SINCLAIR BROADCAST GROUP INC
Form 10-Q/A
September 01, 2006

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

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# FORM 10-Q/A
# (Amendment No. 1)

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(Mark One)

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

For the quarterly period ended March 31, 2006
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: **000-26076**

# SINCLAIR BROADCAST GROUP, INC.

(Exact name of Registrant as specified in its charter)

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| **Maryland**<br>(State or other jurisdiction of Incorporation or organization) | **52-1494660**<br>(I.R.S. Employer Identification No.) |
|---|---|

**10706 Beaver Dam Road**

**Hunt Valley, Maryland 21030**

(Address of principal executive offices)

**(410) 568-1500**

(Registrant s telephone number, including area code)

**None**

(Former name, former address and former fiscal year-if changed since last report)

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 a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (check one):

Large accelerated filer o Accelerated filer x Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date.

| **Title of each class** | **Number of shares outstanding as of May 3, 2006** |
|---|---|
| Class A Common Stock | 47,387,792 |
| Class B Common Stock | 38,348,331 |

**SINCLAIR BROADCAST GROUP, INC.**

**FORM 10-Q**
**FOR THE QUARTER ENDED MARCH 31, 2006**

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**EXPLANATORY NOTE**

We are filing this Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2006, as originally filed with the SEC on May 10, 2006, to restate our financial statements and corresponding financial information for the three months ended March 31, 2006.

We are restating the financial statements and corresponding financial information due to an error made in the accounting treatment for the exchange of our Series D Convertible Exchangeable Preferred Stock (the Preferred Stock) into 6% Convertible Debentures, due 2012 (the Debentures) in June 2005. In previously reported consolidated financial statements, we accounted for this transaction as an exchange and our auditors concurred with this treatment. We now believe, and our auditors concur, that the most appropriate accounting guidance to apply to this exchange is EITF Topic D-42, *The Effect of the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock,* and that the exchange should have been treated as a redemption for accounting purposes. Accordingly, we should have recorded the Debentures at fair value upon issuance and the excess of the carrying amount of the Preferred Stock over the fair value of the Debentures should have been added to net earnings to arrive at net earnings available to common shareholders. The difference in the carrying amount of the Preferred Stock and the fair value of the Debentures should have been recorded as a discount on the Debentures and amortized over the life of the Debentures using the effective interest method. Additionally, in calculating and accounting for the carrying amount of the Preferred Stock, all of the issuance costs of the Preferred Stock should have been charged directly to accumulated deficit rather than a portion of these costs recorded as unamortized costs relating to securities issuances and amortized over the remaining term of the Debentures. For additional information regarding our accounting treatment, see *Note 1. Summary of Significant Accounting Policies,* in the Notes to our Unaudited Consolidated Financial Statements.

In addition, we have revised *Item 4. Controls and Procedures* to discuss the facts and circumstances surrounding the restatement and to disclose the effect of the restatement on the adequacy of our disclosure controls and procedures as of March 31, 2006.

This Amendment No. 1 continues to speak as of the date of the original Form 10-Q for the three months ended March 31, 2006 and we have not updated or amended the disclosures contained herein to reflect events that have occurred since the filing of the original Form 10-Q, or modified or updated those disclosures in any way other than as described in the preceding paragraphs. Accordingly, this Amendment No. 1 should be read in conjunction with our filings made with the SEC subsequent to the filing of the original Form 10-Q on May 10, 2006.

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

**SINCLAIR BROADCAST GROUP, INC.**
**CONSOLIDATED BALANCE SHEETS**
**(In thousands, except share and per share data)**

| **ASSETS** | **As of March 31, 2006 (Unaudited) (Restated - See Note 1)** | **As of December 31, 2005 (Restated - See Note 1)** |
|---|---|---|
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 7,753 | $ 9,655 |
| Accounts receivable, net of allowance for doubtful accounts of $4,225 and $4,596, respectively | 118,176 | 127,913 |
| Current portion of program contract costs | 52,318 | 51,528 |
| Income taxes receivable | 2,072 | |
| Prepaid expenses and other current assets | 7,594 | 17,616 |
| Deferred barter costs | 2,694 | 2,027 |
| Assets held for sale | | 3,678 |
| Deferred tax assets | 9,446 | 10,591 |
| Total current assets | 200,053 | 223,008 |
| | | |
| PROGRAM CONTRACT COSTS, less current portion | 46,042 | 36,494 |
| LOANS TO AFFILIATES | 12 | 14 |
| PROPERTY AND EQUIPMENT, net | 295,798 | 304,355 |
| GOODWILL, net | 1,040,234 | 1,040,234 |
| BROADCAST LICENSES, net | 409,620 | 409,620 |
| DEFINITE-LIVED INTANGIBLE ASSETS, net | 222,039 | 224,673 |
| OTHER ASSETS | 39,649 | 44,907 |
| Total assets | $ 2,253,447 | $ 2,283,305 |
| | | |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | $ 4,677 | $ 3,799 |
| Income taxes payable | | 2,662 |
| Accrued liabilities | 67,367 | 84,623 |
| Current portion notes payable, capital leases and commercial bank financing | 33,700 | 33,802 |
| Current portion of notes and capital leases payable to affiliates | 3,091 | 4,135 |
| Current portion of program contracts payable | 77,064 | 88,510 |
| Deferred barter revenues | 3,129 | 2,501 |
| Deferred gain on sale of broadcast assets | | 3,249 |
| Liabilities held for sale | | 1,407 |
| Total current liabilities | 189,028 | 224,688 |
| | | |
| LONG-TERM LIABILITIES: | | |
| Notes payable, capital leases and commercial bank financing, less current portion | 1,381,103 | 1,397,649 |
| Notes payable and capital leases to affiliates, less current portion | 15,606 | 15,152 |
| Program contracts payable, less current portion | 79,589 | 65,239 |
| Deferred tax liabilities | 285,037 | 277,451 |
| Other long-term liabilities | 49,384 | 52,438 |
| Total liabilities | 1,999,747 | 2,032,617 |
| | | |
| MINORITY INTEREST IN CONSOLIDATED ENTITIES | 766 | 966 |
| | | |
| SHAREHOLDERS EQUITY: | | |

| | | |
|---|---|---|
| Class A Common Stock, $.01 par value, 500,000,000 shares authorized, 47,329,176 and 47,122,407 shares issued and outstanding, respectively | 473 | 471 |
| Class B Common Stock, $.01 par value, 140,000,000 shares authorized, 38,348,331 shares issued and outstanding, convertible into Class A Common Stock | 383 | 383 |
| Additional paid-in capital | 594,941 | 593,259 |
| Accumulated deficit | (342,863) | (344,391) |
| Total shareholders equity | 252,934 | 249,722 |
| Total liabilities and shareholders equity | $ 2,253,447 | $ 2,283,305 |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

**SINCLAIR BROADCAST GROUP, INC.**
**CONSOLIDATED STATEMENTS OF OPERATIONS**
**(In thousands, except per share data) (Unaudited)**

| | Three Months Ended March 31, | |
|---|---|---|
| | 2006 (Restated - See Note 1) | 2005 |
| REVENUES: | | |
| Station broadcast revenues, net of agency commissions | $ 147,925 | $ 144,428 |
| Revenues realized from station barter arrangements | 11,805 | 14,511 |
| Other operating divisions revenues | 3,737 | 4,921 |
| Total revenues | 163,467 | 163,860 |
| | | |
| OPERATING EXPENSES: | | |
| Station production expenses | 38,109 | 37,924 |
| Station selling, general and administrative expenses | 34,146 | 34,777 |
| Expenses recognized from station barter arrangements | 10,825 | 13,405 |
| Amortization of program contract costs and net realizable value adjustments | 18,623 | 17,119 |
| Other operating divisions expenses | 3,989 | 5,053 |
| Depreciation of property and equipment | 12,288 | 13,026 |
| Corporate general and administrative expenses | 5,806 | 5,453 |
| Amortization of definite-lived intangible assets and other assets | 4,325 | 4,527 |
| Total operating expenses | 128,111 | 131,284 |
| Operating income | 35,356 | 32,576 |
| | | |
| OTHER INCOME (EXPENSE): | | |
| Interest expense and amortization of debt discount and deferred financing costs | (29,710) | (28,971) |
| Interest income | 46 | 121 |
| Loss from sale of assets | (287) | (11) |
| Loss from extinguishment of debt | (623) | |
| Unrealized gain from derivative instruments | 2,881 | 8,899 |
| Income from equity and cost investees | 6,099 | 1,179 |
| Other (expense) income, net | (125) | 76 |
| Total other expense | (21,719) | (18,707) |
| Income from continuing operations before income taxes | 13,637 | 13,869 |
| | | |
| INCOME TAX PROVISION | (6,561) | (5,421) |
| Income from continuing operations | 7,076 | 8,448 |
| | | |
| DISCONTINUED OPERATIONS: | | |
| Income from discontinued operations, net of related income tax benefit of $1,114 and tax provision of $1,519, respectively | 1,168 | 2,861 |
| Gain from discontinued operations, net of related income tax provision of $885 | 1,774 | |
| NET INCOME | 10,018 | 11,309 |
| PREFERRED STOCK DIVIDENDS | | (2,502) |
| NET INCOME AVAILABLE TO COMMON SHAREHOLDERS | $ 10,018 | $ 8,807 |
| | | |
| BASIC AND DILUTED EARNINGS PER COMMON SHARE: | | |
| Earnings per common share from continuing operations | $ 0.08 | $ 0.07 |
| Earnings per common share from discontinued operations | $ 0.03 | $ 0.03 |
| Earnings per common share | $ 0.11 | $ 0.10 |
| Weighted average common shares outstanding | 85,533 | 85,235 |
| Weighted average common and common equivalent shares outstanding | 85,535 | 85,236 |
| Dividends declared per common share | $ 0.10 | $ 0.05 |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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**SINCLAIR BROADCAST GROUP, INC.**
**CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY**
**FOR THE THREE MONTHS ENDED MARCH 31, 2006**
(In thousands) (Unaudited)

| | **Class A Common Stock** | **Class B Common Stock** | **Additional Paid-In Capital** | **Accumulated Deficit** | **Total Shareholders Equity** |
|---|---|---|---|---|---|
| BALANCE, December 31, 2005 (a) | $ 471 | $ 383 | $ 593,259 | $ (344,391) | $ 249,722 |
| Dividends declared on Class A and Class B Common Stock | | | | (8,490) | (8,490) |
| Class A Common Stock issued pursuant to employee benefit plans | 2 | | 1,682 | | 1,684 |
| Net income (a) | | | | 10,018 | 10,018 |
| BALANCE, March 31, 2006 (a) | $ 473 | $ 383 | $ 594,941 | $ (342,863) | $ 252,934 |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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(a) Amounts for 2005 and the quarterly period ended March 31, 2006 have been restated. See *Note 1. Summary of Significant Accounting Policies*, in the Notes to our Unaudited Consolidated Financial Statements, for additional information.

**SINCLAIR BROADCAST GROUP, INC.**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(In thousands) (Unaudited)**

| | Three Months Ended March 31, | |
|---|---|---|
| | 2006 (Restated - See Note 1) | 2005 |
| CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES: | | |
| Net income | $ 10,018 | $ 11,309 |
| Adjustments to reconcile net income to net cash flows from operating activities: | | |
| Amortization of debt discount, net of (debt premium) | 480 | (270) |
| Depreciation of property and equipment | 12,288 | 13,189 |
| Recognition of deferred revenue | (1,235) | (1,235) |
| Accretion of capital leases | 152 | 175 |
| Income from equity and cost investees | (6,099) | (1,179) |
| Loss on sale of property | 287 | 11 |
| Gain on sale of broadcast assets related to discontinued operations | (2,659) | |
| Unrealized gain from derivative instruments | (2,881) | (8,899) |
| Amortization of definite-lived intangible assets and other assets | 4,325 | 4,543 |
| Amortization of program contract costs and net realizable value adjustments | 18,623 | 17,350 |
| Amortization of deferred financing costs | 661 | 654 |
| Stock-based compensation | 499 | 233 |
| Loss on extinguishment of debt, non-cash portion | 989 | |
| Amortization of derivative instruments | 134 | 134 |
| Deferred tax provision related to operations | 8,018 | 5,297 |
| Deferred tax (benefit) provision related to discontinued operations | (1,177) | 1,659 |
| Net effect of change in deferred barter revenues and deferred barter costs | (39) | (229) |
| Changes in assets and liabilities, net of effects of acquisitions and dispositions: | | |
| Decrease in accounts receivable, net | 9,737 | 11,769 |
| Increase in taxes receivable | (2,072) | (64) |
| Decrease in prepaid expenses and other current assets | 10,034 | 7,629 |
| Decrease (increase) in other long-term assets | 177 | (103) |
| Decrease in accounts payable and accrued liabilities | (13,863) | (10,101) |
| Decrease in income taxes payable | (772) | |
| Decrease in other long-term liabilities | (1,851) | (788) |
| Dividends and distributions from equity and cost investees | 6,000 | |
| Payments on program contracts payable | (26,289) | (28,163) |
| (Decrease) increase in minority interest | (19) | 17 |
| Net cash flows from operating activities | 23,466 | 22,938 |
| CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES: | | |
| Acquisition of property and equipment | (4,717) | (3,538) |
| Payments for acquisition of television stations | (1,710) | |
| Investments in equity and cost investees | (59) | (518) |
| Proceeds from the sale of assets | 1,358 | 21 |
| Proceeds from the sale of broadcast assets related to discontinued operations | 1,400 | |
| Loans to affiliates | (35) | (20) |
| Proceeds from loans to affiliates | 34 | 28 |
| Net cash flows used in investing activities | (3,729) | (4,027) |
| CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES: | | |
| Proceeds from notes payable, commercial bank financing and capital leases | 49,000 | |
| Repayments of notes payable, commercial bank financing and capital leases | (61,114) | (2,500) |
| Proceeds from exercise of stock options | | 13 |
| Dividends paid on Series D Convertible Exchangeable Preferred Stock | | (2,502) |
| Dividends paid on Class A and Class B Common Stock | (8,470) | (2,129) |
| Repayments of notes and capital leases to affiliates | (1,055) | (953) |
| Net cash flows used in financing activities | (21,639) | (8,071) |

| | | |
|---|---|---|
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (1,902 ) | 10,840 |
| CASH AND CASH EQUIVALENTS, beginning of period | 9,655 | 10,491 |
| CASH AND CASH EQUIVALENTS, end of period | $ 7,753 | $ 21,331 |

The accompanying notes are an integral part of these unaudited consolidated financial statements.

**SINCLAIR BROADCAST GROUP, INC.**
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

***Principles of Consolidation***

The accompanying unaudited consolidated financial statements include the accounts of Sinclair Broadcast Group, Inc. and those of our wholly-owned and majority-owned subsidiaries and variable interest entities. Minority interest represents a minority owner s proportionate share of the equity in certain of our consolidated entities. All significant intercompany transactions and account balances have been eliminated in consolidation.

***Restatement***

***On August 11, 2006, the Audit Committee of our Board of Directors determined that our financial statements for the quarters ended June 30, 2005, September 30, 2005, and March 31, 2006 and for the year ended December 31, 2005 should be restated. The restated financial statements result from an error made in the accounting treatment for the exchange of our Series D Convertible Exchangeable Preferred Stock (the Preferred Stock) into 6% Convertible Debentures, due 2012 (the Debentures) in June 2005. In previously reported consolidated financial statements, we accounted for this transaction as an exchange and our auditors concurred with this treatment. We now believe, and our auditors concur, that the most appropriate accounting guidance to apply to this exchange is EITF Topic D-42,*** The Effect of the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock, and that the exchange should have been treated as a redemption for accounting purposes. Accordingly, we should have recorded the Debentures at fair value upon issuance and the excess of the carrying amount of the Preferred Stock over the fair value of the Debentures should have been added to net earnings to arrive at net earnings available to common shareholders. The difference in the carrying amount of the Preferred Stock and the fair value of the Debentures should have been recorded as a discount on the Debentures and amortized over the life of the Debentures using the effective interest method. Additionally, in calculating and accounting for the carrying amount of the Preferred Stock, all of the issuance costs of the Preferred Stock should have been charged directly to accumulated deficit rather than a portion of these costs recorded as unamortized costs relating to securities issuances and amortized over the remaining term of the Debentures.

***A summary of the aggregate effect of these restatements on our consolidated balance sheet is shown below (in thousands):***

| | As of December 31, 2005 | | |
|---|---|---|---|
| | **As Reported** | **Adjustment** | **As Restated** |
| Total current assets | $ 223,008 | $ | $ 223,008 |
| Total long-term assets | 2,062,645 | (2,348) | 2,060,297 |
| Total assets | $ 2,285,653 | $ (2,348) | $ 2,283,305 |
| | | | |
| Total current liabilities | $ 224,688 | $ | $ 224,688 |
| Notes payable, capital leases and commercial bank financing, less current portion | 1,426,754 | (29,105) | 1,397,649 |
| Notes payable and capital leases to affiliates, less current portion | 15,152 | | 15,152 |
| Deferred tax liabilities | 278,399 | (948) | 277,451 |
| Other long-term liabilities | 117,677 | | 117,677 |
| Total liabilities | 2,062,670 | (30,053) | 2,032,617 |
| | | | |
| Minority interest in consolidated entities | 966 | | 966 |
| | | | |
| Class A and Class B Common Stock | 854 | | 854 |
| Additional paid-in capital | 590,377 | 2,882 | 593,259 |
| Accumulated deficit | (369,214) | 24,823 | (344,391) |

| | | | |
|---|---|---|---|
| Total shareholders equity | 222,017 | 27,705 | 249,722 |
| Total liabilities and shareholders equity | $ 2,285,653 | $ (2,348 ) | $ 2,283,305 |

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| | As of March 31, 2006 As Reported | Adjustment | As Restated |
|---|---|---|---|
| Total current assets | $ 200,053 | $ | $ 200,053 |
| Total long-term assets | 2,055,532 | (2,138 ) | 2,053,394 |
| Total assets | $ 2,255,585 | $ (2,138 ) | $ 2,253,447 |
| | | | |
| Total current liabilities | $ 189,028 | $ | $ 189,028 |
| Notes payable, capital leases and commercial bank financing, less current portion | 1,407,934 | (26,831 ) | 1,381,103 |
| Notes payable and capital leases to affiliates, less current portion | 15,606 | | 15,606 |
| Deferred tax liabilities | 286,902 | (1,865 ) | 285,037 |
| Other long-term liabilities | 128,973 | | 128,973 |
| Total liabilities | 2,028,443 | (28,696 ) | 1,999,747 |
| | | | |
| Minority interest in consolidated entities | 766 | | 766 |
| | | | |
| Class A and Class B Common Stock | 856 | | 856 |
| Additional paid-in capital | 592,059 | 2,882 | 594,941 |
| Accumulated deficit | (366,539 ) | 23,676 | (342,863 ) |
| Total shareholders equity | 226,376 | 26,558 | 252,934 |
| Total liabilities and shareholders equity | $ 2,255,585 | $ (2,138 ) | $ 2,253,447 |

***A summary of the aggregate effect of these restatements on our unaudited consolidated statements of operations is shown below (in thousands, except per share data):***

| | Three Months Ended March 31, 2006 As Reported | Adjustment | As Restated |
|---|---|---|---|
| Total revenues | $ 163,467 | $ | $ 163,467 |
| Total operating expenses | 128,111 | | 128,111 |
| Operating income | 35,356 | | 35,356 |
| Interest expense and amortization of debt discount and deferred financing costs | (29,170 ) | (540 ) | (29,710 ) |
| Other income, net | 9,515 | (1,524 ) | 7,991 |
| Total other expense | (19,655 ) | (2,064 ) | (21,719 ) |
| Income from continuing operations before income taxes | 15,701 | (2,064 ) | 13,637 |
| Income tax (provision) benefit | (7,478 ) | 917 | (6,561 ) |
| Income from continuing operations | 8,223 | (1,147 ) | 7,076 |
| Income and gain related to discontinued operations, net of taxes | 2,942 | | 2,942 |
| Net income | 11,165 | (1,147 ) | 10,018 |
| Preferred stock dividends | | | |
| Excess of preferred stock carrying value over redemption value | | | |
| Net income available to common shareholders | $ 11,165 | $ (1,147 ) | $ 10,018 |
| Basic and diluted earnings per common share: | | | |
| Earnings per common share from continuing operations | $ 0.10 | $ (0.02 ) | $ 0.08 |
| Earnings per common share from discontinued operations | $ 0.03 | $ | $ 0.03 |
| Earnings per common share | $ 0.13 | $ (0.02 ) | $ 0.11 |
| Weighted average common shares outstanding | 85,533 | | 85,533 |
| Weighted average common and common equivalent shares outstanding | 85,535 | | 85,535 |

***The effects of the error on the consolidated statement of cash flows for the three months ended March 31, 2006 were not material.***

***Discontinued Operations***

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we reported the financial position and results of operations of KOVR-TV in Sacramento, California, KSMO-TV in Kansas City,

Missouri and WEMT-TV in Tri-Cities, Tennessee as discontinued operations in the accompanying consolidated balance sheets and consolidated statements of operations. Discontinued operations have not been segregated in the consolidated statements of cash flows and, therefore, amounts for certain captions will not agree with the accompanying consolidated balance sheets and consolidated statements of operations. The operating results of KOVR, KSMO and WEMT are not included in our consolidated results from continuing operations for the quarters ended March 31, 2006 and 2005. In accordance with Emerging Issues Task Force Issue No. 87-24, *Allocation of Interest to Discontinued Operations*, we have allocated $2.6 million of interest expense to discontinued operations for the quarter ended March 31, 2005. No interest expense was allocated for the quarter ended March 31, 2006. See *Note 8. Discontinued Operations,* for additional information.



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***Interim Financial Statements***

The consolidated financial statements for the three months ended March 31, 2006 and 2005 are unaudited. In the opinion of management, such financial statements have been presented on the same basis as the annual consolidated financial statements and include all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation of the consolidated balance sheets, consolidated statements of operations and consolidated statements of cash flows for these periods.

As permitted under the applicable rules and regulations of the Securities and Exchange Commission, the consolidated financial statements do not include all disclosures normally included with audited consolidated financial statements and, accordingly, should be read together with the audited consolidated financial statements and notes thereto in our Annual Report on Form 10-K, as amended, for the year ended December 31, 2005, which we have filed with the Securities and Exchange Commission. The consolidated statements of operations presented in the accompanying consolidated financial statements are not necessarily representative of operations for an entire year.

***Use of Estimates***

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses in the consolidated financial statements and in the disclosures of contingent assets and liabilities. Actual results could differ from those estimates.

***Stock-Based Compensation***

On January 1, 2006, we adopted Statement of Financial Accounting Standard No. 123R, *Share-Based Payment* (SFAS 123R). SFAS 123R requires us to expense the fair value of grants of various stock-based compensation programs over the vesting period of the awards. We elected to adopt the Modified Prospective Application transition method which does not result in the restatement of previously issued consolidated financial statements. For additional information regarding our accounting under SFAS 123R, see *Note 2. Stock-Based Compensation*.

***Restructuring Costs***

During the three months ended March 31, 2006, we incurred costs associated with restructuring the news operations at certain of our stations. Specifically, on or before March 31, 2006, we ceased our locally produced news broadcasts in nine of our markets, terminated the news employees and cancelled our news-related contracts. The total one-time terminated employee benefit costs related to this restructuring were $0.5 million and the total one-time contract cancellation costs were $0.5 million, all of which were recorded as station production expenses for the three months ended March 31, 2006. The remaining unpaid liability associated with these costs was $0.8 million as of March 31, 2006. In addition, we expect to incur costs associated with the transfer of certain news broadcast assets to our other stations that continue to produce local news; these costs will be expensed in the period in which they are incurred. We are still evaluating when and where these assets will be transferred and therefore, we are not able to estimate such costs at this time.

***Income Taxes***

Our income tax provision for all periods consists of federal and state income taxes. The tax provision for the three months ended March 31, 2006 is based on the estimated effective tax rate applicable for the full year, which is expected to be 48.1%. Our effective income tax rate differs from the federal statutory rate of 35% and can vary from period to period due to fluctuations in operating results, new or revised tax legislation and accounting pronouncements and state income taxes. Both the first quarter and estimated annual 2006 effective rates are higher than the statutory rate due primarily to the impact of state income taxes and certain items not deductible for tax purposes.

***Reclassifications***

Certain reclassifications have been made to the prior periods consolidated financial statements to conform with the current period s presentation.

**2. STOCK-BASED COMPENSATION:**

On January 1, 2006, we adopted Statement of Financial Accounting Standard No. 123R, *Share-Based Payment* (SFAS No. 123R). SFAS 123R requires us to expense the fair value of grants of various stock-based compensation programs over the vesting period of the awards. We elected to adopt the Modified Prospective Application transition method which does not result in the restatement of previously issued consolidated financial statements. SFAS 123R also requires us to classify income tax deductions in excess of the compensation cost recognized on stock options exercised during the period as financing cash flows.

***Description of Awards***

We have four types of stock-based compensation awards: compensatory stock options (options), restricted stock awards (RSAs), an employee stock purchase plan (ESPP) and employer matching contributions (the Match) for participants in our 401(k) plan. Below is a summary of the key terms and methods of valuation of our stock-based compensation awards:

*Options.* In June 1996, our Board of Directors adopted, upon approval of the shareholders by proxy, the 1996 Long-Term Incentive Plan (LTIP). The purpose of the LTIP is to reward key individuals for making major contributions to our success and that of our subsidiaries and to attract and retain the services of qualified and capable employees. Options granted pursuant to the LTIP must be exercised within 10 years following the grant date. A total of 14,000,000 shares of Class A Common Stock are reserved for awards under this plan. As of March 31, 2006, 7,020,114 shares (including forfeited shares) were available for future grants.

On April 21, 2005, we accelerated the vesting of 390,039 stock options, which were all of our outstanding unvested options at that time. We accelerated the vesting of these options to prevent recognizing an expense of approximately $0.8 million, before taxes, in 2006 and future periods. The acceleration of the vesting resulted in a modification to the original options. In accordance with FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock-Based Compensation* (FIN 44), we recorded an immaterial compensation charge based on the intrinsic value of the awards (as defined by FIN 44) as measured on the modification date. The exercise prices of these options range from $7.39 to $15.19 per share and there was no material impact to earnings as a result of this acceleration because most options had an exercise price that was above the trading price on the vesting date. We have not issued any options subsequent to accelerating the vesting. There were no options exercised during the three months ended March 31, 2006.

A summary of changes in outstanding stock options is as follows:

| | Options | Weighted-Average Exercise Price | Exercisable | Weighted-Average Exercise Price |
|---|---|---|---|---|
| Outstanding at end of 2004 | 6,576,520 | $ 15.73 | 5,950,757 | $ 15.73 |
| | | | | |
| 2005 Activity: | | | | |
| Granted | 2,000 | $ 8.24 | | |
| Exercised | (20,750) | $ 7.76 | | |
| Forfeited | (205,050) | $ 14.91 | | |
| Outstanding at end of 2005 | 6,352,720 | $ 15.78 | 6,352,720 | $ 15.78 |
| | | | | |
| 2006 Activity: | | | | |
| Granted | | $ | | |
| Exercised | | $ | | |
| Forfeited | | $ | | |
| Outstanding at end of 2006 | 6,352,720 | $ 15.78 | 6,352,720 | $ 15.78 |

We do not expect to issue options in future periods, and instead, we expect to issue RSAs, discussed below. Therefore, the adoption of SFAS 123R did not have a material effect on our consolidated income, cash flows and basic and diluted earnings per share.

In the event the Board of Directors decides to issue options, we would be required to determine the method we would use to estimate the fair value, such as the Black-Scholes method or a lattice method. Additionally, we would be required to estimate certain assumptions, including

expected volatility and estimated forfeitures.

*RSAs.* RSAs are granted to employees pursuant to the LTIP and do not have an expiration. RSAs do have certain restrictions that lapse over three years at 25%, 25% and 50%, respectively. During this period, all RSAs have voting rights similar to any unrestricted shares and will be eligible for dividends subject to our normal dividend policies. As the restrictions lapse, the stock may be freely traded on the open market. We have not previously awarded RSAs, and we did not award any RSAs during the three months ended March 31, 2006. On April 3, 2006, we awarded 40,000 RSAs that had a fair value of $7.81 per share, which was the value of the stock on the trading date immediately prior to the grant date. We will record an expense related to this grant on a straight-line basis over the 3-year lapse period. This expense will reduce our consolidated income, but it will have no effect on our consolidated cash flows. Additionally, RSAs for which the restrictions have lapsed will be included in total shares outstanding, which will have a dilutive effect on our basic earnings per share; and RSAs for which the restrictions have not lapsed will be included in total equivalent shares outstanding, which will have a dilutive effect on our diluted earnings per share.

*ESPP.* In March 1998, the Board of Directors adopted, upon approval of the shareholders by proxy, the 1998 Employee Stock Purchase Plan (the ESPP). The ESPP provides our employees with an opportunity to become shareholders through a convenient arrangement for purchasing shares of Class A Common Stock. On the first day of each payroll deduction period, the participating employee receives options to purchase a number of shares of our common stock with money that is withheld from his or her paycheck. The number of shares available to the participating employee is determined at the end of the payroll deduction period by dividing (1) the total amount of money withheld during the payroll deduction period by (2) the exercise price of the options (as described below). Options granted under the ESPP to employees are automatically exercised to purchase shares on the last day of the payroll deduction period, unless the participating employee has, at least thirty days earlier requested that his or her payroll contributions stop. Any cash accumulated in an employee s account for a period in which an employee elects not to participate is distributed to the employee.

The initial exercise price for options under the ESPP is 85% of the lesser of the fair market value of the common stock as of the first day of the payroll deduction period and as of the last day of that period. No participant can purchase more than $25,000 worth of our common stock in all payroll deduction periods ending during the same calendar year. We value the stock options under the ESPP using the Black-Scholes option pricing model, which incorporates the following assumptions as of March 31, 2006:

| | **2006** | |
|---|---|---|
| Risk-free interest rate | 4.563 | % |
| Expected life | 90 days | |
| Expected volatility | 43.384 | % |
| Annual dividend yield | 4.44 | % |

We use the Black-Scholes model as opposed to a lattice pricing model because employee exercise patterns are not relevant to this plan. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected life is based on the number of days in the quarter. The expected volatility is based on our historical stock prices over the previous 90-day period. The annual dividend yield is based on the annual dividend per share divided by the share price on the grant date.

The stock-based compensation expense recorded for the three months ended March 31, 2006 was less than $0.1 million for the 0.1 million shares issued to employees. This expense reduced our consolidated income, but it had no effect on our consolidated cash flows. Additionally, options issued under the ESPP are included in the total shares outstanding at the end of each period, which results in a dilutive effect on our basic and diluted earnings per share.

*Match.* The Sinclair Broadcast Group, Inc. 401(k) Profit Sharing Plan and Trust (the 401(k) Plan) is available as a benefit for our eligible employees. Contributions made to the 401(k) Plan include an employee elected salary reduction amount, company-matching contributions (the Match) and an additional discretionary amount determined each year by the Board of Directors. The Match and any discretionary contributions may be made using our Class A

Common Stock if the Board of Directors so choose. In general, we make the Match using our Class A Common Stock.

The value of the Match is based on the level of elective deferrals into the 401(k) plan. The amount of shares of our Class A Common Stock used to make the Match is determined using the closing price on or about March 1st of each year for the previous year s Match. The Match is equal to a maximum of 50% of the first 4% of elective deferrals by eligible employees. During the three months ended March 31, 2006, we made the 2005 Match of $1.5 million. Additionally, we recorded an expense related to the 2006 Match of $0.5 million, which will be made using our Class A Common Stock in March of 2007. There has been no change in the method of accounting for the Match as a result of adopting SFAS 123R. Therefore, there will be no changes in the effect of the Match on our consolidated income, cash flows and basic and diluted earnings per share in future periods as compared to previous periods.

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***Compensation Summary***

A brief description of the compensation recorded in the consolidated statements of operations is as follows for each type of stock-based compensation awards:

*Options.* For the three months ended March 31, 2006, we did not record any expense related to our outstanding options. All options were previously vested, as disclosed above, and no options were awarded during the period. See 2005 Pro-Forma Compensation below for our accounting treatment during the three months ended March 31, 2005.

*RSAs.* For the three months ended March 31, 2006, we did not record any expense related to RSAs because there were no RSAs granted prior to that date.

*ESPP.* For the three months ended March 31, 2006, we recorded less than $0.1 million in compensation expenses related to our ESPP. See 2005 Pro-Forma Compensation below for our accounting treatment during the three months ended March 31, 2005.

*Match.* For the three months ended March 31, 2006 and 2005, we recorded $0.5 million and $0.2 million, respectively, in compensation expenses related to our Match.

We have accounted for stock-based compensation in accordance with interpretive guidance provided by the SEC in Staff Accounting Bulletin No. 107. The following table presents the stock-based compensation classified as station production, station selling, general and administrative and corporate general and administrative expenses:

| | **Three Months Ended March 31,** | | | |
|---|---|---|---|---|
| | **2006** | | **2005** | |
| Station production expenses | $ | 37,958 | $ | 37,862 |
| Stock-based compensation | 151 | | 62 | |
| Station production expenses, as reported | $ | 38,109 | $ | 37,924 |
| | | | | |
| Station selling, general and administrative expenses | $ | 33,908 | $ | 34,688 |
| Stock-based compensation | 238 | | 89 | |
| Station selling, general and administrative expenses, as reported | $ | 34,146 | $ | 34,777 |
| | | | | |
| Corporate general and administrative expenses | $ | 5,696 | $ | 5,386 |
| Stock-based compensation | 110 | | 67 | |
| Corporate general and administrative expenses, as reported | $ | 5,806 | $ | 5,453 |

***2005 Pro-Forma Compensation***

For the three months ended March 31, 2005, we applied the intrinsic value method of accounting for stock options as prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* which was permitted by SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123). Accordingly, no expense was recognized for our options or shares granted under the ESPP. Had compensation expense related to our stock options and shares under the ESPP been determined consistent with SFAS 123, our net income available to common shareholders for the three months ended March 31, 2005 would approximate the pro forma amounts below (in thousands, except per share data):

| | 2005 |
|---|---|
| Net income available to common shareholders | $ 8,807 |
| Add: Stock-based employee compensation expense included in net income, net of related tax effects | 218 |
| Less: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (464 ) |
| Net income available to common shareholders, pro forma | $ 8,561 |
| | |
| Earnings per share: | |
| Basic and diluted as reported | $ 0.10 |
| Basic and diluted pro forma | $ 0.10 |

We have computed for pro forma disclosure purposes the value of all options granted during the three months ended March 31, 2005, using the Black-Scholes option pricing model as prescribed by SFAS 123 using the following weighted average assumptions:

| | 2005 |
|---|---|
| Risk-free interest rate | 3.10 % |
| Expected lives | 5 years |
| Expected volatility | 48.0 % |
| Dividend yield | 2.2 % |
| Weighted average fair value | $ 5.48 |

**3. COMMITMENTS AND CONTINGENCIES:**

***Litigation***

We are a party to lawsuits and claims from time to time in the ordinary course of business. Actions currently pending are in various preliminary stages and no judgments or decisions have been rendered by hearing boards or courts in connection with such actions. After reviewing developments to date with legal counsel, our management is of the opinion that the outcome of our pending and threatened matters will not have a material adverse effect on our consolidated balance sheets, consolidated statements of operations or consolidated statements of cash flows.

***Operating Leases***

As of March 31, 2006, we had outstanding letters of credit of $1.1 million under our revolving credit facility. The letters of credit act as a guarantee of lease payments for the property occupied by WTTA-TV in Tampa, Florida, pursuant to the terms and conditions of the lease agreement and as support of the purchase of the license assets of WNYS-TV in Syracuse, New York, pursuant to an Asset Purchase Agreement.

***Network Affiliation Agreements***

As of March 31, 2006, the 58 television stations that we own and operate, or to which we provide programming services or sales services, 56 currently are affiliated as follows: FOX (19 stations), WB (18 stations), ABC (10 stations), UPN (6 stations), CBS (2 stations) and NBC (1 station). The remaining two stations are independent. The networks produce and distribute programming in exchange for each station s commitment to air the programming at specified times and for commercial announcement time during programming.

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On October 24, 2005, NBC informed us that they intend to terminate our affiliation with WTWC-TV in Tallahassee, Florida. This notice is contractually required to avoid automatic renewal of the existing agreement which expires January 1, 2007. NBC has stated it is willing to continue its affiliation with WTWC if revised terms and conditions can be agreed upon. As of March 31, 2006, the net book value of this affiliation agreement was $2.2 million. We continue to negotiate with NBC regarding our affiliation agreement.

On March 2, 2006, we entered into an agreement with Twentieth Television, Inc. to air MyNetworkTV primetime programming on 17 of our stations. This agreement becomes effective on September 5, 2006 and expires on September 4, 2011. As of March 31, 2006, the net book value of the affiliation agreements related to our WB and UPN stations that will be airing MyNetworkTV programming was $6.2 million.

On May 1, 2006, we entered into an agreement with FOX to renew all of our FOX affiliation agreements. These agreements expire on March 31, 2012. As of March 31, 2006, the net book value of these affiliation agreements was $36.4 million.

On May 2, 2006, we entered into affiliation agreements with The CW Television Network to air their programming on nine of our stations. These agreements become effective on September 1, 2006 and expire on August 31, 2010. As of March 31, 2006, the net book value of the affiliation agreements related to our WB stations that will be airing CW programming was $2.6 million.

Beginning in September 2006, our 58 television stations will be affiliated as follows: FOX (19 stations), MyNetworkTV (17 stations), ABC (10 stations), The CW (9 stations), CBS (2 stations) and NBC (1 station). We will no longer have independent stations.

***Changes in the Rules on Television Ownership and Local Marketing Agreements***

There have been no material changes to the Federal Communications Commission (FCC) rules on television ownership and local marketing agreements during the three months ended March 31, 2006. Please refer to *Note 10. Commitments and Contingencies* in our Annual Report on Form 10-K, as amended, for the year ended December 31, 2005.

**4. SUPPLEMENTAL CASH FLOW INFORMATION:**

During the three months ended March 31, 2006 and 2005, our supplemental cash flow information was as follows (in thousands):

| | Three Months Ended March 31, 2006 | 2005 |
|---|---|---|
| Income taxes paid related to continuing operations | $ 26 | $ 548 |
| Income taxes paid related to sale of discontinued operations | $ 4,028 | $ 40 |
| Income tax refunds received | $ 166 | $ 372 |
| Interest paid | $ 28,588 | $ 31,816 |

Non-cash barter and trade expense are presented in the consolidated statements of operations. Non-cash transactions related to capital lease obligations were $0.4 million for the quarter ended March 31, 2006. No capital lease obligations were entered into for the quarter ended March 31, 2005.

**5. DERIVATIVE INSTRUMENTS:**

We enter into derivative instruments primarily to reduce the impact of changing interest rates on our floating rate debt and to reduce the impact of changing fair market values on our fixed rate debt.

We account for derivative instruments under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities Deferral of the Effective Date of FASB Statement* No. 133 and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities, an amendment of FASB Statement No. 133* (Collectively, SFAS 133).

As of March 31, 2006, we held the following derivative instruments (in millions):

| Notional Amount | | | Expiration Date | Interest Payable | | Interest Receivable | | FMV Asset (Liability) (d) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| $ | 375.0 | (a) | June 5, 2006 | 6.25 to 7.00 | % | LIBOR | (c) | $ | | (f) |
| $ | 200.0 | (a) | June 5, 2006 | 6.32 to 7.00 | % | LIBOR | (c) | $ | | (f) |
| $ | 300.0 | (b) | March 12, 2012 | LIBOR + 2.28 | %(c) | 8.00 | % | $ | | (f) |
| $ | 100.0 | (b)(e) | March 12, 2012 | LIBOR + 3.095 | %(c) | 8.00 | % | $ | (3.5 | ) |
| | | | | | | | | $ | (3.5 | ) |

---

(a) These swap agreements do not qualify for hedge accounting treatment under SFAS 133; therefore, changes in their fair market values are reflected currently in earnings as an unrealized gain from derivative instruments. We recorded an unrealized gain related to these instruments of $2.9 million and $8.9 million for the three months ended March 31, 2006 and 2005, respectively. The instrument with a notional amount of $375.0 million was amended on March 2, 2005, resulting in a removal of termination option by the counterparty. The instrument with a notional amount of $200.0 million does not have an option to terminate before it expires.

(b) These swaps are accounted for as fair value hedges in accordance with SFAS 133; therefore, changes in their fair market values are reflected as adjustments to the carrying value of the underlying debt being hedged.

(c) Represents a floating rate based on three-month London Interbank Offered Rate (LIBOR).

(d) The fair market value (FMV) of the interest rate swap agreements is estimated by obtaining quotations from the international financial institution party to each derivative contract. The fair value is an estimate of the net amount that we would (pay) receive on March 31, 2006, if we cancelled the contracts or transferred them to other parties. This amount was a liability of $3.5 million on March 31, 2006 compared to a liability of $8.9 million on March 31, 2005. This decrease in liability was a result of higher interest rates in the first quarter of 2006 versus tew roman"> Q2 2008 Q1 2008 Q4 2007 Q3 2007 Q2 2007 Q1 2007

Compensation for employees, leased employees, officers and directors
$2,377,412 $1,928,272 $1,535,115 $1,760,439 $1,877,103 $1,873,582
Professional fees
191,330 281,418 184,507 529,139 319,948 394,028
Reconfirmation, mailing, billing and other customer-related costs
27,735 17,601 33,662 24,269 34,042 23,715
Depreciation and amortization
487,085 478,433 460,554 396,759 364,724 336,887
Other general and administrative costs

| 761,583 | 689,247 | 757,136 | 522,583 | 531,915 | 558,513 | $3,845,145 | $3,394,971 | $2,970,974 | $3,233,189 | $3,127,732 | $3, |
|---|---|---|---|---|---|---|---|---|---|---|---|

Sales and Marketing Expenses

| | Sales and Marketing Expenses | | | |
|---|---|---|---|---|
| | 2008 | 2007 | Change | Percent |
| Three Months Ended March 31, | $ 1,673,384 | $ 1,116,095 | $ 557,289 | 50% |
| Six Months Ended March 31, | $ 3,859,270 | $ 3,202,128 | $ 657,142 | 21% |

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Sales and marketing expenses increased in the second quarter of fiscal 2008 as compared to the second quarter of fiscal 2007 due to expanded marketing efforts in telemarketing, and online advertising and the amortization of customer acquisition costs related to acquired wholesale customers, partially offset by a reduction of approximately $1 million in direct response advertising costs as we have discontinued our direct mail campaigns. Online advertising has increased from zero in the second quarter of fiscal 2007 to approximately $606,000 in the second quarter of fiscal 2008 as we seek to increase customers' awareness and use of our online marketplace.

Sales and marketing expenses increased similarly for the first six months of fiscal 2008 as compared to the first six months of fiscal 2007. Direct response advertising costs related to our discontinued direct mail campaigns totaled $2,792,000 in the first six months of fiscal 2007. Online advertising has increased from zero in the first six months of fiscal 2007 to approximately $1,199,000 in the first six months of fiscal 2008.

Included in sales and marketing expenses for the three and six months ended March 31, 2008 is depreciation expense of $18,408 and $36,818, respectively, related to our subsidiary in the Philippines that exclusively provides telemarketing services.

Operating Income

| | Operating Income (Loss) | | | |
|---|---|---|---|---|
| | 2008 | 2007 | Change | Percent |
| Three Months Ended March 31, | $ 13,567 | $ 1,105,726 | $ (1,092,159) | (99)% |
| Six Months Ended March 31, | $ 496,050 | $ 1,845,781 | $ (1,349,731) | (73)% |

The decrease in operating income for the three and six months ended March 31, 2008 as compared to the three and six months ended March 31, 2007 is primarily due to increased operating expenses partially offset by increased gross margins, each of which is described above.

Other Income (Expense)

| | Other Income (Expense) | | | |
|---|---|---|---|---|
| | 2008 | 2007 | Change | Percent |
| Three Months Ended March 31, | $ 32,472 | $ 85,153 | $ (52,681) | (62)% |
| Six Months Ended March 31, | $ 67,383 | $ 178,452 | $ (111,069) | (62)% |

Other income (expense), consisting primarily of interest income, decreased in the three and six months ended March 31, 2008 as compared to the three and six months ended March 31, 2007 due primarily to a reduction of our cash and short-term investment balances, which decreased as a result of investments in acquired businesses and the effects of the Attorneys' General settlement.

Income Tax Provision

| | Income Tax Provision | | | |
|---|---|---|---|---|
| | 2008 | 2007 | Change | Percent |
| Three Months Ended March 31, | $ 42,701 | $ 564,617 | $ (521,916) | (92)% |
| Six Months Ended March 31, | $ 234,002 | $ 912,773 | $ (678,771) | (74)% |

The change in our income tax provision in each of the above periods is due primarily to corresponding decreases in our pre-tax income. However, in the three and six months ended March 31, 2008 we incurred additional income tax expense of $22,000 and 23,000 respectively, due to book-tax differences in the recognition of restricted stock awards, as compared to $112,000 and $135,000 for the three and six months ended March 31, 2007. During these periods, a portion of our restricted stock awards had vested and, due to declines in our stock price from grant date to vest date, the tax effects of the vesting of these awards were less than the carrying value of the related deferred tax assets.

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Net Income

| | Net Income (Loss) | | | |
|---|---|---|---|---|
| | 2008 | 2007 | Change | Percent |
| Three Months Ended March 31, | $ 3,338 | $ 626,262 | $ (622,924) | (99)% |
| Six Months Ended March 31, | $ 329,431 | $ 1,111,460 | $ (782,029) | (70)% |

Changes in net income are primarily attributable to changes in operating income and changes in income tax expense. The results from the impact of the Attorneys' General settlement, changes in the use of billing channels, changes in marketing strategies and other operating changes are discussed in more detail in the narratives included above.

Liquidity and Capital Resources

Net cash provided by operating activities increased $1,445,250, or 881%, to $1,609,262 for the first six months of fiscal 2008 as compared to net cash provided of $164,022 for the first six months of fiscal 2007. The increase in cash generated from operations is primarily due to the payment of over $2 million related to the Attorney's General settlement in the first quarter of fiscal 2007 that did not recur in fiscal 2008, partially offset by increases in accounts receivable and other changes in working capital.

Our primary source of cash inflows is net remittances from our billing channels, including ACH billings and LEC billings. For ACH billings, we generally receive the net proceeds through our billing service processors within 15 days of submission. For LEC billings, we receive collections on accounts receivable through the billing service aggregators under contracts to administer this billing and collection process. The billing service aggregators generally do not remit funds until they are collected. Generally, cash is collected and remitted to us (net of dilution and other fees and expenses) over a 60- to 120-day period subsequent to the billing dates. Additionally, for each monthly billing cycle, the billing aggregators and LECs withhold certain amounts, or "holdback reserves," to cover potential future dilution and bad debt expense. These holdback reserves lengthen our cash conversion cycle as they are remitted to us over a 12- to 18-month period of time. We classify these holdback reserves as current or long-term receivables on our consolidated balance sheet, depending on when they are scheduled to be remitted to us. As of March 31, 2008, approximately 53% of our gross accounts receivable are due from three aggregators.

Our most significant cash outflows include payments for marketing expenses and general operating expenses. General operating cash outflows consist of payroll costs, income taxes, and general and administrative expenses that typically occur within close proximity of expense recognition.

Net cash used for investing activities totaled $776,145 during the first six months of fiscal 2008 and consisted of $7,000 of additional closing costs related to the acquisition of LiveDeal, Inc. $16,243 of additional closing costs related to the acquisition of OnCall Subscriber Management Inc., $391,123 of expenditures for software and intangible assets and $361,779 of purchases of equipment. Net cash used in investing activities totaled $644,674 during the first six months of fiscal 2007 and consisted of $502,487 of expenditures for software and intangible assets, equipment purchases totaling $83,922 and $58,265 of purchases of certificates of deposit and other investments.

Net cash used for financing activities was $395,480 during the first six months of fiscal 2008, consisting primarily of treasury stock repurchases as described below. Financing activities also included $960 and $1,437 of preferred stock dividends paid in the first six months of fiscal 2008 and 2007, respectively.

We had working capital of $10,657,862 as of March 31, 2008, compared to $11,632,301 as of September 30, 2007, with current assets increasing by approximately $559,000 and current liabilities increasing approximately $1,533,000 from September 30, 2007 to March 31, 2008. Our cash position increased to $6,112,170 at March 31, 2008 compared to $5,674,533 at September 30, 2007 due to the effects of our results of operations, partially offset by purchases of software, intangible assets, equipment and purchases of treasury stock.

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On May 25, 2007, the Company's Board of Directors terminated our existing stock repurchase plan and replaced it with a new plan authorizing repurchases of up to $1,000,000 of common stock from time to time on the open market. The Company acquired 102,175 shares of its common stock during the six months ended March 31, 2008 at an aggregate cost of $394,519. As of March 31, 2008, all treasury stock has been retired.

The following table summarizes our contractual obligations at March 31, 2008 and the effect such obligations are expected to have on our future liquidity and cash flows

| | Payments Due by Fiscal Year | | | | | | |
|---|---|---|---|---|---|---|---|
| | Total | 2008 | 2009 | 2010 | 2011 | 2012 | Thereafter |
| Operating lease commitments | $ 2,777,240 | $ 466,435 | $ 858,852 | $ 568,136 | $ 465,736 | $ 339,361 | $ 78,720 |
| Noncanceleable service contracts | 957,876 | 299,292 | 558,584 | 100,000 | - | - | - |
| | $ 3,735,116 | $ 765,727 | $ 1,417,436 | $ 668,136 | $ 465,736 | $ 339,361 | $ 78,720 |

We believe that our existing cash on hand and additional cash generated from operations will provide us with sufficient liquidity to meet our operating needs for the next 12 months.

At March 31, 2008, we had no other off-balance sheet arrangements, commitments or guarantees that require additional disclosure or measurement.

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

As of March 31, 2008, we did not participate in any market risk-sensitive commodity instruments for which fair value disclosure would be required under Statement of Financial Accounting Standards No. 107. We believe that we are not subject in any material way to other forms of market risk, such as foreign currency exchange risk or foreign customer purchases (of which there were none in the periods set forth in this report) or commodity price risk.

## ITEM 4. CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed with an objective of ensuring that information required to be disclosed in our periodic reports filed with the Securities and Exchange Commission, such as this Quarterly Report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission. Disclosure controls are also designed with an objective of ensuring that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, in order to allow timely consideration regarding required disclosures.

The evaluation of our disclosure controls by our principal executive officer and principal financial officer included a review of the controls' objectives and design, the operation of the controls, and the effect of the controls on the information presented in this Quarterly Report. Our management, including our chief executive officer and chief financial officer, does not expect that disclosure controls can or will prevent or detect all errors and all fraud, if any. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Also, projections of any evaluation of the disclosure controls and procedures to future periods are subject to the risk that the disclosure controls and procedures may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on their review and evaluation as of the end of the period covered by this Form 10-Q, and subject to the inherent limitations as described above, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective as of the end of the period covered by this report. They are not aware of any significant changes in our disclosure controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses. During the period covered by this Form 10-Q, there have not been any changes in our internal control over financial reporting that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

ITEM 1A. RISK FACTORS

There have been no material changes to the factors disclosed in Item 1A Risk Factors in our Annual Report on Form 10-K/A for the year ended September 30, 2007.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs1 | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| January 2008 | 14,600 | $ 4.10 | 14,600 | $ 646,308 |
| February 2008 | - | - | - | $ 646,308 |
| March 2008 | 10,850 | $ 3.76 | 10,850 | $ 605,481 |
| Total | 25,450 | $ 3.96 | 25,450 | $ 605,481 |

1 On May 18, 2005, we announced the adoption of a $3,000,000 stock repurchase plan, under which 85,385 shares were repurchased at an aggregate price of $686,793. On May 25, 2007, the Company's Board of Directors terminated the May 18, 2005 stock repurchase plan and replaced it with a new plan authorizing repurchases of up to $1,000,000 of common stock from time to time on the open market.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The following matters were submitted to a vote of our stockholders at our annual stockholders meeting held on February 28, 2008:

- Election of Joseph Cunningham, Daniel L. Coury, Sr., Richard Butler, Thomas Clarke, Jr., John Evans, Benjamin Milk and Rajesh Navar to the Company's board of directors.
- Approval of an amendment to the Company's 2003 Stock Plan to increase the number of shares authorized for issuance under the plan from 800,000 shares to 1,100,000 shares.
- Ratification of the appointment of Mayer Hoffman McCann P.C. as the Company's independent auditor for the fiscal year ending September 30, 2008.

Election of Directors

The allocation of votes for the election of the nominees to the board of directors was as follows:

| Nominee | Votes For | Votes Withheld | Abstentions and Broker Non-Votes |
|---|---|---|---|
| Joseph F Cunningham, Jr | 4,479,313 | 930,066 | N/A |
| John Evans | 5,127,230 | 282,149 | N/A |
| Daniel L. Coury Sr. | 4,482,484 | 926,895 | N/A |
| Benjamin Milk | 3,776,748 | 1,632,631 | N/A |
| Richard Butler | 3,776,998 | 1,632,381 | N/A |
| Rajesh Navar | 5,128,010 | 281,369 | N/A |
| Thomas J. Clarke Jr. | 5,128,230 | 281,149 | N/A |

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Approval of Amendment to 2003 Stock Plan

The allocation of votes with respect to the proposed amendment to the Company's 2003 Stock Plan was as follows:

| | Votes For | Votes Against | Abstentions and Broker Non-Votes |
|---|---|---|---|
| Proposal to Increase the Number of Shares Authorized for Issuance Under the 2003 Stock Plan from 800,000 shares to 1,100,000 shares | 2,511,923 | 2,895,056 | 2,400 |

Ratification of Independent Auditors

The allocation of votes for the ratification of Mayer Hoffman McCann P.C. as the Company's independent auditor for the fiscal year ending September 30, 2008 was as follows:

| | Votes For | Votes Against | Abstentions and Broker Non-Votes |
|---|---|---|---|
| Proposal to Ratify Mayer Hoffman McCann P.C. as the Company's Independent Auditor | 5,282,493 | 29,274 | 97,612 |

The proposals above are described in detail in the Company's definitive proxy statement dated January 24, 2008, for the Annual Meeting of Stockholders held on February 28, 2008.

ITEM 6. EXHIBITS

The following exhibits are either attached hereto or incorporated herein by reference as indicated:

| Exhibit Number | Description |
|---|---|
| 3.1 | Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to Form 8-K, SEC File No. 000-24217, filed on August 15, 2007). |
| 3.2 | Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 to Form 10-K, SEC File No. 000-24217, for the year ended September 30, 2007). |
| 31 | Rule 13a - 14(a)/15d - 14(a) Certificates |
| 32 | Section 1350 Certificate |

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SIGNATURES

Pursuant to the requirements of 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.

LiveDeal, Inc.

Dated: May 15, 2008

/s/ Gary L. Perschbacher
Gary L. Perschbacher
Chief Financial Officer