ARBITRON INC
Form 10-Q
November 04, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

Or

o 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	**52-0278528**
(State or other jurisdiction of incorporation or organization)	(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 x No o

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

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

ARBITRON INC.

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PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

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

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

See notes to consolidated financial statements.

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

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

See notes to consolidated financial statements.

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

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

See notes to consolidated financial statements.

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

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

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

See notes to consolidated financial statements.

ARBITRON INC.
Notes to Consolidated Financial Statements
September 30, 2004
(unaudited)

1. Basis of Presentation and Consolidation

Presentation

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

Consolidation

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

2. Pro Forma Disclosures of Stock Based Compensation

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

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

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

3. Purchase Acquisition

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

4. Long-Term Debt

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

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

	$ 50,000	$105,000

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

The Credit Facility has two borrowing options, a Eurodollar rate option or a base rate option, as defined in the agreement. Under the Eurodollar option, the Company may elect interest periods of one, two, three or six months at the inception date and each renewal date. Borrowings under the Eurodollar option bear interest at the London Interbank Offered Rate (LIBOR) plus a margin of 2.00% to 2.75%. Borrowings under the base rate option bear interest at the higher of the lead lender s prime rate or the Federal Funds rate plus 50 basis points, plus a margin of 0.50% to 1.25%. The specific margins, under both options, are determined based on the Company s ratio of indebtedness to earnings before interest, taxes, depreciation and amortization (leverage ratio), and are adjusted every 90 days. The agreement contains a commitment fee provision whereby the Company is charged a fee, ranging from 0.375% to 0.550%, that is applied to the unused portion of the facility. Under the terms of the Credit Facility, the Company is required to maintain certain other financial ratios, in addition to the leverage ratio, and meet other financial conditions. The agreement limits, among other things, the Company s ability to buy or sell assets, incur additional indebtedness, grant or incur liens on its assets, repay indebtedness other than the Credit Facility, make investments or acquisitions, repurchase or redeem capital stock and engage in certain mergers or consolidations. On September 30, 2004, Arbitron paid the remaining $25.0 million outstanding under the Credit Facility. The effective interest rate on the Credit Facility borrowings outstanding prior to the payment on September 30, 2004, was 7.02%.

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

Upon consummation of the spin-off, the Company issued $50.0 million of senior secured notes due January 31, 2008, and distributed the proceeds to Ceridian. The notes bear interest at a fixed rate of 9.96%. The senior secured notes agreement contains covenants similar to the Credit Facility. The agreement also contains a make-whole provision that applies in the event of early prepayment of principal. The fair value of the senior secured notes as of September 30, 2004 and December 31, 2003 was $54.4 million and $55.3 million, respectively, and was estimated using a cash flow valuation model and available market data for securities with similar maturity dates.

5. Interest Rate Swap

The Company entered into an interest rate swap agreement effective March 29, 2001, to hedge its exposure to fluctuations in interest rates relating to its outstanding variable rate debt. The contract s notional amount was $200.0 million at inception and declines each quarter over the life of the contract in proportion to the Company s estimated outstanding balance on the Credit Facility. Under the terms of the contract, the Company paid a fixed rate of 5.02% and received LIBOR, which reset every 90 days. The contract was settled on September 30, 2004 in conjunction with the payment of outstanding debt under the Credit Facility. The interest rate swap agreement was designated as a cash flow hedge, and was designed to be entirely effective by matching the terms of the swap agreement with the debt. The base rate for both the variable rate debt and the swap agreement was LIBOR and the instruments had the same renewal dates over the lives of the instruments. The fair value of the cash flow hedge had been recorded as a noncurrent liability, and the offsetting unrealized loss was recorded in accumulated other comprehensive loss. As a result of the swap and debt retirement, the Company realized a loss of $0.1 million, which was recorded as interest expense in the consolidated statement of income for the three months ended September 30, 2004.

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

6. Stockholders Equity (Deficit)

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

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

7. Net Income Per Weighted Average Common Share

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

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

8. Comprehensive Income

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

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

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

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

	September 30, 2004	December 31, 2003
Foreign currency translation adjustment	$ 289	$ 236
Unrealized loss on interest rate swap		(1,171)
Additional minimum pension liability	(4,706)	(4,706)
Income tax benefit	1,700	2,264
Accumulated other comprehensive loss	$ (2,717)	$ (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 who participate in the pension plan and were hired before January 1, 1992.

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

Defined Benefit Pension Plan Three Months	Postretirement Plan Three Months

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

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

10. Income Taxes

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

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

11. Significant Customers and Concentration of Credit Risk

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