

ARBITRON INC  
Form 10-Q  
August 02, 2004

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

---

**FORM 10-Q**

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

**For the quarterly period ended June 30, 2004**

Or

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

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

Commission file number: 1-1969

**ARBITRON INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**52-0278528**

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

**142 West 57th Street**

**New York, New York 10019**

(Address of principal executive offices) (Zip Code)

**(212) 887-1300**

(Registrant's telephone number, including area code)

---

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

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

The registrant had 31,172,148 shares of common stock, par value \$0.50 per share, outstanding as of July 31, 2004.



ARBITRON INC.

INDEX

|   | <u>Page No.</u> |
|---|-----------------|
| <b>PART I FINANCIAL INFORMATION</b>   |                 |
| Item 1. Financial Statements  |                 |
| Consolidated Balance Sheets June 30, 2004 and December 31, 2003                               | 3               |
| Consolidated Statements of Income Three Months Ended June 30, 2004 and 2003                   | 4               |
| Consolidated Statements of Income Six Months Ended June 30, 2004 and 2003                     | 5               |
| Consolidated Statements of Cash Flows Six Months Ended June 30, 2004 and 2003                 | 6               |
| Notes to Consolidated Financial Statements June 30, 2004                                      | 7               |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations | 13              |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk                            | 21              |
| Item 4. Controls and Procedures   | 22              |
| <b>PART II OTHER INFORMATION</b>  |                 |
| Item 4. Submission of Matters to a Vote of Security Holders                                   | 22              |
| Item 6. Exhibits and Reports on Form 8-K  | 23              |
| Signature   | 24              |

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

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

|  | <b>June 30,<br/>2004</b> | <b>December 31,<br/>2003</b> |
|--|--------------------------|------------------------------|
|  | <b>(unaudited)</b>       | <b>(audited)</b>             |
| <b>Assets</b>  |                          |                              |
| Current assets   |                          |                              |
| Cash and cash equivalents  | \$ 77,337                | \$ 68,433                    |
| Trade accounts receivable, net of allowance for doubtful accounts of \$1,302 in 2004 and \$1,081 in 2003 | 17,966                   | 21,355                       |
| Deferred income taxes and income taxes recoverable   | 13,009                   | 24,183                       |
| Prepaid expenses and other current assets  | 4,824                    | 2,886                        |
|  | <hr/>                    | <hr/>                        |
| Total current assets   | 113,136                  | 116,857                      |
| Investments in affiliate   | 9,732                    | 10,953                       |
| Property and equipment, net  | 14,761                   | 13,182                       |
| Goodwill, net  | 38,027                   | 32,937                       |
| Other intangibles, net   | 4,165                    | 1,487                        |
| Noncurrent deferred tax assets   | 3,089                    | 6,646                        |
| Other noncurrent assets  | 1,805                    | 2,132                        |
|  | <hr/>                    | <hr/>                        |
| Total assets   | <b>\$ 184,715</b>        | <b>\$ 184,194</b>            |
|  | <hr/>                    | <hr/>                        |
| <b>Liabilities and Stockholders Equity (Deficit)</b>   |                          |                              |
| Current liabilities  |                          |                              |
| Accounts payable   | \$ 5,330                 | \$ 5,326                     |
| Accrued expenses and other current liabilities   | 23,228                   | 28,119                       |
| Deferred revenue   | 52,860                   | 58,398                       |
|  | <hr/>                    | <hr/>                        |
| Total current liabilities  | 81,418                   | 91,843                       |
| Noncurrent liabilities   |                          |                              |
| Long-term debt   | 75,000                   | 105,000                      |
| Other noncurrent liabilities   | 5,313                    | 5,424                        |
|  | <hr/>                    | <hr/>                        |
| Total liabilities  | <b>161,731</b>           | <b>202,267</b>               |
|  | <hr/>                    | <hr/>                        |

Edgar Filing: ARBITRON INC - Form 10-Q

|   |                   |                   |
|---|-------------------|-------------------|
| Stockholders' equity (deficit)  |                   |                   |
| Common stock, \$0.50 par value, authorized 500,000 shares, issued<br>32,336 shares                          | 16,168            | 16,168            |
| Additional paid-in capital  | 113,626           | 100,024           |
| Accumulated earnings (net distributions to Ceridian in excess of<br>accumulated earnings) prior to spin-off | (242,870)         | (242,870)         |
| Retained earnings subsequent to spin-off  | 139,514           | 112,795           |
| Common stock held in treasury, 1,168 shares in 2004 and 1,626 shares in<br>2003                             | (584)             | (813)             |
| Accumulated other comprehensive loss  | (2,870)           | (3,377)           |
|   | <u>          </u> | <u>          </u> |
| Total stockholders' equity (deficit)  | <u>22,984</u>     | <u>(18,073)</u>   |
|   |                   |                   |
| Total liabilities and stockholders' equity (deficit)  | <u>\$ 184,715</u> | <u>\$ 184,194</u> |

See notes to consolidated financial statements.

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

|   | <b>Three Months Ended<br/>June 30,</b> |             |
|---|--|-------------|
|   | <b>2004</b>                            | <b>2003</b> |
| Revenue   | \$65,084                               | \$61,448    |
| Costs and expenses                                  |  |             |
| Cost of revenue                                     | 29,561                                 | 28,250      |
| Selling, general and administrative                 | 15,500                                 | 14,115      |
| Research and development                            | 8,004                                  | 6,414       |
| Total costs and expenses                            | 53,065                                 | 48,779      |
| Operating income                                    | 12,019                                 | 12,669      |
| Equity in net income of affiliate                   | 3,857                                  | 3,480       |
| Income before interest and income tax expense       | 15,876                                 | 16,149      |
| Interest income                                     | 196                                    | 185         |
| Interest expense                                    | 1,949                                  | 3,210       |
| Income before income tax expense                    | 14,123                                 | 13,124      |
| Income tax expense                                  | 5,508                                  | 5,118       |
| Net income  | \$ 8,615                               | \$ 8,006    |
| Net income per weighted average common share        |  |             |
| Basic   | \$ 0.28                                | \$ 0.27     |
| Diluted   | \$ 0.27                                | \$ 0.26     |
| Weighted average common shares used in calculations |  |             |
| Basic   | 30,977                                 | 29,805      |
| Potentially dilutive securities                     | 520                                    | 577         |
| Diluted   | 31,497                                 | 30,382      |



See notes to consolidated financial statements.





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

|   | <b>Six Months Ended<br/>June 30,</b> |             |
|---|--------------------------------------|-------------|
|   | <b>2004</b>                          | <b>2003</b> |
| Revenue   | \$141,669                            | \$132,802   |
| Costs and expenses                                  |                                      |             |
| Cost of revenue                                     | 51,258                               | 48,239      |
| Selling, general and administrative                 | 30,291                               | 28,090      |
| Research and development                            | 14,867                               | 12,695      |
| Total costs and expenses                            | 96,416                               | 89,024      |
| Operating income                                    | 45,253                               | 43,778      |
| Equity in net income of affiliate                   | 2,529                                | 2,221       |
| Income before interest and income tax expense       | 47,782                               | 45,999      |
| Interest income                                     | 398                                  | 373         |
| Interest expense                                    | 4,378                                | 6,825       |
| Income before income tax expense                    | 43,802                               | 39,547      |
| Income tax expense                                  | 17,083                               | 15,423      |
| Net income  | \$ 26,719                            | \$ 24,124   |
| Net income per weighted average common share        |                                      |             |
| Basic   | \$ 0.87                              | \$ 0.81     |
| Diluted   | \$ 0.85                              | \$ 0.80     |
| Weighted average common shares used in calculations |                                      |             |
| Basic   | 30,885                               | 29,723      |
| Potentially dilutive securities                     | 615                                  | 551         |
| Diluted   | 31,500                               | 30,274      |



See notes to consolidated financial statements.



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

|  | <b>Six Months Ended<br/>June 30,</b> |                |
|--|--------------------------------------|----------------|
|  | <b>2004</b>                          | <b>2003</b>    |
| Cash flows from operating activities   |                                      |                |
| Net income   | \$ 26,719                            | \$ 24,124      |
| Adjustments to reconcile net income to net cash provided by operating activities:      |                                      |                |
| Depreciation and amortization of property and equipment                                | 2,165                                | 1,824          |
| Other amortization   | 604                                  | 559            |
| Loss on asset disposals  | 181                                  | 45             |
| Asset impairment charges   | 328                                  | 178            |
| Deferred income taxes and income taxes recoverable                                     | 14,299                               | 1,365          |
| Equity in net income of affiliate  | (2,529)                              | (2,221)        |
| Distributions from affiliate   | 3,750                                | 3,250          |
| Bad debt expense   | 223                                  | 200            |
| Tax benefit from stock option exercises  | 2,920                                | 2,071          |
| Other noncash items  | 94                                   |                |
| Changes in operating assets and liabilities, excluding effects of business acquisition |                                      |                |
| Trade accounts receivable  | 3,879                                | 427            |
| Prepaid expenses and other assets  | (229)                                | (465)          |
| Accounts payable   | (13)                                 | (561)          |
| Accrued expenses and other current liabilities   | (4,935)                              | 1,802          |
| Deferred revenue   | (6,024)                              | (3,484)        |
| Other noncurrent liabilities   | 768                                  | (1,006)        |
| Net cash provided by operating activities  | <u>42,200</u>                        | <u>28,108</u>  |
| Cash flows from investing activities   |                                      |                |
| Additions to property and equipment  | (3,864)                              | (1,442)        |
| Payment for business acquisition   | (8,928)                              |                |
| Net cash used in investing activities  | <u>(12,792)</u>                      | <u>(1,442)</u> |
| Cash flows from financing activities   |                                      |                |
| Proceeds from stock option exercises and stock purchase plan                           | 9,443                                | 5,327          |
| Payment of long-term debt  | (30,000)                             | (30,000)       |

Edgar Filing: ARBITRON INC - Form 10-Q

|  |                   |                   |
|--|-------------------|-------------------|
|  | <u>          </u> | <u>          </u> |
| Net cash used in financing activities                        | (20,557)          | (24,673)          |
|  | <u>          </u> | <u>          </u> |
| Effect of exchange rate changes on cash and cash equivalents | 53                | 61                |
|  | <u>          </u> | <u>          </u> |
| Net increase in cash and cash equivalents                    | 8,904             | 2,054             |
| Cash and cash equivalents at beginning of period             | 68,433            | 43,095            |
|  | <u>          </u> | <u>          </u> |
| Cash and cash equivalents at end of period                   | <u>\$ 77,337</u>  | <u>\$ 45,149</u>  |

See notes to consolidated financial statements.

**ARBITRON INC.**

Notes to Consolidated Financial Statements

June 30, 2004

(unaudited)

**1. Basis of Presentation and Consolidation**

***Presentation***

The accompanying unaudited consolidated financial statements of Arbitron Inc. (the Company or Arbitron ) have been prepared in accordance with accounting principles generally accepted in the United States of America (the U.S. ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. In the opinion of management, all adjustments considered for fair presentation have been included. The consolidated balance sheet as of December 31, 2003 was audited at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2003.

***Consolidation***

The consolidated financial statements of Arbitron reflect the consolidated financial position, results of operations and cash flows of Arbitron Inc. and its subsidiaries: Arbitron Holdings Inc., Audience Research Bureau S.A. de C.V., Ceridian Infotech (India) Private Limited, CSW Research Limited and Euro Fieldwork Limited.

**2. Pro Forma Disclosures of Stock Based Compensation**

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

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

**ARBITRON INC.**

Notes to Consolidated Financial Statements Continued

June 30, 2004

(unaudited)

|  | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |           |
|--|--------------------------------|----------|------------------------------|-----------|
|  | 2004                           | 2003     | 2004                         | 2003      |
| Net income, as reported  | \$ 8,615                       | \$ 8,006 | \$ 26,719                    | \$ 24,124 |
| Less: Stock-based compensation expense<br>determined under fair value method, net of tax | 921                            | 678      | 1,609                        | 1,548     |
| Pro forma net income   | \$ 7,694                       | \$ 7,328 | \$ 25,110                    | \$ 22,576 |
| Basic net income per weighted average common<br>share, as reported                       | \$ 0.28                        | \$ 0.27  | \$ 0.87                      | \$ 0.81   |
| Pro forma basic net income per weighted average<br>common share                          | \$ 0.25                        | \$ 0.25  | \$ 0.81                      | \$ 0.76   |
| Diluted net income per weighted average<br>common share, as reported                     | \$ 0.27                        | \$ 0.26  | \$ 0.85                      | \$ 0.80   |
| Pro forma diluted net income per weighted<br>average common share                        | \$ 0.24                        | \$ 0.24  | \$ 0.80                      | \$ 0.75   |
| Options granted  | 101,995                        | 538,122  | 106,937                      | 566,078   |
| Weighted-average exercise price  | \$ 36.69                       | \$ 34.84 | \$ 37.19                     | \$ 34.70  |
| Weighted-average fair value  | \$ 10.27                       | \$ 7.59  | \$ 10.29                     | \$ 7.53   |
| Weighted-average assumptions:  |                                |          |                              |           |
| Expected lives in years  | 4                              | 4        | 4                            | 4         |
| Expected volatility  | 27.1%                          | 23.4%    | 27.1%                        | 24.6%     |
| Expected dividend rate   |                                |          |                              |           |
| Risk-free interest rate  | 3.47%                          | 2.40%    | 3.43%                        | 2.58%     |

**3. Purchase Acquisition**

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

**4. Long-Term Debt**

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

|                                     | <b>June 30,<br/>2004</b> | <b>December 31,<br/>2003</b> |
|-------------------------------------|--------------------------|------------------------------|
|                                     | <hr/>                    | <hr/>                        |
| Senior fixed rate notes             | \$50,000                 | \$ 50,000                    |
| Long-term revolving credit facility | 25,000                   | 55,000                       |
|                                     | <hr/>                    | <hr/>                        |
|                                     | \$75,000                 | \$105,000                    |
|                                     | <hr/>                    | <hr/>                        |

On January 31, 2001, the Company entered into a \$225.0 million five-year revolving credit agreement with a consortium of banks ( Credit Facility ). In connection with the Company s spin-off of Ceridian Corporation ( Ceridian ) in March 2001, \$200.0 million was drawn on the Credit Facility and distributed to Ceridian.

The Credit Facility has two borrowing options, a Eurodollar rate option or a base rate option, as defined in the agreement. Under the Eurodollar option, the Company may elect interest periods of one, two, three or six

**ARBITRON INC.**

Notes to Consolidated Financial Statements Continued

June 30, 2004

(unaudited)

months at the inception date and each renewal date. Borrowings under the Eurodollar option bear interest at the London Interbank Offered Rate ( LIBOR ) plus a margin of 2.00% to 2.75%. Borrowings under the base rate option bear interest at the higher of the lead lender's prime rate or the Federal Funds rate plus 50 basis points, plus a margin of 0.50% to 1.25%. The specific margins, under both options, are determined based on the Company's ratio of indebtedness to earnings before interest, taxes, depreciation and amortization (leverage ratio), and are adjusted every 90 days. The agreement contains a commitment fee provision whereby the Company is charged a fee, ranging from 0.375% to 0.550%, applied to the unused portion of the facility. Under the terms of the Credit Facility, the Company is required to maintain certain other financial ratios, in addition to the leverage ratio, and meet other financial conditions. The agreement limits, among other things, the Company's ability to buy or sell assets, incur additional indebtedness, grant or incur liens on its assets, repay indebtedness other than the Credit Facility, make investments or acquisitions, repurchase or redeem capital stock and engage in certain mergers or consolidations. The effective interest rate on the Credit Facility borrowings outstanding as of June 30, 2004 was 7.02%.

Arbitron's commitment under the Credit Facility, which was \$225.0 million at inception, has been reduced to \$76.2 million as of March 31, 2004 in accordance with the mandatory commitment reduction and excess cash flow provisions. Available borrowings under the Credit Facility were \$51.1 million as of June 30, 2004.

Upon consummation of the spin-off, the Company issued \$50.0 million of senior secured notes due January 31, 2008, and distributed the proceeds to Ceridian. The notes bear interest at a fixed rate of 9.96%. The senior secured notes agreement contains covenants similar to the Credit Facility. The agreement also contains a make-whole provision that applies in the event of early prepayment of principal.

## **5. Interest Rate Swap**

The Company entered into an interest rate swap agreement effective March 29, 2001 to hedge its exposure to fluctuations in interest rates relating to its outstanding variable rate debt. The contract's notional amount was \$200.0 million at inception and declines each quarter over the life of the contract in proportion to the Company's estimated outstanding balance on the Credit Facility. Under the terms of the contract, the Company pays a fixed rate of 5.02% and receives LIBOR, which resets every 90 days. The contract matures on December 31, 2004. The interest rate swap agreement was designated as a cash flow hedge, and was designed to be entirely effective by matching the terms of the swap agreement with the debt. The base rate for both the variable rate debt and the swap agreement is LIBOR and the instruments have the same renewal dates over the lives of the instruments. The fair value of the cash flow hedge was recorded as a non-current liability and the offsetting unrealized loss was recorded in accumulated other comprehensive loss as of June 30, 2004 and December 31, 2003.

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

## **6. Stockholders' Equity (Deficit)**

Changes in stockholders' equity (deficit) for the six months ended June 30, 2004 were as follows (in thousands):





**ARBITRON INC.**  
Notes to Consolidated Financial Statements    Continued  
June 30, 2004  
(unaudited)

|  | <b>Balance</b>      |               | <b>Common</b> | <b>Tax</b>       | <b>Other</b>   | <b>Balance</b>  |
|--|---------------------|---------------|---------------|------------------|----------------|-----------------|
|  | <b>as of</b>        | <b>Net</b>    | <b>Stock</b>  | <b>Benefit</b>   | <b>Compre-</b> | <b>as of</b>    |
|  | <b>December 31,</b> | <b>Income</b> | <b>Issued</b> | <b>from</b>      | <b>hensive</b> | <b>June 30,</b> |
|  | <b>2003</b>         |               |               | <b>Stock</b>     | <b>Income</b>  | <b>2004</b>     |
|  | <b>_____</b>        | <b>_____</b>  | <b>_____</b>  | <b>Option</b>    | <b>_____</b>   | <b>_____</b>    |
|  | <b>_____</b>        | <b>_____</b>  | <b>_____</b>  | <b>Exercises</b> | <b>_____</b>   | <b>_____</b>    |
| Common stock   | \$ 16,168           | \$            | \$            | \$               | \$             | \$ 16,168       |
| Additional paid-in capital   | 100,024             |               | 10,682        | 2,920            |                | 113,626         |
| Accumulated earnings (net distributions to Ceridian in excess of accumulated earnings) prior to spin-off | (242,870)           |               |               |                  |                | (242,870)       |
| Retained earnings subsequent to spin-off   | 112,795             | 26,719        |               |                  |                | 139,514         |
| Common stock held in treasury  | (813)               |               | 229           |                  |                | (584)           |
| Accumulated other comprehensive income (loss)  | (3,377)             |               |               |                  | 507            | (2,870)         |
|  | <b>_____</b>        | <b>_____</b>  | <b>_____</b>  | <b>_____</b>     | <b>_____</b>   | <b>_____</b>    |
| Total stockholders' equity (deficit)   | \$ (18,073)         | \$26,719      | \$10,911      | \$ 2,920         | \$ 507         | \$ 22,984       |
|  | <b>_____</b>        | <b>_____</b>  | <b>_____</b>  | <b>_____</b>     | <b>_____</b>   | <b>_____</b>    |
| Number of shares outstanding   | 30,710              |               | 458           |                  |                | 31,168          |
|  | <b>_____</b>        | <b>_____</b>  | <b>_____</b>  | <b>_____</b>     | <b>_____</b>   | <b>_____</b>    |

### 7. Net Income Per Weighted Average Common Share

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

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

### 8. Comprehensive Income

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



**ARBITRON INC.**

Notes to Consolidated Financial Statements Continued

June 30, 2004

(unaudited)

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

|   | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |          |
|---|--------------------------------|---------|------------------------------|----------|
|   | 2004                           | 2003    | 2004                         | 2003     |
| Net income                                      | \$8,615                        | \$8,006 | \$26,719                     | \$24,124 |
| Items of other comprehensive income             |                                |         |                              |          |
| Foreign currency translation adjustments        | (48)                           | 116     | 58                           | 73       |
| Change in unrealized loss on interest rate swap | 389                            | 927     | 879                          | 1,626    |
| Income tax benefit                              | (246)                          | (352)   | (430)                        | (616)    |
|   |                                |         |                              |          |
| Comprehensive income                            | \$8,710                        | \$8,697 | \$27,226                     | \$25,207 |
|   |                                |         |                              |          |

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

|   | June 30,<br>2004 | December 31,<br>2003 |
|---|------------------|----------------------|
| Foreign currency translation adjustment | \$ 294           | \$ 236               |
| Unrealized loss on interest rate swap   | (292)            | (1,171)              |
| Additional minimum pension liability    | (4,706)          | (4,706)              |
| Income tax benefit                      | 1,834            | 2,264                |
|   |                  |                      |
| Accumulated other comprehensive loss    | \$(2,870)        | \$(3,377)            |
|   |                  |                      |

**9. Retirement Plans**

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

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



**ARBITRON INC.**

Notes to Consolidated Financial Statements Continued

June 30, 2004

(unaudited)

|                                    | <b>Defined Benefit<br/>Pension Plan<br/>Three Months<br/>Ended June 30,</b> |                   | <b>Postretirement<br/>Plan<br/>Three Months<br/>Ended June<br/>30,</b> |                   |
|------------------------------------|---|-------------------|--|-------------------|
|                                    | <b>2004</b>   | <b>2003</b>       | <b>2004</b>  | <b>2003</b>       |
| Service cost                       | \$ 185  | \$ 132            | \$ 7   | \$ 5              |
| Interest cost                      | 354   | 307               | 13   | 13                |
| Expected return on plan assets     | (368)   | (312)             |  |                   |
| Amortization of prior service cost | 6   | 5                 |  |                   |
| Amortization of net loss           | 117   | 101               | 3  | 2                 |
|                                    | <u>          </u>   | <u>          </u> | <u>          </u>  | <u>          </u> |
| Net periodic benefit cost          | \$ 294  | \$ 233            | \$ 23  | \$ 20             |
|                                    | <u>          </u>   | <u>          </u> | <u>          </u>  | <u>          </u> |

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

**10. Income Taxes**

Pursuant to an Internal Revenue Service Revenue Procedure issued during the second quarter of 2004, the Company has changed its tax method of accounting for advanced customer payments. As a result of the method change, income taxes of approximately \$22.2 million paid in 2003 are being applied toward the Company's 2004 tax liability and the deferred tax assets no longer include a temporary difference for deferred revenue. The remaining balance of recoverable income taxes as of June 30, 2004 was \$10.6 million and is reflected as income taxes recoverable.

**11. Significant Customers and Concentration of Credit Risk**

Arbitron's quantitative radio audience measurement service and related software sales accounted for approximately 86% of its revenue in 2003 and for approximately 87% of its revenue for the six months ended June 30, 2004, the largest portion of which is provided to radio broadcasters. In recent years, a small number of enterprises have greatly expanded their holdings of United States radio broadcasters. As a result of this consolidation of United States radio broadcasters, Arbitron has two customers that individually represent approximately 10% or more of its revenue. For the year 2003 those customers represented approximately 21% and 10% of the Company's revenue. The customer that represented approximately 10% of Arbitron's revenue in 2003, Infinity Broadcasting Corp., announced on June 24, 2004 that it has elected not to renew agreements with Arbitron for radio ratings and other services, which expired on March 31, 2004. The agreements that were not renewed collectively accounted for approximately 9% of Arbitron's 2003 revenue.



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

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

### Forward-Looking Statements

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

renew all or part of contracts with large customers as they expire;

successfully execute our business strategies, including implementation of our Portable People Meter<sup>SM</sup> services, as well as expansion of international operations;

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

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

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

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

Additional important factors known to Arbitron that could cause forward-looking statements to turn out to be incorrect are identified and discussed from time to time in Arbitron's filings with the Securities and Exchange Commission, including in particular the risk factors discussed under the caption ITEM 1. BUSINESS Business Risks in Arbitron's Annual Report on Form 10-K for the year ended December 31, 2003.

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

### Overview

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

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



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

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

providing consumer, shopping and media usage information services to the radio, cable, advertising agencies, advertisers, broadcast television, outdoor and out-of-home media, magazine, newspaper and online industries.

Arbitron's quantitative radio audience measurement business and related software sales accounted for approximately 87% of Arbitron's revenue for the six months ended June 30, 2004. Consolidation in the radio broadcasting industry has led to Arbitron's dependence on a limited number of key customers. In 2003, Clear Channel Communications, Inc. ( Clear Channel Communications ) and Infinity Broadcasting Corp. ( Infinity Broadcasting ) represented approximately 21% and 10%, respectively, of Arbitron's revenue. Arbitron's agreements with these customers are not exclusive and contain no renewal obligations. Certain Arbitron license agreements with Clear Channel Communications, which accounted for approximately 17% of Arbitron's 2003 revenue, expire on December 31, 2004. Certain license agreements with Infinity Broadcasting, which accounted for approximately 9% of Arbitron's 2003 revenue, expired on March 31, 2004. Infinity Broadcasting announced on June 24, 2004 that it has elected not to renew any of its agreements with Arbitron. Arbitron cannot in the short-term replace the revenue that will be lost due to Infinity Broadcasting not renewing its license agreements. In light of the nature of our business, Arbitron does not expect a corresponding reduction in costs and expenses related to the loss of revenue. The loss of Infinity Broadcasting will materially impact Arbitron's business, financial condition and operating results.

Arbitron entered into an agreement on May 31, 2000, with Nielsen Media Research, Inc. ( Nielsen Media Research ), a provider of U.S. television and cable audience measurement services, under which Arbitron granted Nielsen Media Research an option to join Arbitron in the potential commercial deployment of the Portable People Meter ( Portable People Meter or PPM) in the United States. In the event Nielsen Media Research exercises the option, the parties would form a joint venture to commercially deploy and operate the business of utilizing the Portable People Meter for the collection of listening and viewing audience data. In 2003, Arbitron worked with Nielsen Media Research on response rate issues and a variety of engineering tests. Arbitron and Nielsen Media Research announced in July 2004 that interim response rate results from two separate recruitment methods were substantially higher than results achieved in Philadelphia in 2002. In 2004, Arbitron is focusing on another market test to be conducted in Houston, Texas to confirm the results of previous tests and demonstrate enhancements to the Portable People Meter system that have been made since it was tested in Philadelphia. Arbitron continues to work with Nielsen Media Research to resolve outstanding issues and to negotiate business terms for a potential Portable People Meter joint venture.

Separate from the proposed joint venture with Nielsen Media Research, Arbitron began testing additional marketing research applications of the Portable People Meter technology in 2003. One application that Arbitron began testing was the use of the Portable People Meter as the media collection tool for a national marketing-oriented panel designed to correlate advertising with shopping behavior and sales. The objective is to provide multimedia exposure data combined with sales data from a single-source to produce a measure of advertising effectiveness for advertisers, agencies and broadcasters. During 2004, Arbitron is continuing to research the marketplace potential and complete additional methods research for a national marketing-oriented panel. This would be a new type of service for which market acceptance is not yet known.

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

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



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

Based on preliminary results, additional initiatives in 20 low response rate markets have had a positive impact on response rates, which have increased by an estimate of 2.5% to 3.0% from the Spring 2003 survey to the Spring 2004 survey.

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

### **Critical Accounting Policies and Estimates**

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

The Company capitalizes software development costs with respect to major product initiatives or enhancements, which are incurred during the period from the time of technological feasibility until the time that the software is ready for use. To the extent that software is being developed for use by customers or to support data collection activities, the Company also considers the recovery of such costs through future revenue streams in its decision to capitalize software development costs. Once the software is placed in service, the capitalized costs are generally amortized over periods of three to five years. If events or changes in circumstances indicate that the carrying value of software may not be recovered, a recoverability analysis is performed based on estimated undiscounted cash flows to be generated from the software in the future. If the analysis indicates that the carrying value is not recoverable from future cash flows, the software cost is written down to estimated fair value and an impairment loss is recognized. The Company's estimates are subject to revision as market conditions and management's assessments change. As of June 30, 2004, the Company's capitalized software developed for internal use had a carrying amount of \$4.5 million, including \$4.3 million of Portable People Meter software.

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

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

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

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

|  | Three Months Ended<br>June 30, |          | Increase<br>(Decrease) |         | Percentage of<br>Revenue |        |
|--|--------------------------------|----------|------------------------|---------|--------------------------|--------|
|  | 2004                           | 2003     | Dollar                 | Percent | 2004                     | 2003   |
| Revenue  | \$65,084                       | \$61,448 | \$ 3,636               | 5.9%    | 100.0%                   | 100.0% |
| Costs and expenses                               |                                |          |                        |         |                          |        |
| Cost of revenue                                  | 29,561                         | 28,250   | 1,311                  | 4.6%    | 45.4%                    | 46.0%  |
| Selling, general and administrative              | 15,500                         | 14,115   | 1,385                  | 9.8%    | 23.8%                    | 23.0%  |
| Research and development                         | 8,004                          | 6,414    | 1,590                  | 24.8%   | 12.3%                    | 10.4%  |
| Total costs and expenses                         | 53,065                         | 48,779   | 4,286                  | 8.8%    | 81.5%                    | 79.4%  |
| Operating income                                 | 12,019                         | 12,669   | (650)                  | (5.1%)  | 18.5%                    | 20.6%  |
| Equity in net income of affiliate                | 3,857                          | 3,480    | 377                    | 10.8%   | 5.9%                     | 5.7%   |
| Income before interest and<br>income tax expense | 15,876                         | 16,149   | (273)                  | (1.7%)  | 24.4%                    | 26.3%  |
| Interest income                                  | 196                            | 185      | 11                     | 5.9%    | 0.3%                     | 0.3%   |
| Interest expense                                 | 1,949                          | 3,210    | (1,261)                | (39.3%) | 3.0%                     | 5.2%   |
| Income before income tax expense                 | 14,123                         | 13,124   | 999                    | 7.6%    | 21.7%                    | 21.4%  |
| Income tax expense                               | 5,508                          | 5,118    | 390                    | 7.6%    | 8.5%                     | 8.3%   |
| Net income                                       | \$ 8,615                       | \$ 8,006 | \$ 609                 | 7.6%    | 13.2%                    | 13.1%  |
| Net income per weighted average<br>common share  |                                |          |                        |         |                          |        |
| Basic  | \$ 0.28                        | \$ 0.27  | \$ 0.01                | 3.7%    |                          |        |
| Diluted  | \$ 0.27                        | \$ 0.26  | \$ 0.01                | 3.8%    |                          |        |

Edgar Filing: ARBITRON INC - Form 10-Q

Other data:

|                                |                   |                   |                   |        |
|--------------------------------|-------------------|-------------------|-------------------|--------|
| EBIT                           | \$15,876          | \$16,149          | \$ (273)          | (1.7%) |
| EBITDA                         | \$17,327          | \$17,305          | \$ 22             | 0.1%   |
| EBIT and EBITDA Reconciliation |                   |                   |                   |        |
| Net income                     | \$ 8,615          | \$ 8,006          | \$ 609            |        |
| Income tax expense             | 5,508             | 5,118             | 390               |        |
| Interest income                | 196               | 185               | 11                |        |
| Interest expense               | 1,949             | 3,210             | (1,261)           |        |
|                                | <u>          </u> | <u>          </u> | <u>          </u> |        |
| EBIT                           | 15,876            | 16,149            | (273)             |        |
| Depreciation and amortization  | 1,451             | 1,156             | 295               |        |
|                                | <u>          </u> | <u>          </u> | <u>          </u> |        |
| EBITDA                         | \$17,327          | \$17,305          | \$ 22             |        |
|                                | <u>          </u> | <u>          </u> | <u>          </u> |        |

**Revenue.** Revenue increased 5.9% to \$65.1 million for the three months ended June 30, 2004 from \$61.4 million for the same period in 2003. Approximately \$1.8 million of the increase was due to increases in the ratings and qualitative subscriber base, analytical software applications and escalations in multi-year customer contracts and contract renewals. The MRP acquisition also accounted for \$1.8 million of the increase. The Company currently

expects that the rate of revenue growth for the remainder of 2004 will be significantly lower than historical trends due to Infinity Broadcasting not renewing its contracts as discussed in the overview.

**Cost of Revenue.** Cost of revenue increased 4.6% to \$29.6 million for the three months ended June 30, 2004 from \$28.3 million for the same period in 2003, but decreased as a percentage of revenue to 45.4% in 2004 from 46.0% in 2003. The \$1.3 million increase was primarily due to increases in data collection costs (\$0.8 million). Arbitron does not expect a reduction in cost of revenue related to Infinity Broadcasting not renewing its contracts.

**Selling, General and Administrative.** Selling, general and administrative expenses increased 9.8% to \$15.5 million for the three months ended June 30, 2004 from \$14.1 million for the same period in 2003, and increased as a percentage of revenue to 23.8% in 2004 from 23.0% in 2003. The \$1.4 million increase was primarily attributed to the MRP acquisition (\$1.1 million).

**Research and Development.** Research and development increased 24.8% to \$8.0 million during the three months ended June 30, 2004 from \$6.4 million for the same period in 2003, and increased as a percentage of revenue to 12.3% in 2004 from 10.4% in 2003. The \$1.6 million increase was due to software development and enhancement costs in U.S. Media (Arbitron's core quantitative, qualitative and software application services) (\$0.6 million), the MRP acquisition (\$0.5 million) and PPM research and development (\$0.5 million).

**Operating Income.** Operating income decreased 5.1% to \$12.0 million for the three months ended June 30, 2004 from \$12.7 million for the same period in 2003. Operating margin declined to 18.5% in 2004 from 20.6% in 2003. The decline in operating margin was primarily attributed to increased research and development expenses. The Company currently expects operating income for the remainder of 2004 will be lower than comparable periods in 2003 due to Infinity Broadcasting not renewing its contracts.

**Equity in Net Income of Affiliate.** Equity in net income of affiliate did not vary significantly.

**Interest Expense.** Interest expense decreased 39.3% to \$1.9 million for the three months ended June 30, 2004 from \$3.2 million for the same period in 2003. The decrease was primarily attributed to a \$69.9 million decline in the average outstanding debt under the Credit Facility in the three months ended June 30, 2004 compared to the three months ended June 30, 2003.

**Income Tax Expense.** Arbitron's effective tax rate was 39.0% for the three months ended June 30, 2004 and 2003.

**Net Income.** Net income increased 7.6% to \$8.6 million for the three months ended June 30, 2004 from \$8.0 million for the same period in 2003. The Company currently expects that net income for the remainder of 2004 will be lower than comparable periods in 2003 due to Infinity Broadcasting not renewing its contracts.

**EBIT and EBITDA.** Earnings before interest and income taxes ( EBIT ) decreased 1.7% to \$15.9 million and earnings before interest, income taxes, depreciation and amortization ( EBITDA ) increased 0.1% to \$17.3 million for the three months ended June 30, 2004. The Company currently expects that for the remainder of 2004 EBIT will be lower than comparable periods in 2003 due to Infinity Broadcasting not renewing its contracts. Arbitron has presented EBIT and EBITDA as supplemental information that management of Arbitron believes may be useful to investors to evaluate Arbitron's results because they exclude certain items that are not directly related to the Company's core operating performance. EBIT is calculated by adding back net interest expense and income tax expense to net income. EBITDA is calculated by adding back net interest expense, income taxes, depreciation and amortization to net income. EBIT and EBITDA should not be considered substitutes either for net income, as indicators of Arbitron's operating performance, or for cash flow, as measures of Arbitron's liquidity. In addition, because EBIT and EBITDA may not be

calculated identically by all companies, the presentation here may not be comparable to other similarly titled measures of other companies.



*Comparison of the Six Months Ended June 30, 2004 to the Six Months Ended June 30, 2003*

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

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

|  | Six Months Ended<br>June 30, |            | Increase<br>(Decrease) |         | Percentage of<br>Revenue |        |
|--|------------------------------|------------|------------------------|---------|--------------------------|--------|
|  | 2004                         | 2003       | Dollar                 | Percent | 2004                     | 2003   |
| Revenue  | \$ 141,669                   | \$ 132,802 | \$ 8,867               | 6.7%    | 100.0%                   | 100.0% |
| Costs and expenses                               |                              |            |                        |         |                          |        |
| Cost of revenue                                  | 51,258                       | 48,239     | 3,019                  | 6.3%    | 36.2%                    | 36.3%  |
| Selling, general and<br>administrative           | 30,291                       | 28,090     | 2,201                  | 7.8%    | 21.4%                    | 21.2%  |
| Research and development                         | 14,867                       | 12,695     | 2,172                  | 17.1%   | 10.5%                    | 9.6%   |
| Total costs and expenses                         | 96,416                       | 89,024     | 7,392                  | 8.3%    | 68.1%                    | 67.1%  |
| Operating income                                 | 45,253                       | 43,778     | 1,475                  | 3.4%    | 31.9%                    | 32.9%  |
| Equity in net income of<br>affiliate             | 2,529                        | 2,221      | 308                    | 13.9%   | 1.8%                     | 1.7%   |
| Income before interest and<br>income tax expense | 47,782                       | 45,999     | 1,783                  | 3.9%    | 33.7%                    | 34.6%  |
| Interest income                                  | 398                          | 373        | 25                     | 6.7%    | 0.3%                     | 0.3%   |
| Interest expense                                 | 4,378                        | 6,825      | (2,447)                | (35.9%) | 3.1%                     | 5.1%   |
| Income before income tax<br>expense              | 43,802                       | 39,547     | 4,255                  | 10.8%   | 30.9%                    | 29.8%  |
| Income tax expense                               | 17,083                       | 15,423     | 1,660                  | 10.8%   | 12.1%                    | 11.6%  |
| Net income                                       | \$ 26,719                    | \$ 24,124  | \$ 2,595               | 10.8%   | 18.8%                    | 18.2%  |
| Net income per weighted<br>average common share  |                              |            |                        |         |                          |        |
| Basic  | \$ 0.87                      | \$ 0.81    | \$ 0.06                | 7.4%    |                          |        |

Edgar Filing: ARBITRON INC - Form 10-Q

|                                   |                   |                   |                   |      |
|-----------------------------------|-------------------|-------------------|-------------------|------|
| Diluted                           | \$ 0.85           | \$ 0.80           | \$ 0.05           | 6.2% |
| Other data:                       |                   |                   |                   |      |
| EBIT                              | \$ 47,782         | \$ 45,999         | \$ 1,783          | 3.9% |
| EBITDA                            | \$ 50,551         | \$ 48,382         | \$ 2,169          | 4.5% |
| EBIT and EBITDA<br>Reconciliation |                   |                   |                   |      |
| Net income                        | \$ 26,719         | \$ 24,124         | \$ 2,595          |      |
| Income tax expense                | 17,083            | 15,423            | 1,660             |      |
| Interest income                   | 398               | 373               | 25                |      |
| Interest expense                  | 4,378             | 6,825             | (2,447)           |      |
|                                   | <u>          </u> | <u>          </u> | <u>          </u> |      |
| <br>                              |                   |                   |                   |      |
| EBIT                              | 47,782            | 45,999            | 1,783             |      |
| Depreciation and<br>amortization  | 2,769             | 2,383             | 386               |      |
|                                   | <u>          </u> | <u>          </u> | <u>          </u> |      |
| <br>                              |                   |                   |                   |      |
| EBITDA                            | \$ 50,551         | \$ 48,382         | \$ 2,169          |      |
|                                   | <u>          </u> | <u>          </u> | <u>          </u> |      |

**Revenue.** Revenue increased 6.7% to \$141.7 million for the six months ended June 30, 2004 from \$132.8 million for the same period in 2003. Approximately \$7.1 million of the increase was due to increases in the ratings and qualitative subscriber base, analytical software applications and escalations in multi-year customer contracts and contract renewals. The MRP acquisition accounted for \$2.2 million of the increase. These increases were partially offset by lower PPM equipment sales (\$0.4 million). The Company currently expects that the 2004 rate of revenue growth for the remainder of 2004 will be significantly lower than historical trends due to Infinity Broadcasting not renewing its contracts as discussed in the overview.

**Cost of Revenue.** Cost of revenue increased 6.3% to \$51.3 million for the six months ended June 30, 2004 from \$48.2 million for the same period in 2003, but decreased as a percentage of revenue to 36.2% in 2004 from 36.3% in 2003. The \$3.0 million increase was primarily due to increases in data collection costs (\$1.1 million), royalties (\$0.6 million), computer center costs (\$0.7 million) and human resources costs (\$0.4 million). Arbitron does not expect a reduction in cost of revenue related to Infinity Broadcasting not renewing its contracts.

**Selling, General and Administrative.** Selling, general and administrative expenses increased 7.8% to \$30.3 million for the six months ended June 30, 2004 from \$28.1 million for the same period in 2003, and increased as a percentage of revenue to 21.4% in 2004 from 21.2% in 2003. The \$2.2 million increase was primarily attributed to the MRP acquisition (\$1.3 million), the write-off of assets with the discontinuance of the MeasureCast service (\$0.5 million), and increased U.S. Media selling expenses (\$0.2 million).

**Research and Development.** Research and development increased 17.1% to \$14.9 million during the six months ended June 30, 2004 from \$12.7 million for the same period in 2003 and increased as a percentage of revenue to 10.5% in 2004 from 9.6% in 2003. The \$2.2 million increase was due to software development and enhancement costs in U.S. Media (\$0.8 million), the MRP acquisition (\$0.7 million) and PPM research and development (\$0.7 million).

**Operating Income.** Operating income increased 3.4% to \$45.3 million for the six months ended June 30, 2004 from \$43.8 million for the same period in 2003. Operating margin decreased to 31.9% in 2004 from 32.9% in 2003. The decline in operating margin was primarily attributed to increased research and development expenses. The Company currently expects operating income for the remainder of 2004 will be lower than comparable periods in 2003 due to Infinity Broadcasting not renewing its contracts.

**Equity in Net Income of Affiliate.** Equity in net income of affiliate did not vary significantly.

**Interest Expense.** Interest expense decreased 35.9% to \$4.4 million for the six months ended June 30, 2004 from \$6.8 million for the same period in 2003. The decrease was primarily attributed to a \$65.0 million decline in the average outstanding debt under the Credit Facility in the six months ended June 30, 2004 compared to the six months ended June 30, 2003.

**Income Tax Expense.** Arbitron's effective tax rate was 39.0% for the six months ended June 30, 2004 and 2003.

**Net Income.** Net income increased 10.8% to \$26.7 million for the six months ended June 30, 2004 from \$24.1 million for the same period in 2003. The Company currently expects that net income for the remainder of 2004 will be lower than comparable periods in 2003 due to Infinity Broadcasting not renewing its contracts.

**EBIT and EBITDA.** EBIT increased 3.9% to \$47.8 million and EBITDA increased 4.5% to \$50.6 million for the six months ended June 30, 2004 from \$46.0 million and \$48.4 million, respectively, for the same period in 2003. The Company currently expects that for the remainder of 2004 EBIT will be lower than comparable periods in 2003 due to Infinity Broadcasting not renewing its contracts. Arbitron has presented EBIT and EBITDA as supplemental information that management of Arbitron believes may be useful to investors to evaluate Arbitron's results because

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

be calculated identically by all companies, the presentation here may not be comparable to other similarly titled measures of other companies.

### **Liquidity and Capital Resources**

As of June 30, 2004, the Company had \$77.3 million in available cash and cash equivalents. In addition, the Company had \$51.1 million in available borrowings under its Credit Facility. Management expects that cash flow generated from operations, as well as available borrowings from its Credit Facility, if necessary, will be sufficient to support the Company's operations for the foreseeable future.

Net cash provided by operating activities was \$42.2 million and \$28.1 million for the six months ended June 30, 2004 and 2003, respectively, an increase of \$14.1 million. The increase was mainly attributable to the following: a decrease in deferred income taxes and income taxes recoverable (\$12.9 million); higher net income in 2004 (\$2.6 million); higher distributions from affiliate (\$0.5 million); higher tax benefit from stock option exercises (\$0.8 million); higher net collections in accounts receivable (\$3.5 million); increased accounts payable (\$0.5 million) and increased other noncurrent liabilities (\$1.8 million). These increases were partially offset by decreases in accrued expenses and other liabilities (\$6.7 million) and deferred revenue (\$2.5 million). The decrease in deferred income taxes is due primarily to a new Internal Revenue Service IRS procedure related to advance customer payments. As a result of the new procedure income taxes of approximately \$11.6 million paid in 2003 have been applied toward the Company's 2004 tax liability. The decrease in accrued expenses and other liabilities of \$6.7 million was also primarily caused by the new IRS procedure related to advance customer payments.

Net cash used in investing activities was \$12.8 million and \$1.4 million for the six months ended June 30, 2004 and 2003, respectively, an increase of \$11.4 million. The increase is attributed to the \$8.9 million MRP acquisition in March 2004 and increased spending on PPM software and other fixed assets.

Net cash used in financing activities was \$20.6 million and \$24.7 million for the six months ended June 30, 2004 and 2003, respectively, a decrease of \$4.1 million. The decrease is primarily attributed to additional cash proceeds from stock option exercises and stock purchase plans.

Arbitron's commitment under its revolving Credit Facility, which was \$225.0 million at inception, was \$76.2 million on June 30, 2004. The commitment is reduced annually in accordance with mandatory commitment reduction and excess cash flow provisions.

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

In 2003, Clear Channel Communications and Infinity Broadcasting represented approximately 21% and 10%, respectively, of Arbitron's revenue. Arbitron's agreements with these customers are not exclusive and contain no renewal obligations. Certain license agreements with Clear Channel Communications that accounted for

approximately 17% of Arbitron's revenue expire on December 31, 2004.

On June 24, 2004, Infinity Broadcasting announced that it has elected not to renew its agreements, which expired on March 31, 2004, with Arbitron for radio ratings and other services effective with the release of the Spring 2004 survey. Those Infinity Broadcasting contracts that were not renewed collectively accounted for approximately 9% of Arbitron's 2003 revenue. Arbitron cannot give any assurances that it will retain current customers or that it will be able to replace the revenue that is lost when a key customer fails to renew its agreement with Arbitron.

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

Separate from the proposed joint venture with Nielsen Media Research, Arbitron began testing additional marketing research applications of the Portable People Meter technology in 2003. One application that Arbitron began testing was the use of the Portable People Meter as the media collection tool for a national marketing-oriented panel designed to correlate advertising with shopping behavior and sales. The objective is to provide multimedia exposure data combined with sales data from a single-source to produce a measure of advertising effectiveness for advertisers, agencies and broadcasters. During 2004, Arbitron is continuing to research the marketplace potential and complete additional methods research for a national marketing-oriented panel. This would be a new type of service for which market acceptance is not yet known.

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

### **Seasonality**

Arbitron recognizes revenue for products and services over the terms of license agreements as products and services are delivered, and expenses are recognized as incurred. Arbitron gathers radio-listening data in approximately 287 United States local markets. All markets are measured at least twice per year (April, May, June, Spring Survey, and October, November, December, Fall Survey). In addition, all major markets are measured two additional times per year (January, February, March, Winter Survey, and July, August, September, Summer Survey). Arbitron's revenue is generally higher in the first and third quarters as the result of the delivery of the Fall Survey and Spring Survey, respectively, to all markets compared to revenue in the second and fourth quarters when delivery of the Winter Survey and Summer Survey, respectively, is only delivered to major markets. Arbitron's expenses are generally higher in the second and fourth quarters as the Spring Survey and Fall Survey are being conducted.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

### ***Interest Risk***

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

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

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

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

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



**ITEM 4. CONTROLS AND PROCEDURES**

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

**PART II OTHER INFORMATION****ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Arbitron's annual meeting of stockholders was held on May 17, 2004. There were 30,890,965 shares of Arbitron common stock outstanding and entitled to vote at the annual meeting. Of the 30,890,965 shares of Arbitron common stock entitled to vote at the annual meeting, a total of 29,545,398 shares were present in person or by proxy at the annual meeting.

The following people designated by Arbitron's Board of Directors as nominees for director were elected at the annual meeting, with the voting as follows:

| <b>Nominee</b>        | <b>Votes For</b> | <b>Votes Withheld</b> |
|-----------------------|------------------|-----------------------|
| Alan Aldworth         | 29,504,974       | 40,424                |
| Erica Farber          | 29,503,469       | 41,929                |
| Kenneth F. Gorman     | 28,890,892       | 654,506               |
| Philip Guarascio      | 29,504,188       | 41,210                |
| Larry E. Kittelberger | 29,294,275       | 251,123               |
| Stephen B. Morris     | 29,504,138       | 41,260                |
| Luis G. Nogales       | 29,504,470       | 40,928                |
| Lawrence Perlman      | 29,082,641       | 462,757               |
| Richard A. Post       | 29,293,983       | 251,415               |

The Amendment and Restatement of the Arbitron Inc. 1999 Stock Incentive Plan was approved at the annual meeting, with the voting as follows:

| <b>Votes For</b> | <b>Votes Against</b> | <b>Abstentions</b> | <b>Broker No Vote</b> |
|------------------|----------------------|--------------------|-----------------------|
| 24,142,207       | 2,648,025            | 84,268             | 2,670,898             |

No additional items were on the agenda of the annual meeting of stockholders and no other items were brought to a vote during the meeting.



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

(a) Exhibits

| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| Exhibit 31.1       | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                              |
| Exhibit 31.2       | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                              |
| Exhibit 32.1       | Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

(b) Reports on Form 8-K

Arbitron filed a Current Report on Form 8-K on June 24, 2004 reporting that Infinity Broadcasting Corp., a division of Viacom Inc., had issued a press release stating that Infinity Broadcasting had elected not to renew its agreements with Arbitron for radio ratings and other services effective with the release of the Spring 2004 survey.

SIGNATURE

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

ARBITRON INC.

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

Date: August 2, 2004

24