

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

LYNCH INTERACTIVE CORP  
Form 10-Q  
August 14, 2002

SECURITIES & EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q  
-----

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the quarterly period ended June 30, 2002  
-----

or

TRANSITION REPORT PURSUANT TO SECTION 13 OF 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934

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

Commission File No. 1-15097  
-----

LYNCH INTERACTIVE CORPORATION  
-----

(Exact name of Registrant as specified in its charter)

Delaware  
-----

(State or other jurisdiction of  
incorporation or organization)

06-1458056  
-----

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

401 Theodore Fremd Avenue, Rye, New York  
-----

(Address of principal executive offices)

10580  
-----

(Zip Code)

(914) 921-8821  
-----

Registrant's telephone number, including area code

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

Indicate the number of shares outstanding of each of the Registrant's classes of Common Stock, as of the latest practical date.

Class -----	Outstanding at August 1, 2002 -----
Common Stock, \$.0001 par value	2,799,551

INDEX

LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

Condensed Consolidated Balance Sheets:

- June 30, 2002
- December 31, 2001

Condensed Consolidated Statements of Operations:

- Three months ended June 30, 2002 and 2001
- Six months ended June 30, 2002 and 2001

Condensed Consolidated Statements of Cash Flows:

- Three months ended June 30, 2002 and 2001
- Six months ended June 30, 2002 and 2001

Notes to Condensed Consolidated Financial Statements

Item 2. Management's Discussion and Analysis of  
Financial Condition and Results of Operations

Item 3. Quantitative and Qualitative Disclosure About Market Risk

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Item 4. Submission of Matters to a Vote of Security Holders

Item 6. Exhibits and Reports on Form 8-K

SIGNATURE

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(In thousands, except share amounts)

ASSETS

CURRENT ASSETS:

Cash and cash equivalents .....  
Restricted cash .....  
Receivables, less allowances of \$928 and  
\$424, respectively .....  
Material and supplies .....  
Prepaid expenses and other current assets .....  
Current assets of Morgan Group Holding Co. ....  
distributed to shareholders .....

TOTAL CURRENT ASSETS .....

PROPERTY, PLANT AND EQUIPMENT:

Land .....  
Buildings and improvements .....  
Machinery and equipment .....

Accumulated Depreciation .....

GOODWILL .....

OTHER INTANGIBLE ASSETS .....

INVESTMENTS IN AND ADVANCES TO AFFILIATED ENTITIES .....

OTHER ASSETS .....

NON CURRENT ASSETS OF MORGAN GROUP HOLDING CO

DISTRIBUTED TO SHAREHOLDERS .....

TOTAL ASSETS .....

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:

Notes payable to banks .....

Trade accounts payable .....

Accrued interest payable .....

Accrued liabilities .....

Current maturities of long-term debt, includes \$10,500 of convertible notes  
due 2004, but subject to a put provision (See note G) .....

Current liabilities of Morgan Group Holding Co. ....

distributed to shareholders .....

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

TOTAL CURRENT LIABILITIES .....	
LONG-TERM DEBT .....	
DEFERRED INCOME TAXES .....	
OTHER LIABILITIES .....	
MINORITY INTEREST .....	
NON CURRENT LIABILITIES AND MINORITY	
INTERESTS OF MORGAN GROUP HOLDING CO .....	
DISTRIBUTED TO SHAREHOLDERS .....	
COMMITMENTS AND CONTINGENCIES	
SHAREHOLDERS' EQUITY	
COMMON STOCK, \$0.0001 PAR VALUE-10,000,000	
SHARES AUTHORIZED; 2,824,766 ISSUED; 2,802,551	
and 2,820,051 outstanding .....	
ADDITIONAL PAID-IN CAPITAL .....	
RETAINED EARNINGS .....	
ACCUMULATED OTHER COMPREHENSIVE INCOME .....	
TREASURY STOCK, 22,215 and 4,715 shares, at cost .....	
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY .....	

Note: The balance sheet at December 31, 2001 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

See accompanying notes.

LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)  
(In thousands, except per share and share amounts)

	Three Months Ended June 30, 2002	
	2002	2001
SALES AND REVENUES .....	\$ 21,098	\$ 17,000
COSTS AND EXPENSES:		
Operations .....	15,881	12,000
Selling and administrative .....	760	1,000
OPERATING PROFIT .....	4,457	4,000
Other income (expense):		
Gain on sale of cellular partnership .....	--	1,000
Investment income .....	235	1,000

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

Interest expense .....	(3,298)	(3)
Equity in earnings of affiliated companies, predominantly cellular operations .....	224	
	(2,839)	(2)
<hr/>		
INCOME BEFORE INCOME TAXES, MINORITY INTERESTS AND OPERATIONS OF MORGAN GROUP HOLDING CO .....	1,618	2
Provision for income taxes .....	(651)	(1)
Minority Interests .....	(62)	
	905	
<hr/>		
INCOME FROM CONTINUING OPERATIONS .....	905	
Income (loss) from operations of Morgan Group Holding Co. .... distributed to shareholders, net of income taxes of \$0, \$255, \$0 and \$255, respectively and minority interests of \$0, \$(278) \$0 and \$(38), respectively .....	--	
<hr/>		
NET INCOME .....	\$ 905	\$ 1
<hr/>		
Basic weighted average shares outstanding .....	2,809,000	2,822
Diluted weighted average shares outstanding - used in earnings per share computation (if the shares to be issued on conversion of the convertible note were included, fully diluted shares are 3,044,000; 3,057,000; 3,049,000; and 3,057,000, respectively).....	2,809,000	2,822
BASIC EARNINGS PER SHARE		
INCOME FROM CONTINUING OPERATIONS .....	\$ 0.32	\$
Income (loss) from operations of Morgan Group Holding Co. .... distributed to shareholders .....	0.00	
	0.32	
<hr/>		
NET INCOME .....	\$ 0.32	\$
<hr/>		
DILUTED EARNINGS PER SHARE		
INCOME FROM CONTINUING OPERATIONS .....	\$ 0.32	\$
Income (loss) from operations of Morgan Group Holding Co. .... distributed to shareholders .....	0.00	
	0.32	
<hr/>		
NET INCOME .....	\$ 0.32	\$
<hr/>		

See accompanying notes.

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

	2002	2001
	----	----
OPERATING ACTIVITIES		
Net Income .....	\$ 905	\$ 1,319
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization .....	4,780	4,120
Net effect of purchases and sales of trading securities .....	--	(646)
Equity in earnings of affiliated companies .....	(224)	(204)
Minority interests .....	62	155
Gain on sale of cellular partnership .....	--	--
Gain on sale of available for sale securities .....	(1)	(154)
Non-cash items and assets and operating assets and liabilities from operations of Morgan Group Holding Co. distributed to shareholders.....	--	380
Changes in operating assets and liabilities:		
Receivables .....	785	(24)
Accounts payable and accrued liabilities .....	(1,737)	(867)
Other .....	(271)	(1,130)
	-----	-----
NET CASH PROVIDED BY OPERATING ACTIVITIES .....	4,299	2,949
	-----	-----
INVESTING ACTIVITIES		
Capital expenditures .....	(4,423)	(4,580)
Investment in and advances to affiliated entities .....	(1,436)	(128)
Proceeds from sale of available for sale securities .....	53	241
Proceeds from sale of cellular partnership .....	--	--
Acquisition of Central Utah Telephone Company (total cost, less debt assumed and cash equivalents acquired) .....	--	(6,889)
Investing activities of operations of Morgan Group Holding Co. distributed to shareholders .....	--	(12)
Other .....	(329)	475
	-----	-----
NET CASH USED IN INVESTING ACTIVITIES .....	(6,135)	(10,893)
	-----	-----
FINANCING ACTIVITIES		
Issuance of long term debt .....	1,362	270
Repayments of long term debt .....	(2,570)	(1,263)
Net repayments (borrowings) lines of credit .....	2,972	(171)
Treasury stock transactions .....	(439)	--
Investment in restricted cash .....	(45)	--
Financing activities of operations of Morgan Group Holding Co. distributed to shareholders .....	--	(77)
Other .....	17	--
	-----	-----
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES .....	1,297	(1,241)
	-----	-----
Net increase (decrease) in cash and cash equivalents .....	(539)	(9,185)
Cash and cash equivalents at beginning of Period .....	24,830	34,324
	-----	-----
CASH AND CASH EQUIVALENTS AT END OF PERIOD .....	\$ 24,291	\$ 25,139
	=====	=====

See accompanying notes

# Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

## LYNCH INTERACTIVE CORPORATION & SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### A. Subsidiaries of the Registrant

As of June 30, 2002, the Subsidiaries of the Registrant are as follows:

Subsidiary	Owned by Lynch
Brighton Communications Corporation .....	100.0%
Lynch Telephone Corporation IV .....	100.0%
Bretton Woods Telephone Company .....	100.0%
World Surfer, Inc. ....	100.0%
Lynch Kansas Telephone Corporation .....	100.0%
Lynch Telephone Corporation VI .....	98.0%
JBN Telephone Company, Inc. ....	98.0%
JBN Finance Corporation .....	98.0%
CLR Video, L.L.C. ....	98.0%
Giant Communications, Inc. ....	100.0%
Lynch Telephone Corporation VII .....	100.0%
USTC Kansas, Inc. ....	100.0%
Haviland Telephone Company, Inc. ....	100.0%
Haviland Finance Corporation .....	100.0%
DFT Communications Corporation .....	100.0%
DFT Telephone Holding Company, L.L.C. ....	100.0%
Dunkirk & Fredonia Telephone Company .....	100.0%
Cassadaga Telephone Company .....	100.0%
Macom, Inc. ....	100.0%
Comantel, Inc. ....	100.0%
Erie Shore Communications, Inc. ....	100.0%
D&F Cellular Telephone, Inc. ....	100.0%
DFT Long Distance Corporation .....	100.0%
DFT Local Service Corporation .....	100.0%
DFT Security Services, Inc. ....	100.0%
LMT Holding Corporation .....	100.0%
Lynch Michigan Telephone Holding Corporation	100.0%
Upper Peninsula Telephone Company .....	100.0%
Alpha Enterprises Limited .....	100.0%
Upper Peninsula Cellular North, Inc. .	100.0%
Upper Peninsula Cellular South, Inc. .	100.0%
Lynch Telephone Corporation IX .....	100.0%
Central Scott Telephone Company .....	100.0%
CST Communications Inc. ....	100.0%
Global Television, Inc. ....	100.0%
Inter-Community Acquisition Corporation .....	100.0%
Lynch Telephone Corporation X .....	100.0%
Central Utah Telephone, Inc. ....	100.0%
Central Telecom Services, LLC .....	100.0%
Cache Valley Wireless, LC .....	100.0%

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

Subsidiary	Owned by Lynch
Lynch Entertainment, LLC .....	100.0%
Lynch Entertainment Corporation II .....	100.0%
Lynch Multimedia Corporation .....	100.0%
Lynch Paging Corporation .....	100.0%
Lynch PCS Communications Corporation .....	100.0%
Lynch PCS Corporation A .....	100.0%
Lynch PCS Corporation F .....	100.0%
Lynch PCS Corporation G .....	100.0%
Lynch PCS Corporation H .....	100.0%
Lynch Telephone Corporation .....	83.1%
Western New Mexico Telephone Company, Inc. ...	83.1%
Interactive Networks Corporation .....	83.1%
WNM Communications Corporation .....	83.1%
WMN Interactive, L.L.C .....	83.1%
Wescel Cellular, Inc. ....	83.1%
Wescel Cellular of New Mexico, L.P. ....	42.4%
Wescel Cellular, Inc. II .....	83.1%
Enchantment Cable Corporation .....	83.1%
Lynch Telephone II, LLC .....	100.0%
Inter-Community Telephone Company, LLC .....	100.0%
Inter-Community Telephone Company II, LLC ..	100.0%
Valley Communications, Inc. ....	100.0%
Lynch Telephone Corporation III .....	81.0%
Cuba City Telephone Exchange Company .....	81.0%
Belmont Telephone Company .....	81.0%

5

### B. Basis of Presentation

-----

The Company consolidates the operating results of its telephone and cable television subsidiaries (81-100% owned at June 30, 2002 and December 31, 2001). All material intercompany transactions and balances have been eliminated. Investments in affiliates in which the Company does not have a majority voting control are accounted for in accordance with the equity method. The Company accounts for the following affiliated companies on the equity basis of accounting: Coronet Communications Company (20% owned at June 30, 2002 and December 31, 2001), Capital Communications Company, Inc. (49% owned at June 30, 2002 and December 31, 2001) and the cellular partnership operations in New Mexico (17% to 21% owned at June 30, 2002 and December 31, 2001).



## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

On January 24, 2002, Interactive spun off its interest in The Morgan Group, Inc. ("Morgan"), its only services subsidiary, via a tax-free dividend to its shareholders of the stock of Morgan Group Holding Co., a corporation that was formed to serve as a holding company for Interactive's controlling interest in Morgan. Morgan Group Holding Co. is now a public company. Accordingly, the amounts for Morgan are reflected on a one-line basis in the condensed consolidated financial statements as of December 31, 2001 and for the three and six months ended June 30, 2002 and 2001, as amounts "distributed to shareholders."

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Articles 10 and 11 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of the management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month period ended June 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that effect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Certain 2001 amounts have been restated to conform to the 2002 presentation.

### C. Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective for fiscal years beginning after December 15, 2001. Statement 141 required that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Statement 141 also includes guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations completed after June 30, 2001. Statement 142 prohibits the amortization of goodwill and assets with indefinite lives. Statement 142 requires that these assets be reviewed for impairment at least annually. Intangible assets with finite lives will continue to be amortized over their estimated useful lives.

The Company tests goodwill for impairment using the two-step process prescribed in Statement 142. The first step is a screen for potential impairment, while the second step measures the amount of impairment, if any. The Company performed the first of the required impairment tests of goodwill and indefinite lived intangible assets as of January 1, 2002 in the second quarter of 2002 and determined that there are no impairments at the current time.

The application of the non-amortization provisions of Statement No. 142 has increased net income in the second quarter of 2002 by approximately \$0.7 million (\$0.24 per basic share) whereas the similar amortization charge for the quarter in 2001 was approximately \$0.5 million (\$0.18 per basic share). For the six months ended June 30, 2002 and 2001, the amounts were \$1.3 million, or \$0.45 in basic earning per share, and \$1.0 million, or \$0.37 in basic earning per share, respectively.

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

The following table discloses what the effects of the non-amortization of goodwill and indefinite lived intangible assets would be for income and per share amounts for the periods displayed:

	Three Months Ended	
	June 30,	
	2002	2001
	-----	-----
As reported: .....	(000s)	
Income from continuing operations .....	\$ 905	\$ 971
Income (loss) from operations of Morgan .....	--	348
	-----	-----
Net Income .....	905	\$ 1,319
	=====	=====
Adjustment from non-amortization Continuing operations net of income taxes of \$0, \$72, \$0, \$147 and minority interest of \$0, \$15, \$0, \$31, respectively.....	--	\$ 522
Operations of Morgan net of minority interest and income taxes.....	--	\$ 62
As adjusted:		
Income from continuing operations.....	\$ 905	\$ 1,493
Income (loss) from operations of Morgan.....	--	410
	-----	-----
Net income.....	\$ 905	\$ 1,903
	=====	=====
Basic earnings per share		
Income from continuing operations.....	\$0.32	\$ 0.53
Income (loss) from operations of Morgan.....	--	0.14
	-----	-----
Net income.....	\$0.32	\$0.67
	=====	=====
Diluted earnings per share		
Income from continuing operations.....	\$0.32	\$0.53
Income (loss) from operations of Morgan.....	--	0.14
	-----	-----
Net income.....	\$0.32	\$0.67
	=====	=====

The following tables display the details of goodwill and intangible assets as of the dates shown.

(00  
June 30, 2002  
-----

Accumulat

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

Intangible assets subject to amortization:	Assets	Amortizat
	-----	-----
Subscriber lists .....	\$7,594	\$1,

7

	2002	2001
	----	-----
Total amortization expense for		
the three months ended June 30 .....	\$405	\$ 617
	=====	=====
Total amortization expense for the six		
months ended June 30 .....	\$808	\$1,227
	=====	=====

	2003	2004	2005	2006	2007
	-----	-----	-----	-----	-----
Estimated aggregate amortization					
expense by year .....	\$1,679	\$1,568	\$ 268	\$ 213	\$213

	June 30, 2002	December 31, 2001
	-----	-----
Intangible assets not subject to amortization:		
Goodwill - net .....	\$60,889	\$60,889
Cellular licenses .....	1,695	1,695

In October 2001, the FASB issued Statement of Financial Accounting Standard No. 144, Accounting for Impairment or Disposal of Long-Lived Assets, effective for fiscal years beginning after December 15, 2001. The FASB's new rules on asset impairment supersede FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of, and provide a single accounting model for long-lived assets to be disposed of. Although retaining many of the fundamental recognition and measurement provisions of FASB Statement No. 121, the new rules significantly change the criteria that would have to be met to classify an asset as held-for-sale. The new rules also will supersede the provisions of APB Opinion 30 with regard to reporting the effects of a disposal of a segment of a business and will require expected future operating losses from discontinued operations to be displayed in discontinued operations in the periods in which the losses are incurred (rather than as of the measurement date as presently required by APB 30). In addition, more dispositions will qualify for discontinued operations treatment in the income statement. The Company has determined that there is no effect of FASB Statement No. 144 on the earnings and financial position of the Company.

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

### D. Acquisitions and Dispositions

On June 22, 2001, Lynch Telephone Corporation X, a subsidiary of Interactive, acquired Central Utah Telephone, Inc. and its subsidiaries, and Central Telecom Services, LLC, a related entity, for approximately \$15.6 million in cash and notes. The Company has recorded approximately \$11.5 million in goodwill.

The above acquisition was accounted for as a purchase, and accordingly, the assets acquired and liabilities assumed were recorded at their estimated fair market values on the date of acquisition.

The operating results of the acquired companies are included in the Statements of Operations from the acquisition date. The following unaudited pro forma information shows the results of the Company's operations as though the acquisition of Central Utah and related entities and the distribution of Morgan were made at the beginning of 2001. The unaudited pro forma information is not necessarily indicative of the results of operations that would have occurred had the transactions been made at this date nor is it necessarily indicative of future results of operations. (In thousands of dollars, except per share data).

8

	Three Months Ended June 30, 2001 -----	Six Months Ended June 30, 2001 -----
Sales and revenues .....	\$ 19,842	\$ 38,387
Income from continuing operations .....	1,088	1,726
Basic earnings per share .....	0.39	0.61
Diluted earnings per share .....	0.39	0.61

In March 2002, the Company sold its 20.8% interest in the New Mexico cellular partnership, RSA #1B, to Verizon Wireless for \$5.6 million (\$5 million pre-tax gain) and repaid \$2.6 million of outstanding indebtedness to Verizon.

### E. Sunshine Rights Offering

In February 2002, Sunshine PCS Corporation issued rights to its shareholders to purchase up to 1,531,593 shares of its Class A Common Stock at a price of \$1.00 per share. On May 3, 2002, the rights offering expired and on May 7, 2002, Sunshine announced that the rights offering was oversubscribed. As the holder of 235,294 shares of Sunshine, Interactive exercised its rights (but did not oversubscribe) to purchase 58,824 shares of Class A Common Stock in the rights offering.

### F. Spin-off of Morgan

On January 24, 2002, Interactive spun off its interest in The Morgan Group, Inc., its only services subsidiary, via a tax-free dividend to its shareholders of the stock of Morgan Group Holding Co., a corporation that was formed to serve as a holding company for Interactive's controlling interest in The Morgan Group,

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

Inc. Morgan Group Holding Co. is now a public company. Morgan's revenues were \$34.4 million (\$5.4 million to date of spin-off) in the first six months of 2002 and \$53.0 million in the first six months of 2001. The net assets of Morgan distributed at the spin-off were approximately \$3.5 million.

Accordingly, prior period financial statements have been restated to reflect the amounts for Morgan on a one-line basis as "distributed to shareholders."

The report of Ernst & Young LLP, Morgan's independent auditors, with respect to its financial statements as of December 31, 2001 and 2000, and for each of the three years in the period ended December 31, 2001 contained an explanatory paragraph which expresses substantial doubt as to Morgan's ability to continue as a going concern.

G. Indebtedness

The parent company maintains a short-term line of credit facility totaling \$10.0 million. Borrowings under this facility were \$9.9 million and \$7.6 million at June 30, 2002 and December 31, 2001, respectively. This facility will expire on August 31, 2002, unless extended. Long-term debt consists of (all interest rates are at June 30, 2002):

9

Rural Electrification Administration (REA) and Rural Telephone Bank (RTB) notes payable through 2027 at fixed interest rates ranging from 2% to 7.5% (4.9% weighted average at June 30, 2002), secured by assets of the telephone companies of \$149.5 million .....

Bank Credit facilities utilized by certain telephone and telephone holding companies through 2016, \$32.1 million at fixed interest rates averaging 7.9% and \$51.9 million at variable interest rates averaging 4.8% .....

Unsecured notes issued in connection with acquisitions through 2006, at fixed interest rates of 10.0% .....

Convertible subordinated note due in December 2004 at a fixed interest rate of 6% .....

Other .....

Current maturities .....

On December 12, 1999, the Company completed the private placement of a \$25 million 6% five-year note, convertible into Interactive common stock at \$42.50 per share. At that time, to assist the Company with the private placement to Cascade Investment LLC ("Cascade"), the Chairman and CEO of Interactive agreed to give the acquirer of the note a one-time option to sell the note to him at 105% of the principal amount thereof. The exercise period was from November 15,

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

2000 to December 1, 2000. The obligation of the Chairman under this option to sell agreement was secured by a bank letter of credit, which, in turn, was secured by a pledge of certain securities of the Chairman. The Company also agreed to reimburse the Chairman for the cost of the letter of credit plus his counsel fees in connection with the option to sell agreement and obtaining the letter of credit.

On January 16, 2001, the option to sell agreement between Cascade and the Company's Chairman was modified and extended. As a condition to such modification and extension, Cascade demanded and obtained the right to sell up to \$15 million of the notes back to the Chairman at any time prior to January 31, 2001 and the right to sell the remaining \$10 million of the notes to the Chairman between November 15 and December 1, 2002 (the "Put"). The Put is at 105% of principal amount sold plus accrued and unpaid interest and is secured by a fully collateralized letter of credit.

In order to induce the Chairman to grant the Put, Company entered into an agreement in December 2000 with its Chairman whereby it agreed (i) to pay for and acquire, on the same terms and conditions, any portion of the note sold by Cascade under the Put, (ii) to reimburse the Chairman for the costs for extending and maintaining the letter of credit and (iii) to pay the Chairman or his assigns a collateral maintenance fee of 10% per annum for any collateral provided by them.

During January 2001, Cascade exercised the Put with regard to the \$15 million of the notes and on February 14, 2001, the Company transferred \$15.9 million to Cascade, including the 5% premium plus accrued and unpaid interest, in exchange for \$15.0 million of the notes held by Cascade.

10

The option to sell the remaining \$10 million continues to be secured by a collateralized letter of credit. Until March 31, 2002, all or a portion of the collateral for the letter of credit was provided by an affiliate of the Chairman and, as noted above, the Company had agreed to pay all legal fees, letter of credit fees and a 10% per annum collateral fee on the amount of collateral provided. As the Company has always had the right to substitute its collateral for that provided, as of March 31, 2002, the Company had replaced all of the \$10.5 million of the collateral provided by an affiliate of the Chairman with \$10.5 million of the Company's U.S. Treasury Bills, which have been pledged to the issuers of the letter of credit and are classified as "Restricted Cash" on the Company's balance sheet.

The balance of the convertible subordinated note is classified as current at June 30, 2002, and December 31, 2001, as the holder has the ability to demand payment of such amount, plus the \$0.5 million premium, prior to December 31, 2002. Management is currently unaware of Cascade's intention with regard to its potential exercise of the Put with respect to the remaining \$10 million of notes outstanding.

### H. Comprehensive Income

Balances of accumulated other comprehensive income, net of tax, which consists of unrealized gains (losses) on available for sale of securities, at June 30, 2002 and December 31, 2001 are as follows (in thousands):

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

	Unrealized Gain (Loss)	Tax Effect	Net
Balance at December 31, 2001 .....	\$ 2,599	\$ (1,057)	\$ 1
Reclassification adjustment .....	(374)	146	
Current period unrealized losses .....	(1,426)	579	
	-----	-----	---
Balance at June 30, 2002 .....	\$ 799	\$ (332)	\$
	=====	=====	====

The comprehensive income (loss), for the three and six month periods ended June 30, 2002 and 2001 are as follows (in thousands):

	Three Month June 30, 2002	2001
	-----	-----
Net income for the period	\$ 905	\$ 1
Reclassification adjustment-net of income tax benefit (expense) of \$20 and (\$4) .....	(32)	
Unrealized (losses) on available for sale securities -net of income tax benefit of \$307 and \$6 .....	(447)	
	-----	---
Comprehensive income .....	\$ 426	\$ 1
	=====	====

	Six Months June 30, 2002
	-----
Net income for the period	\$3,290
Reclassification adjustment-net of income tax benefit of \$146 and \$804, respectively	(228)
Unrealized (losses) on available for sale securities - net of income tax benefit of \$579 and \$6, respectively	(847)
	-----
Comprehensive income	\$2,215
	=====

I. Earnings per share

The following table set forth the computation of basic and diluted earnings per share for the periods indicated: During the six months ended June 30, 2002, the Company purchased 17,500 shares of its common stock for treasury. Subsequent to June 30, 2002, the Company purchased an additional 3,000 shares of Treasury

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

stock.

	Three Months Ended June 30,	
	2002	2001
	-----	-----
Basic earnings per share		
-----		
Numerator:		
Net Income .....	\$ 905,000	\$1,319,000
Denominator:		
Weighted average shares outstanding .....	2,809,000	2,822,000
Earnings per share:		
Net income .....	\$ 0.32	\$ 0.47
	=====	=====
Diluted earnings per share		
Numerator:		
Net Income .....	\$ 905,000	\$1,319,000
Interest saved on assumed conversion of convertible notes - net of tax .....	--	--
	-----	-----
Net Income .....	\$ 980,000	\$1,319,000
	-----	-----
Denominator:		
Weighted average shares outstanding .....	2,809,000	2,822,000
Shares issued on assumed conversion of convertible note .....	--	--
	-----	-----
Weighted average shares and share equivalents .....	2,809,000	2,822,000
	-----	-----
Earnings per share:		
Net income .....	\$ 0.32	\$ 0.47
	=====	=====

For the three months ended June 30, 2002 and 2001 and the six months ended June 30, 2001, the 236,000 shares to be issued on conversion of the Company convertible note have been excluded from the computation of diluted earnings per share because their inclusion would be anti-dilutive.

J. Segment Information

As a result of the decision to spin-off its investment in Morgan (see Note F), the Company is engaged in one business segment: multimedia. All businesses are located domestically, and substantially all revenues are domestic. The Company's operations include local telephone companies, a cable TV company, investment in PCS entities and investment in two network-affiliated television stations. The Company's primary operations are located in the states of Iowa, Kansas, Michigan, New Hampshire, New Mexico, New York, North Dakota, Utah and Wisconsin. 75% of the Company's telephone customers are residential. The remaining customers are businesses.

EBITDA (before corporate allocation) for operating segments is equal to operating profit before interest, taxes, depreciation, amortization and allocated corporate expenses. EBITDA is presented because it is a widely



## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

accepted financial indicator of value and ability to incur and service debt. EBITDA is not a substitute for operating income or cash flows from operating activities in accordance with generally accepted accounting principles.

12

Operating profit (loss) is equal to revenues less operating expenses, including unallocated general corporate expenses and excluding, interest and income taxes. The Registrant allocates a portion of its general corporate expenses to its operating segment. Such allocation was \$328,000 and \$326,000 for the three months ended June 30, 2002 and 2001, respectively and \$655,000 and \$652,000 for the six months ended June 30, 2002 and 2001, respectively.

	Three Months Ended June 30,	
	2002	2001
	Unaudited	
Sales and revenues: .....	\$ 21,098	\$ 17,
	=====	=====
EBITDA (before corporate allocation):		
Operations .....	\$ 9,994	\$ 9,
Corporate expenses, gross .....	(758)	(7
	-----	-----
Combined total .....	\$ 9,236	\$ 8,
	=====	=====
Operating profit:		
Operations .....	\$ 4,890	\$ 4,
Corporate expenses, net .....	(433)	(
	-----	-----
Combined total .....	\$ 4,457	\$ 4,
	=====	=====
Operating profit .....	\$ 4,457	\$ 4,
Other income (expense):		
Gain on sale of cellular partnership .....	--	1,
Investment income .....	235	(3,
Interest expense .....	(3,298)	(3,
Equity in earnings of affiliated companies .....	224	-----
	-----	-----
Income before income taxes, minority interests and operations of Morgan Group Holding Co. distributed to shareholders .....	\$ 1,618	\$ 2,
	=====	=====

### K. Litigation

Taylor Litigation. Interactive and several other parties, including our Chief Executive Officer, and Fortunet Communications, L.P., which was Sunshine PCS Corporation's predecessor-in-interest, have been named as defendants in a

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

lawsuit brought under the so-called "qui tam" provisions of the federal False Claims Act in the United States District Court for the District of Columbia. The complaint was filed under seal with the court on February 14, 2001. At the initiative of one of the defendants, the seal was lifted on January 11, 2002. Under the False Claims Act, a private plaintiff, termed a "relator," may file a civil action on the U.S. government's behalf against another party for violation of the statute. In return, the relator receives a statutory bounty from the government's litigation proceeds if he is successful.

13

The relater in this lawsuit is R.C. Taylor III, an individual who, to the best of our knowledge, has no relationship to any of the Lynch entities and affiliates that have been named parties in this litigation. Indeed at the time of his filings, and to the best of our knowledge, Mr. Taylor was a lawyer at Gardner, Carton & Douglas. Thereafter, we believe he was a lawyer with a Washington, D.C., law firm. We do not know his current status. We issued a press release dealing with this litigation on January 16, 2002.

The main allegation in the case is that the defendants participated in the creation of "sham" bidding entities that allegedly defrauded the federal Treasury by improperly participating in certain Federal Communications Commission spectrum auctions restricted to small businesses, as well as obtaining bidding credits in other spectrum auctions allocated to "small" and "very small" businesses. The lawsuit seeks to recover an unspecified amount of damages, which would be subject to mandatory trebling under the statute.

Interactive strongly believes that this lawsuit is completely without merit, and intends to defend the suit vigorously. The U.S. Department of Justice has notified the court that it has declined to intervene in the case. Nevertheless, we cannot predict the ultimate outcome of the litigation, nor can we predict the effect that the lawsuit or its outcome will have on our business or plan of operation.

Interactive was formally served with the complaint on July 10, 2002. Interactive has until September 5, 2002, to answer, move to dismiss or otherwise respond to the complaint.

### L. Write-off of Uncollectible Receivables

During the three months ended June 30, 2002, the Company wrote off \$0.7 million of receivables relating to the bankruptcy of MCI/Worldcom and Global Crossing.

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### Overview

On January 24, 2002, Interactive spun off its investment in The Morgan Group, Inc. ("Morgan"), its only services subsidiary, via a tax-free dividend to its shareholders of the stock of Morgan Group Holding Co., a corporation that was formed to serve as a holding company for Interactive's controlling interest in Morgan. Morgan Group Holding Co. is now a public company. Note: The Company retains 234,294 shares of Morgan Group Holding Co. in escrow to be provided to the holder(s) of the Company's convertible notes at the time of the conversion. Accordingly, the amounts for Morgan are reflected on a one-line basis in the condensed financial statements as of December 31, 2001, and for the periods ended June 30, 2002 and 2001 as "distributed to shareholders."

#### Sales And Revenues

Revenues for the three months ended June 30, 2002 increased by \$3.6 million to

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

\$21.1 million from the second quarter of 2001. Revenues grew primarily due to acquisitions. The acquisition of Central Utah Telephone, Inc. and its subsidiaries, and Central Telecom Services, L.L.C., a related entity, which were acquired on June 22, 2001, contributed \$2.6 million to the increase and the acquisition of American Alarm acquired on November 30, 2001 added \$0.7 million to the increase. The balance of the increased revenues can be attributed to the growth in both regulated telco services and the provision of non-traditional telephone services such as: Internet, long distance service and local exchange carrier service.

14

For the six months ended June 30, 2002, revenues were \$42.1 million, an increase of \$7.4 million from the \$34.7 million recorded in the first six months of 2001. The inclusion of Central Utah Telephone Company contributed \$5.2 million in revenues and the inclusion of American Alarm contributed \$1.4 million.

The Company anticipates that increases in revenues in the second half of the year will be lower than the increases in the first half as Central Utah will be included in both periods.

In addition, as a result of certain regulatory initiatives in some of the states in which our companies operate, it is possible that revenues at certain telecommunication operations may be reduced in the near future.

### Operating Profit

Operating profit for the three months ended June 30, 2002 increased by \$0.2 million to \$4.5 million from the second quarter of 2001. The acquisition of Central Utah added \$0.7 million to operating profit during the quarter while the acquisition of American Alarm reduced operating profit by \$0.2 million during the quarter due to the amortization of customer contracts of \$0.3 million recorded during the quarter. The absence of \$0.6 million of amortization expense as a result of implementing of SFAS 142 also improved the quarter's results. Also, during the quarter the Company recorded \$0.7 million in allowance for doubtful accounts associated with the recent bankruptcies of two long distance carriers. The Company also notes that additional revenues will be lost for the first three weeks of July prior to the Worldcom filing. The bankruptcy filings may adversely impact the interstate revenues pools administered by the National Exchange Carrier Association ("NECA") of which all of its telephone operating subsidiaries participate. If the Company access settlements from NECA are reduced, the Company's operating results in the remainder of 2002 could be materially affected.

For the six months ended June 30, 2002, operating profits increased by \$1.8 million to \$9.7 million, with Central Utah contributing \$1.7 million to the increase, American Alarm reduced operating profits by \$0.4 million, due to the amortization of customer contracts of \$0.7 million and the non-amortization of goodwill adding \$1.2 million. The recording of \$0.7 million of allowances for doubtful accounts also affected the six month activity.

### Other Income (Expense)

The Company has investments in two affiliates who have acquired wireless Spectrum in two separate auctions conducted by the Federal Communications Commission in 2000, the 700 MHz Guardband Auction and the 39 GHz Auction. The Company's investments in these two affiliates are \$6.2 and \$1.5 respectively. While trading in the public markets for companies that own and operate wireless Spectrum has declined substantially since the end of these Auctions, there is no indication that the value of this Spectrum has declined due in part, to the limited trading of these licenses. On August 27, 2002, the FCC is scheduled to commence a 700 MHz Auction which Spectrum is very analogous to the 700 MHz

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

Guardband Auction noted above. The Company will closely monitor the results of the Auction and will provide a reserve for impairment in the second half of 2002 should the results warrant.

Investment income for the quarter ended June 30, 2002 decreased by \$0.9 million from the prior year period primarily due to the unrealized gains recorded in the second quarter of 2001 in connection with Tremont Advisers, Inc. All of the Company's interest in Tremont was sold in October 2001. For the six month period ended June 30, 2002, investment income decreased by \$1.2 million from the prior year period again due to gains in 2001 in Tremont Advisers, Inc.

During the quarter, the Company sold its interest in a cellular partnership in New Mexico (RSA 1 (North) ) for \$5.6 million resulting in a pre-tax gain of \$5.0 million.

15

Interest expense is approximately the same as the prior year periods at \$3.3 and \$6.7 million respectively, as increased levels of borrowing were offset by lower interest rates.

### Income Tax Provision

The income tax provision includes federal as well as state and local taxes. The tax provision for the six months ended June 30, 2002 and 2001, represent effective tax rates of 39.2% and 50.0%, respectively. The causes of the difference from the federal statutory rate are principally the effect of state income taxes, including the effect of earnings and losses attributable to different state jurisdictions, and the amortization of non-deductible goodwill in 2001.

### Minority Interest

Minority interest decreased earnings by \$62,000 for the three months ended June 30, 2002 versus \$155,000 a year earlier due to the minority interest associated with the acquisition of American Alarm.

For the six months ended June 30, 2002, minority interest decreased earnings by \$0.7 million versus \$0.3 million for the period last year due to minority interest associated with the gain from the sale of RSA 1 (North) in New Mexico offset by minority interest associated with the acquisition of American Alarm.

### Net Income

Income from continuing operations was \$0.9 million, \$0.32 per share (basic and diluted), for the second quarter of 2002 compared to income from continuing operations for the same period last year of \$1.0 million, or \$0.34 per share (basic and diluted). The acquisition of Central Utah and the cessation of the amortization of goodwill (\$0.5 million) offset lower investment income.

For the six months ended June 30, 2002 income from continuing operations was \$5.2 million, or \$1.84 per share (basic, \$1.79 diluted), as compared to income from continuing operations in 2001 of \$1.6 million, or \$0.56 per share (basic and diluted). Factors contributing to this increase were: the gain from the sale of RSA 1 (North) in New Mexico, the acquisition of Central Utah and the cessation of the amortization of goodwill (\$1.0 million).

Net income for the three months ended June 30, 2002 was \$0.9 million or \$0.32 per share (basic and diluted) as compared to net income of \$1.3 million, or \$0.47 per share (basic and diluted), in the previous years' three-month period. For the six months ended June 30, 2002 net income was \$3.3 million or \$1.17 per share (basic, \$1.17 per share diluted), as compared to \$1.6 million or \$0.58 per

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

share in the previous year. In addition to the factors influencing the change in income from continuing operations, the operating result of Morgan impacted the net income results.

### FINANCIAL CONDITION

#### Liquidity/ Capital Resources

As of June 30, 2002, the Company had current assets of \$50.0 million and current liabilities of \$53.4 million. Working capital deficiency was therefore \$3.4 million as compared to \$10.3 million at December 31, 2001, net of Morgan amounts.

For the six months, capital expenditures were \$7.8 million in 2002 versus \$7.6 million in 2001.

16

At June 30, 2002, total debt was \$200.4 million, which was \$3.1 million lower than the \$203.5 million at the end of 2001. At June 30, 2002, there was \$133.5 million of fixed interest rate debt averaging 7.0% and \$66.9 million of variable interest rate debt averaging 4.8%. Debt at year-end 2001 included \$137.1 million of fixed interest rate debt, at an average interest rate of 7.0%, and \$66.4 million of variable interest rate debt, at an average interest rate of 4.8%.

On December 12, 1999, the Company completed the private placement of a \$25 million 6% five-year note, convertible into Interactive common stock at \$42.50 per share. At that time, to assist the Company with the private placement to Cascade Investment LLC ("Cascade"), the Chairman and CEO of Interactive agreed to give the acquirer of the note a one-time option to sell the note to him at 105% of the principal amount thereof. The exercise period was from November 15, 2000 to December 1, 2000. The obligation of the Chairman under this option to sell agreement was secured by a bank letter of credit, which, in turn, was secured by a pledge of certain securities of the Chairman. The Company also agreed to reimburse the Chairman for the cost of the letter of credit plus his counsel fees in connection with the option to sell agreement and obtaining the letter of credit.

On January 16, 2001, the option to sell agreement between Cascade and the Company's Chairman was modified and extended. As a condition to such modification and extension, Cascade demanded and obtained the right to sell up to \$15 million of the notes back to the Chairman at any time prior to January 31, 2001 and the right to sell the remaining \$10 million of the notes to the Chairman between November 15 and December 1, 2002 (the "Put"). The Put is at 105% of principal amount sold plus accrued and unpaid interest and is secured by a fully collateralized letter of credit.

In order to induce the Chairman to grant the Put, Company entered into an agreement in December 2000 with its Chairman whereby it agreed (i) to pay for and acquire, on the same terms and conditions, any portion of the note sold by Cascade under the Put, (ii) to reimburse the Chairman for the costs for extending and maintaining the letter of credit and (iii) to pay the Chairman or his assigns a collateral maintenance fee of 10% per annum for any collateral provided by them.

During January 2001, Cascade exercised the Put with regard to the \$15 million of the notes and on February 14, 2001, the Company transferred \$15.9 million to Cascade, including the 5% premium plus accrued and unpaid interest, in exchange for \$15.0 million of the notes held by Cascade.

The option to sell the remaining \$10 million continues to be secured by a collateralized letter of credit. Until March 31, 2002, all or a portion of the

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

collateral for the letter of credit was provided by an affiliate of the Chairman and, as noted above, the Company had agreed to pay all legal fees, letter of credit fees and a 10% per annum collateral fee on the amount of collateral provided. As of March 31, 2002, the Company eliminated the collateral fee by replacing all of the \$10.5 million of the collateral provided by an affiliate of the Chairman with \$10.5 million of the Company's U.S. Treasury Bills, which have been pledged to the issuers of the letter of credit and are classified as "Restricted Cash" on the Company's balance sheet.

The balance of the convertible subordinated note is classified as current at June 30, 2002, and December 31, 2001, as the holder has the ability to demand payment of such amount, plus the \$0.5 million premium, prior to December 31, 2002. Management is currently unaware of Cascade's intention with regard to its potential exercise of the Put with respect to the remaining \$10 million of notes outstanding.

As of June 30, 2002, Interactive, the parent company, had \$0.1 million available under a \$10 million short-term line of credit facility, which expires on August 31, 2002. The Company has been negotiating with the lender and expects the facility to be renewed for one year.

17

Lynch has not paid any cash dividends on its common stock since 1989. Interactive does not expect to pay cash dividends on its Common Stock in the foreseeable future. Interactive currently intends to retain its earnings, if any, for use in its business. Future financings may limit or prohibit the payment of dividends.

Interactive has a high degree of financial leverage. As of June 30, 2002, the ratio of total debt to equity was 8.8 to 1. Certain subsidiaries also have high debt to equity ratios. In addition, the debt at subsidiary companies contains restrictions on the amount of readily available funds that can be transferred to the respective parent of the subsidiaries.

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

The Company is obligated under long-term debt provisions and lease agreements to make certain cash payments over the term of the agreements. The following table summarizes these contractual obligations for the period shown:

	Total	Payments Due (In thousands)	
		Less than 1 year	1 - 5 years
	-----	-----	-----
Long-term Debt (a) .....	\$187,584	\$ 21,151	\$ 4,000
Operating Leases .....	1,306	321	---
	-----	-----	-----
Total Contractual Cash Obligations .....	\$188,890	\$ 21,472	\$ 4,000
	=====	=====	=====

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

- (a) Does not include interest payments on debt
- (b) Contains \$10 million of convertible subordinated debt due in 2004, that has a put option that if exercised, would accelerate the debt to the last quarter of 2002.

The company has certain financing commitments from banks and other financial institutions that provide liquidity. The following table summarizes the expiration of these commitments for the periods shown:

	Amount of Co		
	Total	Less than	(In
	Amounts	1 year	1 - 3 y
	Committed	-----	-----
Other Commercial Commitments.....	-----	-----	-----
Lines of Credit .....	\$12,776	\$12,776	
Standby Letter of Credit .....	10,500	10,500	
	-----	-----	-----
Total Commercial Commitments .....	\$23,276	\$23,276	=====
	=====	=====	=====

The Company has initiated an effort to monetize certain of its assets, including selling a portion or all of certain in vestment and/or certain of its operating entities. These may include minority interest in network affiliated television stations and certain telephone operations where growth opportunities are not readily apparent. There is no assurance that all or any part of this program can be effectuated on acceptable terms. In March 2002, the Company sold its 20.8% interest in the New Mexico cellular property, RSA 1 (North), to Verizon Wireless for \$5.6 million and repaid certain outstanding indebtedness to Verizon.

Critical Accounting Policies and Estimates

General

Interactive's discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires Interactive to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, Interactive evaluates its estimates, including those related to revenue recognition, carrying value of its investments in the spectrum entities and long-lived assets, purchase price allocations, and contingencies and litigation. Interactive bases its estimates

## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Interactive believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

### Revenue Recognition

The principal business of Interactive's telephone companies is to provide telecommunications services. These services fall into four major categories: local network, network access, long distance and other non-regulated telecommunications services. Toll service to areas outside franchised telephone service territory is furnished through switched and special access connections with intrastate and interstate long distance networks.

Local service revenues are derived from providing local telephone exchange services. Local service revenues are based on rates filed with various state telephone regulatory bodies.

Revenues from long distance network services are derived from providing certain long distance services to the Company's local exchange customers and are based on rates filed with various state regulatory bodies.

Revenue from intrastate access is generally billed monthly in arrears based on intrastate access rates filed with various state regulatory bodies. Interactive recognizes revenue from intrastate access service based on an estimate of the amounts billed to interexchange carriers in the subsequent month. Estimated revenues are adjusted monthly as actual revenues become known.

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

19

Other ancillary revenues derived from the provision of directory advertising and billing and collection services are billed monthly based on rates under contract.

### Purchase Price Allocation

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

### Depreciation and Amortization



## Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

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

### Item 3. Quantitative and Qualitative Disclosure About Market Risk

The Company is exposed to market risk relating to changes in the general level of U.S. interest rates. Changes in interest rates affect the amounts of interest earned on the Company's cash and cash equivalents (\$34.8 million at June 30, 2002 and \$31.2 million at December 31, 2001).

The Company generally finances the debt portion of the acquisition of long-term assets with fixed rate, long-term debt. The Company generally maintains the majority of its debt as fixed rate in nature either by borrowing on a fixed long-term basis or, on a limited basis, entering into interest rate swap agreements. The Company does not use derivative financial instruments for trading or speculative purposes. Management does not foresee any significant changes in the strategies used to manage interest rate risk in the near future, although the strategies may be reevaluated as market conditions dictate.

At June 30, 2002, approximately \$66.9 million, or 33% of the Company's long-term debt and notes payable bears interest at variable rates. Accordingly, the Company's earnings and cash flows are affected by changes in interest rates. Assuming the current level of borrowings for variable rate debt and assuming a one percentage point change in the 2002 average interest rate under these borrowings, it is estimated that the Company's 2002 six-month interest expense would have changed by less than \$0.4 million. In the event of an adverse change in interest rates, management would likely take actions to further mitigate its exposure. However, due to the uncertainty of the actions that would be taken and their possible effects, the analysis assumes no such actions. Further, the analysis does not consider the effects of the change in the level of overall economic activity that could exist in such an environment.

20

### FORWARD LOOKING INFORMATION

Included in this Management Discussion and Analysis of Financial Condition and Results of Operations are certain forward looking financial and other information, including without limitation, the Company's effort to monetize certain assets, Liquidity and Capital Resources and Market Risk. It should be recognized that such information are estimates or forecasts based upon various assumptions, including the matters, risks, and cautionary statements referred to therein, as well as meeting the Registrant's internal performance assumptions regarding expected operating performance and the expected performance of the economy and financial markets as it impacts Registrant's businesses. As a result, such information is subject to uncertainties, risks and inaccuracies, which could be material.

21

# Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

Taylor Litigation. Interactive and several other parties, including our Chief Executive Officer, and Fortunet Communications, L.P., which was Sunshine PCS Corporation's predecessor-in-interest, have been named as defendants in a lawsuit brought under the so-called "qui tam" provisions of the federal False Claims Act in the United States District Court for the District of Columbia. The complaint was filed under seal with the court on February 14, 2001. At the initiative of one of the defendants, the seal was lifted on January 11, 2002. Under the False Claims Act, a private plaintiff, termed a "relator," may file a civil action on the U.S. government's behalf against another party for violation of the statute. In return, the relator receives a statutory bounty from the government's litigation proceeds if he is successful.

The relator in this lawsuit is R.C. Taylor III, an individual who, to the best of our knowledge, has no relationship to any of the Lynch entities and affiliates that have been named parties in this litigation. Indeed at the time of his filings, and to the best of our knowledge, Mr. Taylor was a lawyer at Gardner, Carton & Douglas. Thereafter, we believe he was a lawyer with a Washington, D.C., law firm. We do not know his current status. We issued a press release dealing with this litigation on January 16, 2002.

The main allegation in the case is that the defendants participated in the creation of "sham" bidding entities that allegedly defrauded the federal Treasury by improperly participating in certain Federal Communications Commission spectrum auctions restricted to small businesses, as well as obtaining bidding credits in other spectrum auctions allocated to "small" and "very small" businesses. The lawsuit seeks to recover an unspecified amount of damages, which would be subject to mandatory trebling under the statute.

Interactive strongly believes that this lawsuit is completely without merit, and intends to defend the suit vigorously. The U.S. Department of Justice has notified the court that it has declined to intervene in the case. Nevertheless, we cannot predict the ultimate outcome of the litigation, nor can we predict the effect that the lawsuit or its outcome will have on our business or plan of operation.

Interactive was formally served with the complaint on July 10, 2002. Interactive has until September 5, 2002, to answer, move to dismiss or otherwise respond to the complaint.

### Item 4. Submission of Matters to a Vote of Security Holders

At the Annual Meeting of Stockholders of the Company held on May 9, 2002, the following persons were elected as Directors with the following votes:

Name	Votes For	Votes Withheld
----	-----	-----
Paul J. Evanson ....	2,264,804	9,741
John C. Ferrara ....	2,268,199	6,346
Mario J. Gabelli ...	2,208,401	66,144

Edgar Filing: LYNCH INTERACTIVE CORP - Form 10-Q

Daniel R. Lee .....	2,269,279	5,266
David C. Mitchell ..	2,269,279	5,266
Salvatore Muoio ....	2,268,209	6,336
Ralph R. Papitto ...	2,268,199	6,346
Vincent S. Tese ....	2,269,279	5,266

22

Also at such Annual Meeting, a proposal to amend the bylaws of the Company to require that the exercise price for all stock options be no less than fair market value of the time of the grant was approved with the following votes:

Number of Votes

-----

For .....	2,216,373
Against .....	50,608
Abstaining ....	7,564

Item 6. Exhibits and Reports on Form 8-K

- (a) Exhibit 99.1 - Section 906 Certifications.
- (b) None.

23

SIGNATURE

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LYNCH INTERACTIVE CORPORATION  
(Registrant)

By: /s/Robert E. Dolan

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

August 14, 2002

24