatives is subject to various limitations and issues which we may be unable to control. A strategic transaction will, in most circumstances, require that we seek the consent of, or refinance, redeem or repay, NBC and the other holders of our preferred stock, as well as the holders of our senior and subordinated debt. FCC regulations may limit the type of strategic alternatives we may pursue and the parties with whom we may pursue strategic alternatives. In addition, our ability to pursue a strategic alternative will be dependent upon the attractiveness of our assets and business plan to potential new transaction parties. Among other things, potential transaction parties may find unattractive our capital structure and high level of indebtedness, our carriage of the PAX TV programming and the overnight programming provided by The Christian Network, Inc., and certain of our television stations serving major television markets. Our relatively low tax basis in our television station assets (resulting in part from the Section 1031 like kind exchange discussed below) is a significant factor to be considered in structuring any potential transactions involving sales of a material portion of our television station assets, and may make certain types of transactions less attractive or not viable. Potential transaction parties may believe our stations and other assets to be less valuable than as shown in prior appraisals we have obtained. We may be prevented from consummating a strategic transaction due to any of these and other factors, or we may incur significant costs to terminate obligations and commitments with respect to, or receive less consideration in a strategic transaction as a result of, these and other factors. We may not be successful in our efforts to find or effectuate strategic alternatives for our company.

We could be subject to a material tax liability if the IRS successfully challenges our position regarding the 1997 disposition of our radio division.

We structured the disposition of our radio division in 1997 and our acquisition of television stations during the period following this disposition in a manner that we believed would qualify these transactions as a "like kind" exchange under Section 1031 of the Internal Revenue Code and would permit us to defer recognizing for income tax purposes up to



approximately $333 million of gain. The IRS has examined our 1997 tax return and has issued us a "30-day letter" proposing to disallow all of our gain deferral.

We have filed our protest to this determination with the IRS appeals division, but we cannot predict the outcome of this matter at this time, and we may not prevail. In addition, the "30-day letter" offered an alternative position that, in the event the IRS is unsuccessful in disallowing all of the gain deferral, approximately $62 million of the $333 million gain deferral will be disallowed. We have filed a protest to this alternative determination as well. We may not prevail with respect to this alternative determination. Should the IRS successfully challenge our position and disallow all or part of our gain deferral, because we had net operating losses in the years subsequent to 1997 in excess of the amount of the deferred gain, we would not be liable for any tax deficiency, but could be liable for interest on the tax liability for the period prior to the carryback of our net operating losses. We have estimated the amount of interest for which we could be held liable to be approximately $16.6 million should the IRS succeed in disallowing all of the deferred gain. If the IRS were successful only in disallowing part of the gain under its alternative position, we estimate we would be liable for only a nominal amount of interest.

We could be adversely affected by actions of the FCC, the Congress and the courts that could alter broadcast television ownership rules in a way that would materially affect our present operations or future business alternatives.

On June 2, 2003, the FCC adopted new rules governing, among other things, national and local ownership of television broadcast stations and cross-ownership of television broadcast stations with radio broadcast stations and newspapers serving the same market. The new rules would change the regulatory framework within which television broadcasters hold, acquire and transfer broadcast stations. Numerous parties have asked the FCC to reconsider portions of its decision and other parties have sought judicial review. On September 3, 2003, the U. S. Court of Appeals for the Third Circuit issued an order staying the effectiveness of the new media ownership rules pending its review of the FCC's action. Argument on the merits of the underlying appeal of the FCC's order was held on February 11, 2004. Further, legislation regarding indecent broadcasts has recently been passed by the House of Representatives. The bill on indecent broadcasts that has been introduced in the Senate would also result in the suspension of the effectiveness of the FCC's newly adopted ownership rule changes for a period of one year, with the prior rules remaining in effect during the one year period. The legislation would require the United States General Accounting Office to conduct a study during that one year period to determine whether any relationship exists between the horizontal and vertical consolidation of media companies and the number of violations (and complaints regarding violations) of indecency prohibitions under applicable laws and regulations.

Among other things, the FCC's new rules would have increased the percentage of the nation's television households that may be served by television broadcast stations in which the same person or entity has an attributable interest from 35% to 45% of national television households. The Consolidated Appropriations Act of 2004, which became law on January 23, 2004, directed the FCC to increase this percentage to 39% of national television households and allows an entity that acquires licensees in excess of 39% two years to come into compliance with the new cap. The enactment of the 39% cap mooted the FCC's proposed 45% cap. The Third Circuit has not ruled on whether the Consolidated Appropriations Act of 2004 mooted any other issues before it. This act also provides that the FCC shall conduct a quadrennial, rather than biennial, review of its ownership rules. The new rules also relax FCC restrictions on local television ownership and on cross-ownership of television stations with radio stations or newspapers in the same market. In general, these new rules would reduce the regulatory barriers to the acquisition of an interest in our television stations by various industry participants who already own television stations, radio stations, or newspapers.

In assessing compliance with the national ownership caps, the FCC counts each UHF station as serving only half of the television households in its market. This "UHF Discount" is intended to take into account that UHF stations historically have provided less effective coverage of their markets than VHF stations. All of our television stations are UHF stations and, without the UHF Discount, we would not meet the old 35% national coverage cap, the 45% cap that was proposed by the FCC or the 39% cap that is now in effect under the recently enacted Consolidated Appropriations Act of 2004. In its June 2, 2003 decision, the FCC concluded that the future transition to digital television may eliminate the need for a UHF Discount. For that reason, the FCC provided that the UHF Discount will "sunset"--i.e., expire--for the top four broadcast networks (ABC, NBC, CBS, and Fox) on a market-by-market basis as the digital transition is completed, unless otherwise extended by the FCC. The FCC also announced, however, that it will examine in a future review (as noted above, the FCC is required to conduct such reviews on a quadrennial basis under the Consolidated Appropriations Act of 2004) whether to include in this sunset provision the UHF television stations owned by other networks and group owners, which would include our television stations.

Since the FCC's adoption of the new rules, in addition to the legislation enacting the 39% cap, separate legislation has been introduced in Congress to prohibit the application of the UHF Discount to UHF stations sold after June 2, 2003, to sunset the UHF Discount in 2008 for all UHF stations, to prohibit the cross ownership of newspapers and television stations in the same market and to nullify in their entirety the rule changes adopted by the FCC. Further, several parties have filed petitions urging the FCC to eliminate the UHF Discount altogether. On February 19, 2004, the FCC announced that it is seeking public comment regarding the effect of the Consolidated Appropriations Act of 2004 on the FCC's authority to modify or eliminate the UHF Discount. We cannot predict whether any pending legislation ultimately will be adopted or



whether any petitions for reconsideration or judicial review of the FCC's decision of June 2, 2003 or for elimination of the UHF Discount will result in significant changes to the ownership rules. A further rollback of the nationwide television ownership cap, the prohibition of newspaper and television cross ownership by Congress, any further limitation on the ability of a party to own two television stations without regard to signal contour overlap if each station is located in a separate designated market area, or action by the FCC or Congress affecting the availability of the UHF Discount, may adversely affect the opportunities we might have for sale of our television broadcast stations to those television group owners and major television broadcast networks that otherwise would be the most likely purchasers.

Also, in its June 2, 2003 decision, the FCC stated that it intends in the future to begin a rule making proceeding to consider whether to treat a television licensee's joint sales agreement to sell the advertising time of another television station in the same market as the equivalent of ownership of that station for purposes of the FCC's local television ownership rules. A joint sales agreement, or "JSA," is an arrangement by which a brokering station provides advertising sales services, but not programming, for another station in the market. We have entered into JSAs for 47 of our television stations, 42 of which are with NBC owned or affiliated stations in our markets. The FCC may adopt rules affecting these arrangements that could adversely affect our current operations under existing JSAs. If a rule adopted by the FCC effectively precludes the continuation of our current arrangements, it may be necessary for us to renegotiate aspects of our current relationships. Also, if a new FCC rule were to require that we terminate a JSA in a particular market, we may incur significant costs to transfer the JSA to another broker or to resume operation of the station without the sales and other services of a JSA broker. We cannot predict what rules the FCC will adopt or what effect any new rules are likely to have upon our operations and our present relationship with NBC and NBC's affiliates.

We are required by the FCC to abandon the analog broadcast service of 23 of our full power stations occupying the 700 MHz spectrum and may suffer adverse consequences if we are unable to secure alternative distribution on reasonable terms.

We hold FCC licenses for full power stations which are authorized to broadcast over either an analog or digital signal on channels 52-69 ("the 700 MHz band"), a portion of the broadcast spectrum that is currently allocated to television broadcasting by the FCC. As part of the nationwide transition from analog to digital broadcasting, the 700 MHz band is in the process of being transitioned to use by new wireless and public safety entities. A federal statute requires that, after December 31, 2006, or the date on which 85% of television households in a television market are capable of receiving digital services, incumbent broadcasters must surrender analog signals and broadcast only on their allotted digital frequency. In some cases, broadcasters, including our company, have been given a digital channel allocation within the 700 MHz band of spectrum. During this transition these new wireless and public safety entities are permitted to operate in the 700 MHz band provided they do not interfere with incumbent or allotted analog and digital television operations. The FCC has conducted spectrum auctions to select the future users of portions of the 700 MHz band. Four such auctions have been completed in which future users were selected for 18 MHz of spectrum on channels 54, 55 and 59 and six MHz of spectrum on portions of channels 60, 62, 65 and 67. In addition, the FCC has set aside channels 63-64 and 68-69 for use by public safety entities. On June 19, 2002, Congress passed the Auction Reform Act of 2002 temporarily postponing an auction for commercial uses of