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LYNCH INTERACTIVE CORP
Form 10-K
April 01, 2005

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FORM 10-K

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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

For the fiscal year ended December 31, 2004 Commission file number 1-106

OR

[] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

LYNCH INTERACTIVE CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware -----	06-1458056 -----
State of other jurisdiction incorporation or organization	(I.R.S. Employer Identification No.)

401 Theodore Fremd Avenue, Rye, NY -----	10580 -----
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (914) 921-8821

Securities registered pursuant to Section 12(b) of the Act:

Title of each class -----	Name of each exchange on which registered -----
Common Stock, \$.0001	American Stock Exchange

Securities registered pursuant to section 12(g) of the Act: None

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 Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No

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

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

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The aggregate market value of voting stock held by non-affiliates of the Registrant as of June 30, 2004 (based upon the closing price of the Registrant's Common Stock on the American Stock Exchange of \$34.54 per share) was \$72.0 million. (In determining this figure, the Registrant has assumed that all of the Registrant's directors and officers are affiliates. This assumption shall not be deemed conclusive for any other purpose.)

The number of outstanding shares of the Registrant's Common Stock was 2,752,251 as of March 25, 2005.

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DOCUMENTS INCORPORATED BY REFERENCE:

Part III: Certain portions of Registrant's Proxy Statement for the 2005 Annual Meeting of Shareholders.

FORWARD LOOKING INFORMATION

This Form 10-K contains certain forward looking information, including without limitation Item 1-I.A "Regulatory Environment" and possible changes thereto and "Competition," Item 1.-I.B "Cable Television," Item 1-I.C "Personal Communications and other Wireless Services," including without limitation the risks described, "Impairment of Assets," and "Risk Management, Safety and Insurance," Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations," including without limitation Liquidity and Capital Resources, and Market Risk. It should be recognized that such information contains estimates or forecasts based upon various assumptions, including the matters, risks, and cautionary statements referred to therein, as well as meeting the Registrant's internal performance assumptions regarding expected operating performance and the expected performance of the economy and financial markets as it impacts Registrant's businesses. As a result, such information is subject to uncertainties, risks and inaccuracies, which could be material.

PART I

ITEM 1. BUSINESS

Lynch Interactive Corporation ("Interactive" or the "Company") was incorporated in 1996 under the laws of the State of Delaware. On September 1, 1999, Interactive was spun off by Lynch Corporation to its shareholders (the "Spin Off") and became a public company. In its first day of trading, Interactive closed at \$28.00 (adjusted for stock splits). Prior to the Spin Off, Interactive had no significant assets, liabilities or operations. As a successor to certain businesses of Lynch Corporation, Interactive, at that time, became a diversified holding company with subsidiaries primarily engaged in multimedia and transportation services. Interactive spun off its ownership interest in Sunshine PCS to its shareholders in 2001 and its 63% interest in the Morgan Group, Inc. to its shareholders in 2002. Interactive's executive offices are located at 401 Theodore Fremd Avenue, Rye, New York 10580-1430. Its telephone number is 914-921-8821.

Interactive's business development strategy is to expand its existing operations through internal growth and acquisitions. It may also, from time to time, consider the acquisition of other assets or businesses that are not related to its present businesses. The Company currently operates in one business segment, multimedia, which consists of telecommunications, security, cable television and

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broadcasting. The Company is considering the distribution of certain investments to its shareholders. Such distribution is subject to numerous approvals. As used herein, Interactive includes subsidiaries.

Lynch Interactive Corporation to consider delisting, and going to what Wall Street refers to as "Pink Sheets", and others refer to as "Going Dark"

The Company's Board of Directors has voted to include in our proxy statement for the 2005 annual meeting a proposal that the shareholders give the Board of Directors authority to execute a "going dark" transaction, pursuant to which the company would reduce its number of shareholders of record below 300 through a reverse split and then delist from the American Stock Exchange, thereby suspending its reporting obligations under the Securities Exchange Act of 1934. If this transaction is consummated, the Company's common stock would be quoted, if at all, in the "pink sheets". We point out that not withstanding trading volumes, the Company currently intends voluntarily to disseminate press releases, quarterly financial statements, and audited annual financial statements to its stockholders and the investment community generally.

The principal reason for considering this step is the cost required to comply with section 404 of the Sarbanes-Oxley Act of 2002. While the Company is committed to having in place and consistently improving those controls necessary to generate reliable financial statements, the documentation and testing process required by section 404 of Sarbanes-Oxley will likely impose considerable costs and a staffing strain on the Company and its subsidiaries unless the standards are revised for smaller companies. The Company believes it is appropriate to consider ways to mitigate these significant burdens.

I. MULTIMEDIA OPERATIONS

Wireline Telecommunications

Operations. Interactive conducts its telecommunications operations through subsidiary companies. The telecommunications group has been expanded through the selective acquisition of local exchange telephone companies serving rural areas and by offering additional services such as Internet service, alarm services, long distance service and

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competitive local exchange carrier service. Since 1989, Interactive has acquired fourteen telephone companies, four of which have indirect minority ownership of 2% to 19%, whose operations range in size from approximately 900 to over 10,000 access lines. The Company's telephone operations are located in Iowa, Kansas, Michigan, New Hampshire, New Mexico, New York, North Dakota, Utah and Wisconsin. Our service areas are largely residential and not densely populated. As of December 31, 2004, total lines, including both access and DSL, were 54,901, 100% of which are served by digital switches.

In March 2004, the Company signed an agreement to acquire California-Oregon Telecommunications Company ("Cal-Ore") located in Dorris, California. Cal-Ore's subsidiary Cal-Ore Telephone Company is the incumbent service provider for a rural area of about 850 square miles along the Northern California border with Oregon with approximately 2,500 access lines. Cal-Ore's other businesses include an Internet service provider, Competitive Local Exchange Carrier ("CLEC") that is planning to provide services in the surrounding area and interests in certain cellular partnerships. The acquisition price is \$21.2 million, subject to certain closing adjustments. In March 2005, the administrative law judge for the California Public Utilities Commission issued a proposed opinion approving the transaction subject to various conditions. The Company is reviewing the opinion, which remains subject to the approval of the Commission.

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The principal business of Interactive's telephone companies is to provide telecommunications services. These services fall into three major categories:

Local network services. We provide telephone wireline access services to residential and non-residential customers in our service areas. We provide our local network customers a number of calling features including call forwarding, conference calling, caller identification, voicemail and call waiting. We offer packages of telecommunications services. These packages permit customers to bundle their basic telephone line with their choice of enhanced services, or to customize a set of selected enhanced features that fit their specific needs.

Network access services. We provide network access services to long distance carriers and other carriers in connection with the use of our facilities to originate and terminate interstate and intrastate telephone calls. Such services are generally offered on a month-to-month basis and the service is billed on a minutes-of-use basis. Access charges to long distance carriers and other customers are based on access rates filed with the Federal Communications Commission ("FCC") for interstate services and with the respective state regulatory agency for intrastate services.

Other Business. Interactive also provides non-regulated telephone-related services, including Internet access service and long distance resale service in certain of its telephone service (and adjacent) areas. Interactive also provides and intends to provide more local telephone and other telecommunications service outside certain of its franchise areas by establishing CLEC operations in certain nearby areas. In selected areas, Interactive provides security installation and monitoring services to homes and businesses and cable television services ("CATV").

We expect future growth in telephone operations to be derived from the acquisition of additional telephone companies, from providing service to new customers or additional services to existing customers, from upgrading existing customers to higher grades of service, and from new service offerings. Interactive is currently exploring how to best incorporate Voice over Internet Protocol ("VoIP") into its business model.

The following table summarizes certain information regarding Interactive's multimedia operations:

	Years Ended December 31,		
	2002	2003	2004
Telecommunications operations			
Access lines (a)	53,963	52,517	50,803
DSL Lines	1,466	2,709	4,098
	-----	-----	-----
Total access lines	55,429	55,226	54,901
% Residential	74%	73%	76%
% Business	26%	27%	24%
Internet subscribers (including DSL)	21,890	20,853	20,240
Security customers	6,500	6,712	6,667
Cable subscribers	2,831	2,731	3,630
 Total Multimedia Revenues			
Local service	14%	14%	13%
Network access	61%	62%	63%
Other businesses	25%	24%	24%
	-----	-----	-----
Total multimedia revenues	100%	100%	100%

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- (a) An "access line" is a telecommunications circuit between the customer's establishment and the central switching office.
- (b) Other Businesses includes Internet, security, CLEC, CATV and other non-regulated revenues.

Telephone Acquisitions. Interactive pursues an active program of acquiring operating telephone companies. Since 1989, Interactive acquired fourteen telephone companies serving a total of approximately 45,600 access lines, at the time of these acquisitions, for an aggregate consideration totaling approximately \$153.6 million. Such acquisitions are summarized in the following table:

	Year of Acquisition	Number of Access Lines Yr. Of Acq.	Number of Access Lines 12/31/04	Ownership Percentage
Western New Mexico Telephone Co.	1989	4,200	6,906	83.1 (c)
Inter-Community Telephone Co.	1991	2,550 (a)	2,569	100.0
Cuba City Telephone Co. & Belmont Telephone Co.	1991	2,200	2,629	81.0
Bretton Woods Telephone Co.	1993	250	908	100.0
JBN Telephone Co.	1993	2,300 (b)	2,653	98.0
Haviland Telephone Co.	1994	3,800	3,705	100.0
Dunkirk & Fredonia Telephone Co. & Cassadaga Telephone Co.	1996	11,100	11,682	100.0
Upper Peninsula Telephone Co.	1997	6,200	6,641	100.0
Central Scott Telephone Co.	1999	6,000	5,837	100.0
Central Utah Telephone Co./Skyline Telephone Company/Bear Lake Telephone Company	2001	7,000	7,273	100.0

(a) Includes 1,350 access lines acquired in 1996.

(b) Includes 354 access lines acquired in 1996.

(c) Does not include a 36% interest in a company that owns the 16.9% minority interest. The Company is in the process of acquiring the remaining 64% interest subject to final negotiations. Closing is expected by the second quarter of 2005.

Interactive continually evaluates acquisition opportunities targeting domestic rural telephone companies with a strong market position, good growth potential and predictable cash flow. In addition, Interactive generally seeks companies with excellent local management already in place who will remain active with their company. At times, certain large telephone companies have offered certain of their rural telephone exchanges for sale, often on a statewide or larger area basis. Interactive has and in the future may, bid on such groups of exchanges. Telephone holding companies and others actively compete for the acquisition of

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telephone companies and such acquisitions are subject to the consent or approval of regulatory agencies in most states. While management believes it will be successful in making additional acquisitions, any acquisition program is subject to various risks, including being able to find and complete acquisitions at an attractive price and being able to integrate and operate successfully any acquisition made.

Related Services and Investments. Affiliates of twelve of Interactive's telephone companies now offer Internet access service. At December 31, 2004, Internet access customers totaled 20,240 compared to 20,853 at December 31, 2003. Interactive companies have increased DSL service offset by a decrease in dial up service. Affiliates of six of Interactive's telephone companies now offer long distance service, and affiliates of two of Interactive's telephone companies now offers CLEC services.

An affiliate of Dunkirk & Fredonia Telephone Company ("DFT") provides CLEC service on a resale basis in neighboring Dunkirk, New York, certain areas of Buffalo, New York, and two other western New York counties. Some of DFT's CLEC services are being provided via an unbundled network elements platform (UNE-P), which allows for increased margins over a resale CLEC business model. In addition, DFT is in position with network functions and agreements to begin offering services through their own facilities. Giant Communications also provides CLEC services to selected areas in Northeast Kansas.

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Giant Communications (formerly CLR Video, L.L.C.), a 98% owned subsidiary of Interactive, is a provider of cable television in northeast Kansas with approximately 2,400 subscribers.

Central Telcom Services, LLC, a 100% owned subsidiary of the Company based in Fairview, Utah, acquired certain cable television assets in February 2004 and has entered into an agreement in January 2005 to acquire a cable television system located in nearby counties. The acquisition closed in March 2005, after completion of necessary regulatory approvals and other steps. The acquisition expanded Lynch Interactive's existing customer base by 2,411 cable subscribers and positions the company to promote additional services to its customer base.

DFT Security Systems, Inc. (which is 63.6% owned by Interactive), another affiliate of DFT, acquired American Alarm Company in December 2001. DFT Security Systems provides alarm services to western New York, including the Buffalo area, and now serves 6,667 alarm customers. As part of Company's effort to reduce debt and or monetize certain assets, it is considering selling a portion of its alarm accounts.

A subsidiary of Inter-Community Telephone Company in North Dakota, and Western New Mexico Telephone Company in New Mexico have filed with their respective state regulatory commissions to provide CLEC services in those states. Final plans to offer CLEC service in areas adjacent to Interactive's telephone operations in those states have not been completed. There is no assurance that Interactive can successfully develop these businesses or that these new or expanded businesses can be made profitable within a reasonable period of time. Such businesses, in particular any CLEC business, would be expected to operate at losses initially and for a period of time.

Regulatory Environment. Operating telephone companies are regulated by state regulatory agencies with respect to intrastate telecommunications services and the FCC with respect to interstate telecommunications services.

Telecommunications Act of 1996. In recent years, various aspects of federal and state telephone regulation have been subject to re-examination and on-going modification. In February 1996, the Telecommunications Act of 1996 (the "1996

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Act"), which is the most substantial revision of communications regulations since the 1930's, became law. The 1996 Act is intended generally to allow telephone, cable, broadcast and other telecommunications providers to compete in each other's businesses, while loosening regulation of those businesses. Among other things, the 1996 Act (i) allows major long distance telephone companies and cable television companies to provide local exchange telephone service; (ii) allows new local telephone service providers to connect into existing local telephone exchange networks and purchase services at wholesale rates for resale; (iii) provides for a commitment to universal service for high-cost, rural areas and authorizes state regulatory commissions to consider their status on certain competition issues; (iv) allows the Regional Bell Operating Companies to offer long distance telephone service and enter the alarm services and electronic publishing businesses; (v) removes rate regulation over non-basic cable service; and (vi) increases the number of television stations that can be owned by one party. The 1996 Act had dual goals of fostering local and intrastate competition while ensuring universal service to rural America.

National Exchange Carrier Association. For interstate services, Interactive's telephone subsidiaries participate in the National Exchange Carrier Association ("NECA") common line and traffic sensitive tariffs and access revenue pools. Where applicable, Interactive's subsidiaries also participate in similar pooling arrangements approved by state regulatory authorities for intrastate services. Such interstate and intrastate arrangements are intended to compensate local exchange carriers ("LECs"), such as Interactive's operating telephone companies, for the costs, including a fair rate-of-return, of facilities furnished in originating and terminating interstate and intrastate long distance services.

In addition to access pool participation, certain of Interactive's subsidiaries are compensated for their intrastate costs through billing and keeping intrastate access charge revenues (without participating in an access pool). Intrastate access charge revenues are based on intrastate access rates filed with the state regulatory agency.

Intercarrier Compensation Reform. The FCC released a Further Notice of Proposed Rulemaking ("FNPRM") on March 3, 2005 to examine all aspects of intercarrier compensation including access charges, reciprocal compensation, transport and transiting services, as well as, various network interconnection issues. Currently, the rate for intercarrier compensation depends on the type of traffic at issue, the types of carriers involved, and the end points of the communication. Many believe these rate differentials create both opportunities for regulatory arbitrage and incentives for inefficient investment and deployment decisions. The intent of this proceeding is to replace the existing patchwork of intercarrier compensation rules with a unified approach.

Universal Service Fund. The FCC has completed numerous regulatory proceedings required to implement the 1996 Act. For certain issues, the FCC bifurcated the proceedings between price-cap and rate-of-return companies or in the case of the Universal Service Fund ("USF") mechanisms between rural and non-rural companies. All of Interactive's telephone subsidiaries are rural, rate-of-return companies for interstate regulatory purposes. Rate-of-return companies receive support based on their costs while price cap companies receive support based on the prices of communications services.

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USF is intended, among other things, to provide special support funds to high cost rural LECs so that they can provide affordable services to their customers, notwithstanding their high cost due to low population density.

On February 25, 2005, the FCC adopted measures addressing the minimum requirements for a telecommunications carrier to be designated as an eligible telecommunications carrier ("ETC") and thus be eligible to receive federal USF. All of Interactive's companies are already designated as ETCs. New carriers

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seeking ETC designation must now:

- o Provide a five-year plan demonstrating how high-cost universal service support will be used to improve its coverage, service quality or capacity throughout the service area for which it seeks designation.
- o Demonstrate its ability to remain functional in emergency situations.
- o Demonstrate that it will satisfy consumer protection and service quality standards.
- o Offer local usage plans comparable to those offered by the incumbent local exchange carrier ("ILEC") in the areas for which it seeks designation.
- o Acknowledge that it may be required to provide equal access, if all other ETCs in the designated service area relinquish their designations.

The FCC added that these same requirements are applicable to ETCs previously designated by the commission, and these carriers must submit evidence by October 1, 2006, showing compliance. The FCC encourages states that have jurisdiction over ETC designations to adopt these requirements.

The FCC adopted the Rural Task Force ("RTF") order related to USF for rural carriers in May 2001 that mandates the continued use of actual embedded costs as the basis for USF support for rural carriers through June 2006. In such order, the FCC emphasized that it would provide predictability, certainty and stability to rural LECs for five years, so as to allow rural carriers to continue to provide supported telecommunications services at affordable rates to American consumers. On June 28, 2004, the FCC referred the issue of what modifications are needed for rural carriers for a post-RTF USF mechanism to a Federal-State Joint Board on Universal Service after June 2006.

The federal and state USF mechanisms, including that which the Company receives, are subject to considerable scrutiny and possible modification by the FCC. It is not possible to predict what modifications the FCC may adopt regarding USF, the timing of such modifications or the impact of those modifications on the Company.

Voice Over Internet Protocol. Interactive's local exchange carrier telephone operations do not have significant wireline competition at the present time. However, wireless usage and VoIP is continuing to increase across the nation, including in the areas served by Interactive, which could have substantial detrimental impact on future revenues and create additional uncertainty for the Company. It is not possible to predict the extent these complimentary or substitutable services might impact Interactive's revenues. Because of the rural nature of their operations and related low population density, Interactive's rural LEC subsidiaries are primarily high cost operations, which receive substantial Federal and state support. However, the regulatory environment for LEC operations has begun to change. VoIP usage is increasing as both a transport facility to haul traffic between switching centers, as well as the means to serve the end user customer's voice telephone needs. As a transport facility, it is expected to decrease the overall cost of transport in the long run. Interactive is analyzing if VoIP could be utilized for transport in a cost effective manner in the most rural portions of the nation, such as those served by the Company.

The Interexchange carriers ("IXCs") would like to have access minutes that are transported over VoIP exempt from paying access charges. If the IXCs were exempted from paying access charges on traffic transported over VoIP, it would have a significant detrimental impact to the Company's access charge revenues. While the FCC has initially determined that computer-to-computer VoIP traffic should not be considered a telecommunications service, it is not possible to

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predict the FCC's actions regarding the transport issue since the FCC has not issued a decision on this matter. The FCC has opened a more comprehensive proceeding to determine the extent VoIP should be subject to regulation.

In addition to transport, companies are increasing the use of VoIP in providing voice services to the end user. The VoIP end user traffic requires the use of a broadband service, such as DSL or cable, in order to receive the low price (or free) VoIP voice service. Since DSL cannot be purchased from the ILEC without the customer first purchasing a traditional local access line service, the ILEC still receives the DSL and the local service revenue as long as the end user purchases the DSL from the ILEC. Obviously, if the end user purchases the broadband service from a competitor, such as a cable or wireless broadband company, the ILEC loses all revenue associated with the customer switching to VoIP. Of greater concern is the fact that the Company loses the access charge revenue associated with intrastate calls that previously were provided through the Company's switched network. It is not possible to determine the potential lost revenue from calls that are handled by VoIP rather than the public switched network. This is very similar to revenue losses due to wireless usage where minutes of use are being removed from the Company's switching platform to the wireless carrier's switch thus reducing the Company's access revenues.

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Competition. Competition in the telecommunications industry is increasing. Although all of Interactive's current telephone companies have historically been monopoly wireline providers in their respective area for local telephone exchange service, except to a very limited extent in Iowa, the regulatory landscape has begun to change and we now experience competition from long distance carriers, from cable companies and internet service providers with respect to internet access and potentially in the future from cable telephony, and from wireless carriers. Competition may result in a greater loss of access lines and minutes of use and the conversion of retail lines to wholesale lines, which negatively affects revenues and margins from those lines. Competition also puts pressure on the prices we are able to charge for some services, particularly for some non-residential services.

As a result of the 1996 Act, FCC and state regulatory authority initiatives and judicial decisions aimed at increasing competition, certain telecommunications providers have attempted to bypass local exchange carriers to connect directly with high-volume toll customers. For example, in the last few years, the States of New Mexico, New York, Michigan, Wisconsin and Kansas passed or amended telecommunications bills intended to reduce regulations and introduce more competition among providers of local services. In addition, regulatory authorities in certain states, such as New York, have taken steps to promote competition in local telephone exchange service by requiring certain companies to offer wholesale rates to resellers. To date, no substantial impact has been seen on Interactive's telephone subsidiaries, which do not consider this a significant near-term competitive threat due to the limited number of high-volume customers they serve.

Other Multimedia Services

Broadcasting

Station WHBF-TV - Lynch Entertainment, L.L.C. ("Lynch Entertainment I"), a wholly-owned subsidiary of Interactive, and Lombardo Communications, Inc., wholly-owned by Philip J. Lombardo, are the general partners of Coronet Communications Company ("Coronet"). Lynch Entertainment I has a 20% interest in Coronet and Lombardo Communications, Inc. has an 80% interest. In addition, on the sale of the stations, Interactive is entitled to an additional fee of 5% of the Capital Proceeds (as defined). Coronet owns a CBS-affiliated television station WHBF-TV serving Rock Island and Moline, Illinois and Davenport and

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Bettendorf, Iowa.

Station WOI-TV - Lynch Entertainment Corporation II ("LEC-II"), a wholly-owned subsidiary of Interactive, owns 49% of the outstanding common shares of Capital Communications Corporation which owns Station WOI-TV ("Capital") and convertible preferred stock, which when converted, would bring LEC-II's common share ownership to 50%. WOI-TV is an ABC affiliate and serves the Ames/Des Moines, Iowa market. Lombardo Communications, Inc. II, controlled by Philip J. Lombardo, has the remaining share interest in Capital.

The Company's investments in broadcasting investments are carried on the equity basis and do not materially impact our current operating results.

Based upon a multiple of twelve times broadcast cash flow, plus cash, less debt, Interactive estimates its value in these stations at almost \$16 million as compared to the net book value of these investments of a negative \$0.6 million. It is not assured that the results of these stations will continue at the current level or that they could be sold at twelve times cash flow.

Operations. Revenues of a local television station depend to some extent upon its relationship with an affiliated television network. In general, the affiliation contracts of WHBF-TV and WOI-TV with CBS and ABC, respectively, provide that the network will offer to the affiliated station the programs it generates, and the affiliated station will transmit a number of hours of network programming each month. The programs transmitted by the affiliated station generally include advertising originated by the network, for which the network is compensated by its advertisers.

The affiliation contract has historically provided that the network will pay to the affiliated station an amount which is determined by negotiation, based upon the market size and rating of the affiliated station. Recently, however, the networks have begun in some instances to charge affiliated stations for certain programming. Typically, the affiliated station also makes available a certain number of hours each month for network transmission without compensation to the local station, and the network makes available to the affiliated station certain programs, which will be broadcast without advertising, usually public information programs. Some network programs also include "slots" of time in which the local station is permitted to sell spot advertising for its own account. The affiliate is permitted to sell advertising spots preceding, following, and sometimes during network programs.

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A network affiliation is important to a local station because network programs, in general, have higher viewer ratings than non-network programs and help to establish a solid audience base and acceptance within the market for the local station. Because network programming often enhances a station's audience ratings, a network-affiliated station is often able to charge higher prices for its own advertising time. In addition to revenues derived from broadcasting network programs, local television stations derive revenues from the sale of advertising time for spot advertisements, which vary from 10 seconds to 120 seconds in length, and from the sale of program sponsorship to national and local advertisers. Advertising contracts are generally short in duration and may be canceled upon two-weeks notice. WHBF-TV and WOI-TV are represented by a national firm for the sale of spot advertising to national customers, but have local sales personnel covering the service area in which each is located. National representatives are compensated by a commission based on net advertising revenues from national customers.

Competition. WHBF-TV and WOI-TV compete for revenues with local television and radio stations, cable television, and other advertising media, such as newspapers, magazines, billboards and direct mail. Generally, television stations such as WHBF-TV and WOI-TV do not compete with stations in other

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markets.

Other sources of competition include cable television systems, which carry television broadcast signals by wire or cable to subscribers who pay a fee for this service. CATV systems retransmit programming originated by broadcasters, as well as providing additional programming that is not originated on, or transmitted from, conventional broadcasting stations. Direct Broadcast Services ("DBS") are satellites providing local to local video services to a growing percentage of the population in the United States. In addition, some alternative media operators provide for a fee and, on a subscription basis, programming that is not a part of regular television service. Additional program services are provided by low-power television stations as well.

Federal Regulation. Television broadcasting is subject to the jurisdiction of the FCC under the Communications Act of 1934, as amended (the "Communications Act"). The Communications Act, and/or the FCC's rules, among other things, (i) prohibit the assignment of a broadcast license or the transfer of control of a corporation holding a license without the prior approval of the FCC; (ii) prohibit the common ownership of a television station and a daily newspaper in the same market; (iii) restrict the total number of broadcast licenses which can be held by a single entity or individual or entity with attributable interests in the stations and prohibits such individuals and entities from operating or having attributable interests in most types of stations in the same service area (loosened in the 1996 Act); and (iv) limit foreign ownership of FCC licenses under certain circumstances. In June 2003, the FCC adopted substantial rule changes that relax many of the prohibitions on the ownership of broadcast licenses. Currently, however, these rule changes are being challenged in federal court. In calculating media ownership interests, The Company's interests may be aggregated under certain circumstances with certain other interests of Mr. Mario J. Gabelli, Chairman and Chief Executive Officer of the Company, and certain of his affiliates.

Television licenses are issued for terms of eight years and are renewable for terms of eight years. The current licenses for WHBF-TV and WOI-TV expire on December 1, 2005 and February 1, 2006, respectively.

Other.

Sunshine PCS Corporation. On December 31, 2003, Sunshine PCS Corporation ("Sunshine") completed the sale of its three C-Block personal communications services licenses to Cingular Wireless LLC ("Cingular") for \$13,750,000 in cash. The licenses, which are for the provision of C-Block personal communications services in the Florida cities of Tallahassee, Panama City and Ocala, represented substantially all of the assets of Sunshine. In related transactions, Sunshine used a portion of the sales proceeds to acquire all of its preferred stock and warrants held by Interactive for an aggregate amount of \$7,587,000 (the "Preferred Stock and Warrant Repurchase") and all of its outstanding Class B Common Stock for an aggregate amount of \$613,862 (the "Class B Stock Repurchase"). Interactive's cash investment in Sunshine and its predecessor companies, beginning in 1993, was a cumulative \$21.9 million. In 1997 and in 1999, Interactive recorded impairment losses of \$7.0 million and \$15.4 million, respectively, which included the impairment of interest the Company capitalized on these investments during the development of the licenses. Following the Preferred Stock and Warrant Repurchase and the Class B Stock Repurchase, Interactive owns 294,117 shares of Sunshine's Class A Common Stock, representing 6.4% of all outstanding Class A Shares of Sunshine. During 2004, the Company received a cash distribution from Sunshine equal to \$.83 per share and on March 25, 2005, Sunshine was quoted at \$.12 per share on bulletin board market.

Las Cruces, NM PCS License. Another subsidiary of Interactive, Lynch PCS Corporation G ("LPCSG") holds a 10 MHz PCS license for the Basic Trading Area

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(BTA) covering Las Cruces, New Mexico. Las Cruces is the principal city in the BTA, which covers a population of approximately 249,902 (as of the 2000 census). In April 2002, LPCSG completed a build-out of the licensed area sufficient to meet the FCC requirement that it provide service coverage to at least one-quarter of the population in this BTA. In a February 2005 FCC auction for similar spectrum, the price per

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MHz of population was materially lower than the price paid by Interactive for this spectrum. Accordingly, at December 31, 2004, Interactive recorded a \$0.3 million impairment of this investment, which is included in amortization expense.

Logan, UT PCS License. As part of the acquisition of Central Utah Telephone Company by Interactive in June 2001, Interactive acquired Central Telecom Services, LLC, a related entity that now owns a 10 MHz PCS license in the Logan, Utah, BTA, which has a population of approximately 102,702 (as of 2000 census). Similar to LPCSG, Central Telecom Services has completed a build-out sufficient to meet the FCC requirement that service coverage be available to at least one-quarter of the population in this BTA. In respect of the traditions of many staff members and former owners, Interactive committed to donate 20% of the net profits (as defined in the donation letter) from any sale of the Logan license to the Church of Jesus Christ of Latter Day Saints. In a February 2005 FCC auction for similar spectrum, the price per MHz of population was materially lower than the price paid by Interactive for this spectrum. Accordingly, at December 31, 2004, Interactive recorded a \$0.4 million impairment of this investment, which is included in amortization expense.

Iowa PCS Licenses. Central Scott has a 10 MHz PCS License for its wireline territory covering a population of 11,470. Central Scott is also an approximately 14% minority owner of an entity that has a 10 MHz PCS license for portions of Clinton and Jackson Counties in Iowa, with a total population of 68,470.

RSA Cellular Interests. Interactive owns minority interests in certain entities that provide wireless cellular telephone service in two Rural Service Areas ("RSAs") in New Mexico and two RSA's in North Dakota, covering areas with a total population of approximately 163,000. Equity in earnings from these two operations was \$2.9 million in 2004 on a combined basis and the combined book value of these entities was \$6.5 million at December 31, 2004. Interactive's proportional share of these operations combined revenues, EBITDA and operating profits were \$3.9 million, \$1.9 million and \$1.6 million respectively, for the year ended December 31, 2004, and we received \$0.7 million in cash distributions, net of cash paid to minority interests, from these investments in 2004. An additional \$0.9 million was received from these investments in the first quarter of 2005. The difference between EBITDA and operating profit is depreciation of plant and equipment. EBITDA is presented because it is a widely accepted financial indicator of value and ability to incur and service debt in this industry. The Company utilizes the EBITDA metric for valuing potential acquisitions. EBITDA is not a substitute for operating profit, in accordance with generally accepted accounting principles. The entities have no debt and Interactive's proportional share of their cash equivalents is \$1.1 million.

Other Interests in Wireless Licenses. In 1997, LPCSG entered into an agreement with Bal/Rivgam LLC (in which an affiliate of the CEO has a 49.9% equity interest), which won licenses in the FCC's Wireless Communications Services ("WCS") Auction in 1997, to receive a fee equal to 5% of the realized net profits of Bal/Rivgam (after an assumed cost of capital), in return for providing bidding and certain other services to Bal/Rivgam. Bal/Rivgam holds 5 WCS licenses covering a population of approximately 42 million with an aggregate cost of \$0.7 million and certain Local Multipoint Distribution Services ("LMDS") licenses. Betapage Communications, L.L.C., in which Interactive has a 49.9%

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equity interest, was a winning bidder in the FCC auction for 929 MHz paging licenses, which was conducted in 2000. Betapage won 24 paging licenses covering a population of 76.7 million at a cost of approximately \$77,000. Interactive also has the right to receive a fee equal to 20% of the realized net profits of Betapage (after an assumed cost of capital).

Another subsidiary of Interactive is a 49.9% owner of PTPMS Communications, L.L.C. ("PTPMS"), which was a winning bidder in the FCC auction of licenses for fixed point-to-point microwave services, which was conducted in 2000. PTPMS won 22 licenses covering a population of 27.6 million for an aggregate cost of \$1.5 million. Interactive's subsidiary has loaned PTPMS approximately \$1.4 million. Interactive's subsidiary also has the right to receive a fee equal to 20% of the realized net profits of PTPMS (after an assumed cost of capital).

Another subsidiary of Interactive is a 49.9% owner of PTPMS Communications II, L.L.C. ("PTPMS II"), which was a winning bidder in the FCC auction of licenses for 700 MHz Guard Band spectrum for wireless data transmission and wireless Internet services, which was conducted in 2000. PTPMS II won three licenses covering a population of 6.4 million in BTAs including the cities of Buffalo, NY, Des Moines-Quad-Cities, IA and El Paso, TX, at an aggregate cost of approximately \$6.3 million. Interactive has loaned PTPMS II approximately \$6.1 million. Interactive's subsidiary has the right to receive a fee equal to 20% of the realized net profits of PTPMS II (after an assumed cost of capital). In a FCC auction conducted in September 2002 for similar spectrum, called the Lower 700 MHz Band Auction, the price per MHz of population was materially lower than the price paid by PTPMS II in 2000. Accordingly, during 2002, Interactive provided a reserve for impairment for its investment in PTPMS II of \$5.5 million.

Another subsidiary of Interactive, Lynch 3G Communications Corporation, participated in the Lower 700 MHz auction conducted in August 2002. Lynch 3G won eight 12 MHz licenses in the following areas: Reno, NV; Santa Barbara, CA; Des Moines, IA; Quad Cities area of Davenport and Bettendorf, IA and Rock Island and Moline, IL; Las Cruces, NM; Elmira, NY; and two RSAs in the western part of New Mexico. The total population covered by these licenses is approximately 1.7 million. Lynch 3G paid \$1.1 million for these licenses.

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In June 2003, Lynch 3G participated in a re-auction of Lower 700 MHz spectrum that was not licensed in the August 2002 auction and won four 12 MHz licenses in the following areas: Dubuque, IA, Gogebic, MI, San Juan, NM and Chautauqua, NY. The total population covered by these licenses is approximately 1.1 million. Lynch 3G paid \$620,000 for these licenses.

In July 2004, Lynch 3G participated in the Auction for 24 GHz Spectrum and was high bidder for two licenses, Buffalo - Niagara, NY and Doverport, IA - Maline, IL, for a total cost of \$49,000.

In February 2005, Lynch 3G participated in Auction 58 for PCS Spectrum and was high bidder for two licenses, Marquette, MI and Kalamath Falls, OR, for a total cost of \$0.5 million.

Interactive expects to continue to participate in the spectrum auctions being conducted by the FCC in order to have the flexibility to accommodate present and future needs of existing and future customers as well as establish high bandwidth opportunities.

In addition to the build out requirements for PCS licenses, FCC rules impose build-out requirements for WCS, LMDS, paging licenses, point-to-point microwave services and the licenses granted in 700 MHz (guard band) and Lower 700 MHz spectrum. There are also substantial restrictions on the transfer of control of

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licensed spectrum.

There are many risks relating to PCS and other FCC wireless licenses including without limitation, the high cost of PCS and certain other licenses, the fact that it involves start-up businesses, raising the substantial funds required to pay for the licenses and the build out, determining the best way to develop the licenses and which technology to utilize, the small size and limited resources of companies compared to other potential competitors, existing and changing regulatory requirements, additional auctions of wireless telecommunications spectrum and actually building out and operating new businesses profitably in a highly competitive environment (including already established cellular telephone operators and other new PCS licensees). There can be no assurance that any licenses granted to entities in which subsidiaries of Interactive have interests, can be successfully sold or financed or developed, thereby allowing Interactive's subsidiaries to recover their debt and equity investments.

Morgan Group Holding Company. In January 2002, Interactive spun off its interest in The Morgan Group, Inc. ("Morgan"), its only services subsidiary, via a tax-free dividend to its shareholders.

II. OTHER INFORMATION

While Interactive holds licenses of various types, Interactive does not believe they are critical to its overall operations, except for (1) the television-broadcasting licenses of WHBF-TV and WOI-TV; (2) Interactive's telephone subsidiaries' franchise certificates to provide local-exchange telephone service within their service areas; (3) FCC licenses to operate point-to-point microwave systems; (4) licenses held by partnerships and corporations in which certain of Interactive's subsidiaries own minority interests to operate cellular telephone systems covering various service areas in New Mexico and North Dakota, (5) Giant Communications' franchises to provide cable television service within its service areas and (6) personal communications services and other wireless communication licenses held by companies in which Interactive's subsidiaries have investments, including the PCS licenses for Las Cruces, New Mexico, Logan, Utah, and portions of Iowa as described above in more detail.

The capital expenditures, earnings and competitive position of Interactive have not been materially affected by compliance with current federal, state, and local laws and regulations relating to the protection of the environment; however, Interactive cannot predict the effect of future laws and regulations.

No portion of the business of Interactive is regarded as seasonal.

Interactive does not believe that its multimedia business is dependent on any single customer of local telephone service. Most local exchange carriers, including Interactive's, received a significant amount of revenues in the form of access fees from long distance companies.

Interactive had a total of 356 employees at December 31, 2004, including 6 corporate employees and the remainder responsible for providing rural telephone services, compared to 349 employees at December 31, 2003.

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III. EXECUTIVE OFFICERS OF THE REGISTRANT

Pursuant to General Instruction G (3) of Form 10-K, the following list of executive officers of the Registrant is included in Part 1 of this Annual Report on Form 10-K in lieu of being included in the Proxy Statement for the 2004 Annual Meeting of Shareholders. Such list sets forth the names and ages of all

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executive officers of the Registrant indicating all positions and offices with the Registrant held by each such person and each such person's principal occupations or employment during the past five years.

Name -----	Offices and Positions Held -----
Mario J. Gabelli	Chairman and Chief Executive Officer of Lynch Interactive since December 2004 (and also from September 1999 to December 2002) and Vice Chairman and Chief Executive Officer from December 2002 to December 2004. He is also Chairman, Chief Executive Officer, and a director of Gabelli Asset Management Inc. and its predecessors (since November 1976) (and in connection with those responsibilities, he serves as a director or trustee and/or an officer of registered investment companies managed by subsidiaries of Gabelli Asset Management); and Chairman and Chief Executive Officer of GGCP, Inc., a private company
Robert E. Dolan	Chief Financial Officer (since January 2004); Chief Financial Officer and Controller from September 1999 to January 2004; Chief Financial Officer (1992-2000) and Controller (1990-2000) of Lynch Corporation
Evelyn C. Jerden	Senior Vice President-Operations (since September 2003); Vice President-Regulatory Affairs (2002-2003); Director of Revenue Requirements of Western New Mexico Telephone Company, Inc. (since 1992)
John A. Cole	Vice President-Corporate Development, Secretary and General Counsel (since December 2004); Counsel at LeBoeuf, Lamb, Greene & MacRae, LLP (1994 to 2004)

The executive officers of the Registrant are elected annually by the Board of Directors at its meeting in May and hold office until the organizational meeting in the next subsequent year and until their respective successors are chosen and qualified.

ITEM 2. PROPERTIES

Interactive leases approximately 3,300 square feet of office space from an affiliate of its Chairman and CEO for its executive offices in Rye, New York. The lease expires at the end of 2007.

Western New Mexico Telephone Company ("Western") owns a total of 16.9 acres at 15 sites located in southwestern New Mexico. Its principal operating facilities are located in Silver City, where Western owns one building comprising a total of 6,480 square feet housing its administrative offices and certain storage facilities and another building comprising 216 square feet, which houses core network equipment. In Cliff, New Mexico, Western owns five buildings with a total of 14,055 square feet in which are located additional offices and storage facilities, as well as a vehicle shop, a fabrication shop, and central office switching equipment. Smaller facilities, used mainly for storage and for housing central office switching equipment, with a total of 9,984 square feet, are located in Lordsburg, Reserve, Magdalena and five other localities in New Mexico. In addition, Western leases 1.28 acres on which it has constructed four microwave towers and a 120 square-foot equipment building. Western has the use of 46 other sites under permits or easements at which it has installed various equipment either in small company-owned buildings (totaling 2,403 square feet) or under protective cover. Western also owns 3,757 miles of copper cable and 494

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miles of fiber optic cable running through rights-of-way within its 15,000 square mile service area. All of these properties are encumbered under mortgages held by the Rural Utilities Service ("RUS") and the National Bank for Co-Operatives ("Co-Bank").

Inter-Community Telephone Company owns 12 acres of land at 10 sites. Its main office at Nome, ND, contains 4,326 square feet of office and storage space. In addition, it has 4,400 square feet of garage space and 5,035 square feet

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utilized for its switching facilities. Inter-Community has 2,036 miles of copper cable and 243 miles of fiber optic cable. All of these properties are encumbered under mortgages held by Co-Bank.

Cuba City Telephone Company is located in a 3,800 square foot brick building on 0.4 of an acre of land. The building serves as the central office, commercial office, and garage for vehicle and material storage. The company also owns a cement block storage building of 1,490 square feet on 0.1 of an acre. Belmont Telephone Company is located in a cement block building of 800 square feet on .5 acre of land in Belmont, Wisconsin. The building houses the central office equipment for Belmont. The companies own a combined total of 302 miles of copper cable and 51 miles of fiber optic cable. All of Cuba City and Belmont's properties described above are encumbered under first mortgages held by the RUS and Rural Telephone Bank, respectively, and second mortgages held by Co-Bank.

J.B.N. Telephone Company owns a total of approximately 2.25 acres at fifteen sites located in northeast Kansas. Its administrative and commercial office consisting of 7,000 square feet is located in Holton, Kansas and a 3,000 square feet garage warehouse facility is located in Wetmore, Kansas. In addition, J.B.N. owns thirteen smaller facilities housing central office switching equipment and over 1,207 miles of copper cable and 206 miles of fiber optic cable. All of these properties are encumbered under mortgages held by the RUS.

Giant Communications, LLC (formerly CLR Video) has its headquarters in Holton, Kansas, leased from J.B.N. Telephone Company. It also owns one small parcel of land and leases 13 small sites, which it uses for its cable receiving and transmission equipment. All of these properties are encumbered under a mortgage to Co-Bank. Also, see under Item 1.I.B. Cable Television.

Haviland Telephone Company owns a total of approximately 3.9 acres at 20 sites located in south central Kansas. Its administrative and commercial office consisting of 4,450 square feet is located in Haviland, Kansas. In addition, Haviland owns 19 smaller facilities housing garage, warehouse, and central office switching equipment and over 1,503 miles of copper cable and 529 miles of fiber optic cable. All of these properties are encumbered under a mortgage held by the RUS.

Dunkirk & Fredonia Telephone Company (including its affiliates) owns a total of approximately 15 acres at five locations in western New York. Its central office switching equipment, administrative and commercial offices consisting of 18,297 square feet is located in Fredonia, New York. In addition, Dunkirk & Fredonia owns four other properties, including a service garage, a paging tower site, a small central office in Cassadaga, N.Y., sales and service center in Jamestown, New York. Dunkirk & Fredonia also owns 358 miles of copper telephone cable and 96 miles of fiber optic cable. All of these properties are encumbered under a mortgage held by RUS.

Bretton Woods Telephone Co., Inc. leases approximately 2,800 square feet of business office space and garage/storage space located in Bretton Woods, New Hampshire. Bretton Woods Telephone owns a 444 square foot central office building also located in Bretton Woods, New Hampshire that is built on leased

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land. Bretton Woods Telephone has 28 miles of copper cable and 6 miles of fiber optic cable.

Upper Peninsula Telephone Company owns a total of approximately 25 acres at 19 sites located principally in the Upper Peninsula of Michigan. Its host central office switching equipment, administrative and commercial offices consisting of 11,200 square feet is located in Carney, Michigan. In addition, Upper Peninsula owns 25 other smaller facilities housing garage, warehouse and central office switching equipment and over 2,123 miles of copper cable and 198 miles of fiber optic cable. All properties described herein are encumbered under mortgages held by the RUS and Co-Bank.

Central Scott Telephone Company owns 3 acres of land at 5 sites. Its main office in Eldridge, Iowa contains 3,104 square feet of office and 341 square feet of storage space. In addition, it has 3,360 square feet of garage space and 2,183 square feet utilized for its switching facilities. Central Scott has 357 miles of copper cable and 34 miles of fiber optic cable. All of these properties are encumbered under mortgages held the First National Bank of Omaha.

Central Utah Telephone, Inc., and its subsidiaries own a total of 9.76 acres at sixteen sites and have an additional 1.54 acres at fifteen sites, which are under leases, permits or easements. These sites are located in the central, northeastern and mid-western areas of Utah. Central Utah Telephone's principal operating facilities are located in Fairview, Utah, where it owns a new commercial office building containing 14,400 square feet, and a plant office and central office building containing 5,200 square feet. In addition it has 720 square feet of office space, 2,455 square feet of warehouse space, 6,595 square feet of vehicle maintenance facilities, 4,252 square feet of protective cover and 3 rental homes. Central Utah Telephone owns smaller facilities used mainly for housing central office switching equipment with a total of 9,405 square feet in 25 various locations. In addition, Central Utah Telephone owns 897 miles of copper cable and 199 miles of fiber optic cable running through rights-of-way within its 6,867 square mile service area. All of Central Utah Telephone's properties described herein are encumbered under mortgages held by the RUS and CoBank.

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It is Registrant's opinion that the facilities referred to above are in good operating condition and suitable and adequate for present uses.

ITEM 3. LEGAL PROCEEDINGS

False Claims Act "Qui Tam" Litigation.

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

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

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mandatory trebling under the statute, a document filed by the relator with the Court on February 24, 2004 discloses an initial computation of damages of not less than \$88 million resulting from bidding credits awarded to the defendants in FCC auctions and \$120 million of unjust enrichment through the sale or assignment of licenses obtained by the defendants in FCC auctions, in each case prior to trebling. Later computations have increased this amount. As discussed below, the bidding credits the defendants received were considerably less than the \$88 million amount reported.

Interactive strongly believes that this lawsuit is completely without merit and that relator's damage computations are without basis, and intends to defend the suit vigorously. The U.S. Department of Justice has notified the court that it has declined to intervene in the case. Nevertheless, we cannot predict the ultimate outcome of the litigation, nor can we predict the effect that the lawsuit or its outcome will have on our business or plan of operation. Interactive does not have any insurance to cover its cost of defending this lawsuit, which costs will be material. Interactive does have a directors and officers liability policy but the insurer has reserved its rights under the policy and, as a result, any coverage to be provided to any director or officer of Interactive in connection with a judgment rendered in this action is unclear at this time.

Interactive was formally served with the complaint on July 10, 2002. On September 19, 2002, the defendants filed two motions with the United States District Court for the District of Columbia: a motion to dismiss the lawsuit and a motion to transfer the action to the Southern District of New York. On November 25, 2002, the relator filed an opposition reply to our motion to dismiss and on December 5, 2002; the defendants filed a reply in support of its motion to dismiss. On September 30, 2003, the Court granted our motion to transfer the action to the Southern District of New York. A scheduling conference was held on February 10, 2004, at which time, the judge approved a scheduling order and discovery commenced.

On July 28, 2004, the judge denied in part and granted in part our motion to dismiss. Defendant bidding entities that did not win licenses were dismissed and the "reverse" false claims act count was dismissed as redundant. Interactive and its subsidiaries remain parties to the litigation.

In December 2004, the defendants filed a motion in the United States District Court for the District of Columbia to compel the FCC to provide certain information subpoenaed by them in order to enable them to conduct a defense. This motion is still pending and discovery is continuing. See "History of Lynch's "C" Block Activities" below.

Also see Footnote 4 - Wireless Communication Services with regards to a potential indemnification obligation of the Company.

History of Lynch's "C" Block Activities.

As part of the Omnibus Budget Resolution of 1993, Congress authorized the FCC to employ competitive bidding procedures to select among mutually exclusive applicants for certain spectrum licenses. Initially the FCC had an initiative to include, among others, African Americans, Native Americans, Asian Americans and women. As a result of this, the FCC conducted auctions beginning in 1995 to allocate spectrum in a competitive manner. Interactive was a participating investor and/or service provider to various entities in this "C-Block" auction.

By December 18, 1995, Interactive (through its predecessor Lynch Corporation) had investments in five entities that participated in the FCC auction for broadband PCS "C" block spectrum (Auction 5). When the auction closed, on May

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6,1996, these five entities, on a combined basis, were the higher bidders for thirty-one 30 MHz licenses at a gross cost of \$288.2 million. These entities were initially put together under the FCC's initiative to include, among others, women, African Americans, Native Americans and Asian Americans. As a result of changes in these initiatives, these same individuals were qualified as small businesses and remained eligible as bidders. These entities received \$72 million of bidding credits, and accordingly the net cost was \$216.2 million. The federal government provided financing for 90% of the cost of these licenses, or \$194.6 million. Interactive's investments in these entities totaled \$21 million.

Events during and subsequent to Auction 5, made financing these licenses through the capital markets much more difficult than originally anticipated. On April 18, 1997, among other reasons, in order to obtain some economies of scale, such as financing, the five entities merged into Fortunet Communications, Inc. The FCC, in partial response to actions by Nextwave and others, promoted a plan for refinancing the "C" block licenses. In 1997, many of the license holders from Auction 5, including Fortunet, petitioned the FCC for relief in order to afford these small businesses the opportunity to more realistically restructure and build out their systems. The President of Fortunet, Karen Johnson, participated in an FCC sponsored forum on this issue on June 30, 1997. The response from the FCC, which was announced on September 26, 1997 and modified on March 24, 1998, afforded license holders four options. One of these options was the resumption of current debt payments, which had been suspended earlier in 1997 for all such license holders. Another option, amnesty, was to return all licenses and forgo any amounts deposited in exchange for forgiveness of the FCC debt. Other options included: disaggregation, splitting a 30 MHz license into two 15 MHz licenses and forgoing 50% of the amount deposited; and prepayment, return of certain licenses and utilizing 70% of the amount deposited to acquire other licenses, with the other 30% of the deposits to be forfeited.

On June 8, 1998, Fortunet elected to apply its eligible credits relating to its original down payment to the purchase of three licenses for 15 MHz of PCS spectrum in Tallahassee, Panama City and Ocala, Florida. Consistent with an FCC promulgated disaggregation alternative, Fortunet surrendered all the remaining licenses and forfeited 30% of its original down payment in full satisfaction of its government obligations, including forgiveness of all accrued interest. Accordingly, Fortunet retained 15 MHz of spectrum in the three Florida markets covering a population of approximately 962,000 at a net auction cost of \$15.8 million. As a result of this FCC process, disaggregation resulted in a reduction of the bidding credits to \$5.3 million. Fortunet also lost \$6.0 million of its down payment. As a result of this decision, during 1997, Interactive recorded a \$7.0 million write down of its investment in Fortunet. A lawyer who worked on many applications for FCC licenses, Mr. Taylor, the relator in this case, is aware of the details of these FCC initiated alternatives for the "C" Block, as presumably are his law firms.

On April 15, 1999, the FCC completed a reauction of all the C-Block licenses that were surrendered, including the 15 MHz of spectrum that Fortunet returned to the FCC on June 8, 1998 in respect of the Tallahassee, Panama City and Ocala, Florida markets. In that reauction, the successful bidders paid a total of \$2.7 million for those three 15 MHz licenses returned by Fortunet versus the \$15.8 million paid by Fortunet. As a result of this auction, Interactive recorded a further write down of its investment of \$15.4 million, including capitalized costs, to reflect the amount bid for the similar licenses in the reauction.

In February 2000, Fortunet merged with Sunshine PCS Corporation, which by way of a spin-off from Lynch Interactive became a public company. It traded under the symbol SUNPA.

On December 31, 2003, Sunshine, after appropriate corporate and regulatory steps, sold its three 15 MHz licenses to Cingular Wireless for \$13.75 million.

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Interactive received \$7.6 million as part of the sale transaction versus its cash investment of \$21.9 million initially invested in the original five entities in 1992.

Other Litigation. In addition to the litigation described above, Interactive is a party to routine litigation incidental to its business. Based on information currently available, Interactive believes that none of this ordinary routine litigation, either individually or in the aggregate, will have a material effect on its financial condition and results of operations.

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

None in the fourth quarter of 2004.

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PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Common Stock of Lynch Interactive Corporation is traded on the American Stock Exchange under the symbol "LIC." The market price high and lows in consolidated trading of the Common Stock for the last two years are as follows:

	2004			
	Three Months Ended			
	March 31	June 30	September 30	December 31
	-----	-----	-----	-----
High	\$ 37.90	\$ 37.95	\$ 36.50	\$ 34.75
Low	\$ 23.50	\$ 28.00	\$ 29.50	\$ 30.45

	2003			
	Three Months Ended			
	March 31	June 30	September 30	December 31
	-----	-----	-----	-----
High	\$ 28.00	\$ 24.80	\$ 27.75	\$ 27.41
Low	\$ 21.50	\$ 19.50	\$ 23.95	\$ 21.80

At March 22, 2005, Interactive had 803 shareholders of record and the closing price of our Common Stock was \$25.75.

Neither Interactive nor Lynch Corporation, the company from which Interactive was spun off, has paid any cash dividends on its common stock since 1989. Interactive does not expect to pay cash dividends on its common stock in the foreseeable future. In addition, current and future financings may limit, prohibit, or otherwise affect the payment of such dividends.

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Issuer Purchases of Equity Securities

Period -----	Total Number of Shares (or Units) Purchased -----	Average Price Paid per Share (or Unit) -----	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1) -----	Maximum Number (or Approximate Value) of Shares May Yet Be Purchased Under the Plans Programs -----
10/1/04 to 10/31/04	3,600	32.36	3,600	35,300
11/1/04 to 11/30/04	1,000	31.62	1,000	34,300
12/1/04 to 12/31/04	1,300	31.62	1,300	33,000
	-----	-----	-----	
Total	5,900 =====	32.07 =====	5,900 =====	

(1) In September 1999, the Board of Interactive approved a stock repurchase program providing for the purchase of up to 100,000 shares of Common Stock in such manner, at such times and at such prices as the Chief Executive Officer or his designee determines.

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ITEM 6. SELECTED FINANCIAL DATA

LYNCH INTERACTIVE CORPORATION SELECTED FINANCIAL DATA (In Thousands, Except Per Share Data)

	Years Ended December 31,			
	2000	2001	2002	2003
Revenues (h).....	\$ 65,789	\$ 77,892	\$ 84,225	\$ 85,111
Operating profit (b)	15,331	19,985	19,233	18,750
Interest expense, net of investment income	(10,308)	(11,074)	(11,266)	(10,800)
Equity in earnings of affiliates	2,594	1,456	1,938	2,100
Impairment of investment in Spinnaker Industries, Inc. Reserve for impairment of investment in spectrum and spectrum license holders (c)	--	(3,194)	--	--
Gain on sale of subsidiary stock and other Assets	4,187	--	4,965	3,100
Income (loss) before income taxes, minority interests, and discontinued operations of Morgan ...	11,804	7,173	9,391	13,150

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(Provision) benefit for income taxes	(4,971)	(3,454)	(3,924)	(4,971)
Minority interests	(1,802)	(1,185)	(1,706)	(1,802)
	-----	-----	-----	-----
Income (loss) from continuing operations before discontinued operations of Morgan	5,031	2,534	3,761	5,031
Income (Loss) from operations of Morgan distributed to shareholders (g)	(2,666)	(1,386)	(1,888)	(2,666)
	-----	-----	-----	-----
Net income (loss)	\$ 2,365	\$ 1,148	\$ 1,873	\$ 2,365
	=====	=====	=====	=====
Basic and diluted earnings				
Per common share (d)				
Income (loss) from continuing operations before operations of Morgan	\$ 1.78	\$ 0.90	\$ 1.34	\$ 1.78
Income (loss) from operations of Morgan distributed to shareholders (e)	(0.94)	(0.49)	(0.67)	(0.94)
	-----	-----	-----	-----
Net income (loss)	\$ 0.84	\$ 0.41	\$ 0.67	\$ 0.84
	=====	=====	=====	=====

			December 31,	
			-----	-----
	2000	2001	2002	2003
	-----	-----	-----	-----
Cash, securities and short-term investments	\$ 26,900	\$ 31,233	\$ 23,356	\$ 26,900
Total assets (g)	\$217,742	\$256,350	\$249,639	\$217,742
Long-term debt	\$162,304	\$193,202	\$176,621	\$162,304
Shareholders' equity (f)	\$ 19,391	\$ 24,517	\$ 22,632	\$ 19,391

- (a) Includes results of Central Utah Telephone Company from June 23, 2001, its date of acquisition.
- (b) Operating profit is sales and revenues less Multimedia cost of sales, and selling and administrative expenses. Goodwill amortization was \$2.5 million in 2000 and \$2.8 million in 2001. On January 1, 2002, the Company adopted the provisions of SFAS 142 and ceased amortizing goodwill. In 2004, goodwill of \$0.5 million and \$0.7 million of spectrum investments were written off as a result of the Company's annual test for impairment. (See note 1 in the accompanying financial statements.)
- (c) See Note 4 "Wireless Communications Services" in the Company's consolidated financial statements.
- (d) Adjusted to reflect a 2 for 1 stock split which occurred in September 2000.
- (e) Net of income tax and minority interest.
- (f) No cash dividends have been declared or paid during the 5-year period.
- (g) Amounts do not include assets associated with The Morgan Group, Inc.
- (h) Revenues for prior periods have been reclassified to conform to 2004 presentation.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion should be read together with the Consolidated Financial

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Statements of Interactive and the notes thereto included elsewhere in this Annual Report.

RESULTS OF OPERATIONS

Overview

Interactive has grown primarily through the selective acquisition of rural local exchange carriers ("RLECs") and by offering additional services such as Internet service, alarm services, long distance service and competitive local exchange carrier ("CLEC") service. From 1989 through the current reporting period, Interactive (and its predecessor corporation) acquired fourteen telephone companies, four of which have indirect minority ownership of 2% to 19%, whose operations range in size from approximately 800 to over 10,000 access lines. The Company's telephone operations are located in Iowa, Kansas, Michigan, New Hampshire, New Mexico, New York, North Dakota, Utah and Wisconsin.

The telecommunications industry in general and the RLECs that comprise Interactive's business face a number of economic or industry-wide issues and challenges.

- o Regulatory- The Telecommunications Act of 1996 and other federal and state legislation and regulations have a significant impact on the industry and on rural carriers in particular. Interactive's telephone companies are all RLECs serving very high cost areas with a significant portion of their revenues being derived from federal or state support mechanisms, which are referred to as Universal Service Funds ("USF"). The revenues and margins of our RLEC subsidiaries are largely dependent on the continuation of such support mechanisms.
- o Competition- The effects of competition from CLECs, wireless service, high speed cable, Voice Over Internet Protocol ("VoIP") and other internet providers is an industry-wide issue that is felt to varying degrees by our rural telephone companies.
- o The economy- Unemployment, building starts, business bankruptcies and the overall health of the economy have a significant effect on demand for our services.
- o Telecommunication bankruptcies- Interactive's telephone companies have significant, normal course of business receivables from interexchange carriers, such as MCI or Global Crossings who filed for bankruptcy and, as a result, have been written-off. Additional bankruptcies could have a significant effect on our financial condition. The Company expects to recover settlements from MCI in 2005.
- o Market challenges- Our phone companies are required to comply with industry-wide initiatives such as local number portability and the requirements of the Communications Assistance for Law Enforcement Act ("CALEA") that are expensive to implement and that in some cases have limited demand in our markets.

Interactive generates cash and earns telecommunications revenues primarily from local network access, intrastate and interstate access revenue and from state and federal USF support mechanisms. Due to the nature of the Company's regulated telephone operations, revenues and operating expenses are relatively stable period to period.

- o Local Revenues - The number of access lines is the primary driver of local network access revenues. In addition, the ratio of business to residential lines, as well as the number of features subscribed to by customers are secondary drivers.

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- o Intrastate access revenues - Customer usage, primarily based on minutes of use, and the number of access lines are the primary drivers of intrastate access revenues since the Company's RLECs are on a "bill-and-keep" basis.
- o All of our RLECs participate in the National Exchange Carrier Association ("NECA") access pools. Interstate access revenues depend upon whether the RLEC has elected to be "cost-based" or has remained an "average schedule" carrier. The revenues of our nine cost-based carriers directly correlate to the rate-of-return on regulated net investment earned by the NECA access pools plus the amount of regulated operating expenses including taxes. The revenues of the Company's five average schedule subsidiaries correlate to usage based measurements such as access lines, interstate minutes-of-use, and the number and mileage of different types of circuits. The average schedule formulas are intended to be a proxy for cost-based recovery.

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- o USF subsidies are primarily driven by investments in specific types of infrastructure, as well as certain operating expenses and taxes of the Company. Interstate and intrastate USF subsidies are included in the respective interstate and intrastate access revenue captions in the breakdown of revenue and operating expenses which follows.
- o Other business revenue: Interactive's companies also provide non-regulated telecommunications related services, including Internet access service, wireless and long distance resale service, in certain of its telephone service and adjacent areas. Interactive also provides and intends to provide more local telephone and other telecommunications service outside certain of its franchise areas by establishing CLEC operations in selected nearby areas. In addition, certain of Interactive's companies have expanded into cable and security businesses in the areas in which they operate.
- o Long Distance revenues are only retained by the Company if it is providing the long distance service to the end user customer as the toll provider. For unaffiliated IXCs who contract with Interactive for billing services, the Company provides billing services and receives an administrative handling fee.

The following are material opportunities, challenges and risks that Interactive's executives are currently focused on, as well as actions that are being taken to address the concerns:

- o Universal Service Reform: Efforts to modify universal service mechanisms are currently underway at the FCC. In June 2004, the FCC asked the Federal-State Joint Board on Universal Service ("Joint Board") to review the rules relating to the high-cost universal service support mechanisms for rural carriers and to determine the appropriate rural mechanism to succeed the five-year plan adopted in the Rural Task Force Order. In particular, the FCC asked the Joint Board to make recommendations on a long-term universal service plan that ensures that support is specific, predictable, and sufficient to preserve and advance universal service. The FCC asked the Joint Board to ensure that its recommendations are consistent with the goal of ensuring that consumers in rural, insular, and high-cost areas have access to telecommunications and information services at rates that are affordable and reasonably comparable to rates charged for similar services in urban areas. The FCC also asked the Joint Board to consider how support can be effectively targeted to rural telephone companies serving the highest cost areas, while protecting against excessive fund growth. In conducting its review, the Joint Board is supposed to take into account the significant distinctions among rural carriers, and between rural and

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non-rural carriers and consider all options for determining appropriate universal service support. The Company participated with the RLEC industry in comments to the FCC regarding the potential impact to customers and RLECs in rural America. Total USF support payments are material to the Company's financial results.

- o Intercarrier Compensation and Access Charge Reform: The Company is actively participating in the RLEC industry's efforts to determine how intercarrier compensation and access charges should be modified without sustaining revenue losses for RLECs.
- o Loss of Access Revenues from VoIP and wireless usage: The Company is experiencing revenue losses as usage transfers from landline service provided by the Company's subsidiaries to either VoIP or wireless services. VoIP traffic currently does not pay access charges or contribute to universal service. The FCC has several proceedings underway to determine whether VoIP traffic should contribute for the use of the network and contribute to USF. The Company is participating in the RLEC industry efforts to have VoIP traffic contribute for use of the underlying network on which the VoIP call travels. To offset revenue losses from traditional voice services, Interactive is installing more broadband services and is exploring how to best incorporate VoIP into its business model.
- o Intrastate revenue at our Michigan telephone company could be substantially reduced in the future due to a state requirement to expand the local calling area. The Company intends to file with the state commission recover some or all of the revenue deficiency, however, there is no assurance that it will be successful.

In January 2002, Interactive spun off its investment in Morgan, its only services subsidiary, via a tax-free dividend to its shareholders of the stock of Morgan Group Holding Co., a corporation that was initially formed to serve as a holding company for Interactive's controlling interest in Morgan. Accordingly, the amounts for Morgan are reflected on a one-line basis in the consolidated financial statements as "to be distributed to shareholders."

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Year 2004 compared to 2003

The following is a breakdown of revenues and operating costs and expenses for 2004 and 2003 (in thousands):

	----- 2004	2003	Increase (Decrease) -----
(Unaudited)			
Revenues:			
Local access	\$11,851	\$11,836	\$ 15
Interstate access	39,644	37,686	1,958
Intrastate access	15,263	15,352	(89)
Other business	21,036	20,518	518
	-----	-----	-----
Total	87,794	85,392	2,402
	-----	-----	-----

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Operating Cost and Expense:			
Cost of revenue	29,992	29,460	532
General and administrative costs at operations	13,800	12,693	1,107
Corporate office expenses	6,401	4,529	1,872
Depreciation and amortization	21,870	20,282	1,588
	-----	-----	-----
Total	72,063	66,964	5,099
	-----	-----	-----
Operating profit	\$15,731	\$18,428	\$(2,697)
	=====	=====	=====

Total revenues in 2004 increased \$2.4 million, or 2.8%, to \$87.8 million compared to \$85.4 million in 2003. Local access revenue increased by \$15,000 in 2004 resulting from the sale of additional features and rate increases, partially offset by a 3.3% decrease in access lines. The decrease in access lines is due to the increase in cell phone usage and reduction in dial-up internet service. Interstate access revenue increased \$2.0 million in 2004 primarily due to infrastructure development undertaken in 2002 and 2003, which entitled the Company to increased network access and USF support primarily at the Haviland Telephone Company in Kansas. Such increase was partially offset by the loss of a telecommunications transport contract in Utah and by a one-time NECA adjustment to our reported rate base, which reduced revenue. Intrastate network access revenue decreased \$0.1 million as increases resulting from the infrastructure development in Haviland were offset by an increase in local dial-up access to the internet at our Michigan telephone company. Other business revenues increased \$0.5 million due to increased DSL penetration, the sale of telecommunications equipment to an Iowa school district, revenues from a small cable company in Utah that the Company acquired in February 2004, and partially offset by lower revenues in the Company's security operation.

Total costs and expenses increased by \$5.1 million to \$72.1 million in 2004. Costs of revenue increased \$0.5 million, or 1.8%, due to additional operating costs related to the infrastructure development in Haviland, costs related to the sale of equipment to the Iowa school district, costs generated by the cable television operation acquired in February 2004 and partially offset by cost savings in the Company's security operation. General and administrative costs incurred at the operations increased \$1.1 million primarily due to increased staffing, increased audit and consulting costs resulting from Sarbanes-Oxley implementation, increased advertising, and higher professional fees offset by a \$0.1 million decrease in consulting fees relating to the Kansas Commission audit incurred in 2003. Corporate office expenses increased \$1.9 million resulting from \$3.2 million of legal costs incurred defending the "qui tam" litigation in 2004, partially offset by the absence in 2004 of a \$1.6 million management incentive accrual recorded in 2003. Depreciation and amortization increased \$1.6 million including an increase of \$0.5 million in depreciation and \$1.1 million of amortization expense. The increase in depreciation was primarily as a result of the infrastructure development at Haviland, as well as a regulatory approved change in depreciable lives, which resulted in increased depreciation expense at our Michigan telephone company. The increase in amortization resulted from the Company's 2004 annual test of goodwill and other indefinite life intangible assets for impairment in accordance with SFAS No.142. Interactive recorded a \$0.7 million impairment of its investments in certain 10MHz PCS licenses in Las Cruces, NM and Logan, UT. Such impairment was based on a February 2005 FCC auction of similar spectrum in which the price per MHz of population was materially lower than the price Interactive paid for such spectrum. In addition, \$0.5 million of goodwill was considered to be impaired and was written off in amortization expense.

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As a result of the above, operating profit in 2004 decreased by \$2.7 million to \$15.7 million compared to 2003.

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EBITDA

EBITDA represents the Company's earnings from continuing operations before interest, taxes, depreciation and amortization. EBITDA is not intended to represent cash flows from operating activities and should not be considered as an alternative to net income or loss as an indicator of the Company's operating performance or to cash flows as a measure of liquidity, in each case as determined in accordance with generally accepted accounting principles. EBITDA from operations is presented herein because it is a commonly used metric in the communications industry to analyze companies on the basis of operating performance and liquidity. The Company's senior management believes it facilitates a standardized comparison among companies in the telecommunications industry, while minimizing differences among those companies based on depreciation, financial leverage and tax policies. In addition, Interactive utilizes EBITDA as one of its metrics for valuing potential acquisitions. The following table reconciles EBITDA to Operating profit and to Income before income taxes and minority interests (in thousands).

	2004	2003	Increase (Decrease)

(Unaudited)			
EBITDA from operations	\$ 44,002	\$ 43,239	\$ 763
Corporate office expenses:			
Qui Tam and SOX consulting	3,501	24	3,477
Bonus accrual	--	1,600	(1,600)
Other	2,900	2,905	(5)
	-----	-----	-----
Corporate office expenses:	6,401	4,529	1,872
	-----	-----	-----
Total EBITDA	37,601	38,710	(1,109)
Depreciation and amortization	21,870	20,282	1,588
	-----	-----	-----
Operating profit	15,731	18,428	(2,697)
Investment income	1,289	1,120	169
Interest expenses	(11,204)	(11,864)	660
Equity in earnings of affiliates	3,564	2,280	1,284
Gain on sale of investment in Sunshine	185	3,919	(3,734)
	-----	-----	-----
Income before income taxes and minority interest	\$ 9,565	\$ 13,883	\$ (4,318)
	=====	=====	=====

Other Income (Expense)

In 2004, investment income increased by \$0.2 million primarily due to an increase in CoBank patronage refunds offset by a reduction in interest income due to lower interest rates.

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Interest expense decreased by \$0.7 million in 2004 compared to 2003 due primarily to lower outstanding borrowings partially offset by higher interest rates.

Equity in earnings of affiliates in 2004 increased \$1.3 million compared to 2003 due to higher earnings at the Company's New Mexico cellular investments (RSA 3 and 5).

Income Tax Provision

The income tax provision includes federal, as well as state and local taxes. The tax provision for the 2004 and 2003, represent effective tax rates of 36.8% and 35.8%, respectively. The difference between these effective rates and the federal statutory rate is principally due to state income taxes, including the effect of earnings attributable to different state jurisdictions. In addition, in December 2004 Interactive reversed certain tax reserves that were no longer required.

Minority Interests

Minority interests decreased earnings by \$2.0 million in 2004, as compared to \$1.6 million in 2003. The change was due to higher earnings from the Company's New Mexico cellular investments.

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Net Income

Net income in 2004, was \$4.5 million, or \$1.61 per share (basic and diluted), compared to a net income last year of \$7.4 million, or \$2.64 per share (basic and diluted). The Company has no dilutive instruments outstanding.

Year 2003 compared to 2002

The following is a breakdown of revenues and operating expenses for the two years ended December 31, 2003 and 2002:

	----- 2003	2002	Increase (Decrease)
----- (Unaudited)			
Revenues:			
Local access	\$11,836	\$11,890	(54)
Interstate access	37,686	34,830	2,856
Intrastate access	15,352	16,723	(1,371)
Other business	20,518	20,782	(264)
	-----	-----	-----
Total	85,392	84,225	1,167
	-----	-----	-----
Operating Cost and Expense:			
Cost of revenue	29,460	29,020	440
General and administrative costs at operations	12,693	13,285	(592)
Corporate office expenses	4,529	3,334	1,195
Depreciation and amortization	20,282	19,353	929

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	-----	-----	-----
Total	66,964	64,992	1,972
	-----	-----	-----
Operating profit	\$18,428	\$19,233	(805)
	=====	=====	=====

Total revenues in 2003 increased \$1.2 million, or 1.4%, to \$85.4 million compared to \$84.2 million in 2002. Local access revenue decreased by \$54,000 in 2003 compared to 2002 as a 2.7% decrease in the number of access lines, due primarily to additional DSL lines sold, offset a 1% increase in the percentage of business lines, which typically generate higher revenues, compared to residential access lines. Interstate revenues increased \$2.9 million in 2003 compared to 2002 primarily due to the effect of infrastructure development, which entitled the Company to increased USF support primarily at the Haviland Telephone Co. and Central Utah Telephone Co. ("CUT"). In addition, interstate access revenue increased \$0.8 million primarily due to the recovery in revenue of increased operating expenditures, in accordance with our ratemaking structure, associated with the increased infrastructure development. Under the rate of return model in which these companies are regulated, further increases in revenue are expected in 2004, as the 2003 capital expenditures are fully recognized by the model. Intrastate revenues decreased \$1.4 million in 2003 compared to 2002 primarily due to state initiatives in Kansas and New York. The Kansas initiative has been fully recognized in the regulatory model, but additional revenue reductions are expected in New York of approximately \$0.1 million per year over the next four years. Other Business revenues, which include the Company's internet, CLEC, wireless, long-distance, cable and security operations, decreased \$0.3 million in 2003 compared to 2002. The sale of a wireless equipment operation in upstate New York with 2002 revenues of \$0.8 million was offset by a \$0.6 million increase due to additional subscribers in the Company's 63.6% owned security business in upstate New York. In addition, decreased revenue in long-distance resale and other lines of business offset an increase of \$0.6 million in the Company's CLEC operations in New York.

Total costs and expenses increased by \$2.0 million to \$67.0 million in 2003. Cost of revenue increased \$0.4 million, or 1.5%, due to additional operating costs related to the infrastructure development in Haviland, additional bandwidth and system maintenance costs in 2003, and a \$0.8 million reduction in costs due to the sale of a wireless business in upstate New York in late 2002. General and administrative costs at the operations decreased \$0.6 million in 2003 compared to 2002, primarily due to \$0.9 million of bad debt expense in 2002 associated with the bankruptcies of MCI/Worldcom and Global Crossings. Corporate costs increased \$1.2 million in 2003, primarily due to a \$1.2 million increase in the bonus accrual. The Company recorded a \$1.6 million accrual in 2003 in accordance with a shareholder approved management incentive program compared to a \$0.4 million bonus accrual in 2002. The gain on the sale of the Sunshine Preferred Stock and warrants resulted in \$0.8 million of such increase to the bonus accrual. Depreciation expense increased by \$1.6 million in 2003, of which \$0.8 million was due to increased capital expenditures at one of our Kansas operations and \$0.3 million was due to revised depreciation rates that more accurately reflect asset lives at our Michigan subsidiary.

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Amortization expense decreased by \$0.7 million during 2003, as the Dunkirk & Fredonia security operation increased the amortization period for its subscriber lists from three to ten years in the fourth quarter of 2002.

As a result of the above, operating profit was \$18.4 million in 2003, \$0.8 million less than the \$19.2 million recorded in 2002.

EBITDA

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The following table reconciles EBITDA to Operating profit and to Income before income taxes, minority interests and operations of Morgan.

	2003	2002	Increase (Decrease)

(Unaudited)			
EBITDA from operations	\$ 43,239	\$ 41,920	\$ 1,319
Corporate office expenses:			
Qui Tam and SOX consulting ...	24	515	(491)
Bonus accrual	1,600	463	1,137
Other	2,905	2,356	549
	-----	-----	-----
Corporate office expenses: ...	4,529	3,334	1,195
	-----	-----	-----
Total EBITDA	38,710	38,586	124
Depreciation and amortization ..	20,282	19,353	929
	-----	-----	-----
Operating profit	18,428	19,233	(805)
Investment income	1,120	1,765	(645)
Interest expenses	(11,864)	(13,031)	1,167
Equity in earnings of affiliates	2,280	1,938	342
Other gains and losses	3,919	(514)	4,433
	-----	-----	-----
Income before income taxes and minority interest	\$ 13,883	\$ 9,391	\$ 4,492
	=====	=====	=====

Other Income (Expense)

Investment income was \$1.1 million in 2003 as compared to \$1.8 million in 2002. The decrease was attributed to absence of interest income associated with an escrow account securing our previously outstanding convertible note which was repaid in November 2002, interest on an IRS refund that was recorded in 2002, lower realized gain on sales of marketable securities and lower patronage capital income associated with our long term borrowings.

Interest expense was \$11.9 million in 2003, as compared to \$13.0 million in 2002, primarily due to the repayment in November 2002 of a \$10 million Convertible Note. The company recorded \$0.7 million of interest expense associated with the note in 2002. The remaining decrease was the result of lower interest rates on the Company's variable rate borrowings. The Company is considering converting a significant portion of its current variable interest rate debt to fixed interest rate debt, which would increase interest expense in the future, based on current interest rate levels.

On December 31, 2003, Sunshine sold its three PCS licenses to Cingular Wireless for \$13.75 million in cash. As part of this sale, Interactive received \$7.2 million in exchange for all its preferred stock in Sunshine and \$0.4 million for its warrants, resulting in a pre-tax gain of \$3.9 million. Interactive's cash investment in Sunshine and its predecessor companies, beginning in 1995, was a cumulative \$21.9 million. In 1997 and in 1999, Interactive recorded impairment losses of \$7.0 million and \$15.4 million, respectively, which included the impairment of interest the Company capitalized on these investments during the development of the licenses.

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The Company has made loans to and has investments in PTPMS Communications II, LLC, totaling \$6.2 million. PTPMS II acquired wireless spectrum in an auction conducted by the Federal Communications Commission in 2000 called the 700 MHz Guard Band Auction. In a FCC auction conducted in September 2002 for similar spectrum, called the Lower 700 MHz Band Auction, the price per MHz of population was materially lower than the price paid by PTPMS II in 2000. Accordingly, during 2002, Interactive provided for the impairment for its investment in PTPMS II of \$5.5 million (\$3.6 net of income tax effects).

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During 2002, the Company sold its interest in a cellular partnership in New Mexico RSA # 1 (North) for \$5.5 million resulting in a pre-tax gain of \$5.0 million (\$2.5 million net of income tax and minority interests effect).

Equity in earning of affiliates increased by \$0.3 million in 2003 compared to 2002 due to higher revenues and earnings of our investments in cellular telephone affiliates in New Mexico.

Income Tax Provision

The income tax provision includes federal, as well as state and local taxes. The tax provision in 2003 and 2002, represent effective tax rates of 35.8% in 2003 and 41.8% in 2002. The differences from the federal statutory rate are primarily due to the effects of state income taxes. In addition, in 2003, no state provision was required on the gain on sale of the investment in Sunshine and the Company reassessed certain tax accruals.

Minority Interests

Minority interests decreased earnings by \$1.5 million in 2003 and \$1.7 million in 2002. The gain in 2002 from the sale of New Mexico RSA #1 (North) resulted in a \$0.5 million reduction in minority interests in 2003 when compared to 2002. Such reduction in minority interests was offset by higher earnings in 2003 at several of our less than 100% owned subsidiaries.

Income from Continuing Operations

As a result of all of the above, income from continuing operations of \$7.4 million in 2003, or \$2.65 per share (basic and diluted), increased by \$3.6 million from the \$3.8 million, or \$1.34 per share (basic and diluted), recorded in 2002.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

The debt at each of Interactive's subsidiary companies contains restrictions on the amount of funds that can be transferred to their respective parent companies. The Interactive parent company ("Parent Company") needs cash primarily to pay corporate expenses, federal income taxes and to invest in new opportunities, including spectrum licenses. The Parent Company receives cash to meet its obligations primarily through management fees charged to its subsidiaries, a tax sharing agreement with its subsidiaries, usage of a line of credit facility, and has obtained additional liquidity by refinancing certain subsidiary debt. In addition, the Parent Company considers various alternative long-term financing sources: debt, equity, or sale of investments and other assets.

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The Parent Company's short-term line of credit facility, which expires August 31, 2005, has a maximum availability totaling \$5.0 million, \$3.8 million of which was available at December 31, 2004. The Company is pursuing various financing alternatives including a replacement for its current line of credit with a larger business base renewal of the line of credit, refinancing substantially all or individual pieces of its currently outstanding debt, and sale of certain investments. The Company expects to obtain an additional line of credit in the next year. While it is management's belief that the Company will have adequate resources to fund operations over the next twelve months, there can be no assurance that the Company will obtain financing on terms acceptable to management. The obtaining of a replacement line of credit is a critical element of the Company's financing strategy.

The Company's RLECs and other businesses need cash to fund their current operations, as well as future long-term growth initiatives. Each RLEC and other business finances its cash needs with cash generated from operations, by utilizing existing borrowing capacity or by entering into new long-term debt agreements. New business acquisitions are generally financed with a combination of new long-term debt, secured by the acquired assets, as well as cash from the Parent. While management expects that both Parent and the operating subsidiaries will be able to obtain adequate financing resources to enable the Company to meet its obligations, there is no assurance that such can be readily obtained or at reasonable costs. The Company is obligated under long-term debt provisions and lease agreements to make certain cash payments over the term of the agreements. The following table summarizes, as of December 31, 2004 for the periods shown, these contractual obligations and certain other financing commitments from banks and other financial institutions that provide liquidity:

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	Payments Due by Period (In thousands)				
	Total	Less than 1 year	1 - 3 years	4 - 5 years	After
Long-term debt (a)	\$168,966	\$ 14,364	\$ 66,085	\$ 35,966	\$ 52,541
Operating leases	1,343	283	503	248	---
Notes payable to banks	4,793	4,793	--	--	---
Guarantees	3,750	--	3,750	--	---
Total contractual cash obligations and commitments	\$178,852	\$ 19,440	\$ 70,338	\$ 36,214	\$ 52,541

(a) Does not include interest payments on debt.

A subsidiary of the Company has guaranteed \$3.8 million of an equity investee's total debt of \$10.1 million. The guarantee is in effect for the duration of the loan which expires on December 31, 2005 and would be payable if the equity investee fails to make such payment in accordance with the terms of the loan.

At December 31, 2004, total debt (including notes payable to banks) was \$173.8 million, a decrease of \$5.5 million from December 31, 2003. At December 31, 2004, there was \$106.5 million of fixed interest rate debt outstanding averaging 7.0% and \$67.2 million of variable interest rate debt averaging 5.3%. The debt at fixed interest rates includes \$39.0 million of subordinated notes at interest

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rates averaging 9.5% issued to sellers as part of acquisitions. The long-term debt facilities at certain subsidiaries are secured by substantially all of such subsidiaries assets, while at other subsidiaries it is secured by the common stock of such subsidiaries. In addition, the debt facilities contain certain covenants restricting distribution to Lynch Interactive. At December 31, 2003 and 2004, substantially all of the subsidiaries' net assets are restricted.

Interactive has a high degree of financial leverage. As of December 31, 2004, the ratio of total debt to equity was 5.0 to 1. Certain subsidiaries also have high debt to equity ratios. Management believes that it is currently more beneficial to hold excess cash at certain of our subsidiaries rather than utilizing the cash to pay-down existing credit facilities.

As of December 31, 2004, Interactive had current assets of \$39.4 million and current liabilities of \$35.5 million resulting in a working capital surplus of \$3.9 million compared to a surplus of \$7.2 million at December 31, 2003. This \$3.3 million reduction in the surplus was primarily due to the receipt in 2004 of a \$2.4 million federal income tax refund included in the December 31, 2003 balance sheet. In 2004, net cash provided by operations of \$27.8 million was used to invest in plant and equipment, to invest in cable assets and to repay debt.

Sources and Uses of Cash

Cash at December 31, 2004, was \$27.2 million, an increase of \$0.7 million compared to 2003. In 2004, net cash provided by operations of \$27.3 million was used to invest in plant and equipment, to invest in cable assets and repay debt. In 2003, net cash provided by operations of \$29.1 million and \$7.6 million proceeds from the sale of Interactive's investment in Sunshine were used to invest in plant and equipment and repay debt. In 2002, the Company used \$7.6 million of restricted cash as part of the repurchase of \$10.5 million of convertible debt. In addition, in 2002, Interactive received \$3.0 million of cash proceeds for the sale of a minority interest in a cellular operation and issued \$7.1 million in long-term debt.

Capital expenditures were \$16.5 million in 2004, \$22.7 million in 2003, and \$23.8 million in 2002 which is predominantly spent at the RLECs and will be included in their rate bases for rate setting purposes. Capital expenditures in 2005 are expected to be approximately \$10 million, most of which will be added to the RLEC rate bases.

On December 31, 2003, Sunshine sold its three PCS licenses to Cingular Wireless for \$13.75 million in cash. As part of this sale, Interactive received \$7.2 million in exchange for all its preferred stock in Sunshine and \$0.4 million for its warrants. The cash proceeds were used to repay amounts outstanding under the \$10 million credit facility. As part of this transaction, Interactive agreed to provide an indemnification to Cingular for up to \$8 million of losses that Cingular might incur in the event of an adverse ruling in the "qui tam" litigation (see Contingencies below) in which Interactive and Sunshine are defendants. Management believes the probability that Cingular will incur such losses is highly remote.

The Company has initiated an effort to monetize certain of its assets, including selling a portion or all of its investment in certain of its operating entities and equity investments. These initiatives may include the sale of certain telephone

operations where growth opportunities are not readily apparent. There is no assurance that all or any part of this program can be effectuated on acceptable

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terms.

Subsequent to the spin-off by Lynch Corporation, the Board of Directors of Lynch Interactive Corporation authorized the purchase of up to 100,000 shares of common stock. Through December 31, 2004, 67,000 shares had been purchased at an average cost of \$32.32 per share including 22,000 shares purchased in 2004 at an average investment of \$31.05 per share. Subsequent to year-end, an additional 5,700 shares have been acquired at an average investment of \$31.53 per share.

President Bush's proposed Budget for Fiscal Year 2006 establishes the process and terms to implement the dissolution of the Rural Telephone Bank ("RTB"). Under RTB's By-Laws, on dissolution, the holders of its Class B and Class C stock would be paid the par value of their stock. As of December 31, 2004, the total par value of RTB Class B and Class C stock at the Company's subsidiaries was \$11.3 million. The net book value and tax basis of this stock, at that date, was \$1.1 million. The dissolution of the RTB and payments to the stock holders is subject to numerous approvals and actions, including Congressional approval of President Bush's proposed Budget for Fiscal Year 2006 and actions by RTB's Board of Directors. Therefore, the Company cannot predict whether, or when, such payments will actually be made to the Company's subsidiaries.

Lynch Corporation, the Company's predecessor, has not paid any cash dividends on its common stock since 1989. The Company has not paid any cash dividends since its inception in 1999 and does not expect to pay cash dividends on its common stock in the foreseeable future. Interactive currently intends to retain its earnings, if any, for use in its business. Further financing may limit or prohibit the payment of dividends.

Contingencies

False Claims Act "Qui Tam" Litigation.

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

The main allegation in the case is that the defendants participated in the creation of "sham" bidding entities that allegedly defrauded the federal Treas