LYNCH INTERACTIVE CORP
Form 10-Q
May 17, 2005

SECURITIES & EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2005

or

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

For the transition period from _______ to __________

Commission File No. 1-15097

LYNCH INTERACTIVE CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware	06-1458056
State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
401 Theodore Fremd Avenue, Rye, New York	10580
(Address of principal executive offices)	(Zip Code)

(914) 921-8821

Registrant's telephone number, including area code

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

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

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

Class	Outstanding at April 30, 2005
Common Stock, $.0001 par value	2,752,251

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LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

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

	March 31, 2005 Unaudited)	December 31, 2004 (Audited)	March 31, 2004 Unaudited)
ASSETS			
Current assets:			
Cash and cash equivalents	$ 29,698	$ 27,214	$ 29,572
Receivables, less allowances of $255, $260 and $270,respectively ..	7,573	8,225	7,923
Material and supplies	2,502	2,314	2,736
Prepaid expenses and other current assets	1,175	1,685	1,110
Total current assets	40,948	39,438	41,341
Property, plant and equipment:			
Land	983	983	840
Buildings and improvements	17,712	17,640	13,336
Machinery and equipment	220,496	216,429	216,855
	239,191	235,052	231,031
Accumulated depreciation	(119,252)	(114,724)	(107,683)
	119,939	120,328	123,348
Excess of cost over fair value of net assets acquired, net (goodwill) .	60,501	60,042	60,580
Other intangibles	10,763	10,026	10,321
Investments in and advances to affiliated entities	11,416	12,340	5,310
Other assets	15,167	14,906	13,176
Total assets ....;;;;;;;..........	$ 28,734	$ 257,080	$ 254,076

See accompanying Notes to Consolidated Financial Statements

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

	March 31, 2005 (Unaudited)	December 31, 2004 (Audited)	March 31, 2004 (Unaudited)
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Notes payable to banks	$ 5,980	$ 4,793	$ 3,535
Trade accounts payable	3,125	4,326	4,457
Accrued interest payable	822	825	696
Accrued liabilities	15,100	11,238	10,925
Current maturities of long-term debt ...	14,295	14,364	13,071
Total current liabilities	39,322	35,546	32,684
Long-term debt	153,593	154,602	160,388
Deferred income taxes	16,080	17,549	15,812
Other liabilities	3,431	3,268	2,976
Total liabilities	212,426	210,965	211,860
Minority interests	11,313	11,543	10,297
Commitments and contingencies (Note 12)			
Shareholders' equity			
Common stock, $0.0001 par value-10,000,000 shares authorized; 2,824,766 issued; 2,752,251, 2,757,951 and 2,774,651 outstanding	--	--	--
Additional paid-in capital	21,406	21,406	21,406
Retained earnings	14,430	13,735	10,872
Accumulated other comprehensive income .	1,495	1,588	1,253
Treasury stock, 72,515, 66,815 and 50,115 shares, at cost	(2,336)	2,157)	(1,612)
	34,995	34,572	31,919
Total liabilities and shareholders' equity.	$ 258,734	$ 257,080	$ 254,076

See accompanying Notes to Consolidated Financial Statements.

LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(in thousands, except per share data)

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Revenues	$ 21,618	$ 21,424
Costs and expenses:		
Cost of revenue	7,651	7,203
General and administrative costs at operations ...	3,423	3,139
Corporate office expenses	2,091	973
Depreciation and amortization	5,195	5,221
Total Expense	18,360	16,536
Operating profit	3,258	4,888
Other income (expense):		
Investment income	793	728
Interest expense	(2,823)	(2,819)
Equity in earnings of affiliated companies	711	712
	(1,319)	(1,379)
Income before income taxes and minority interests	1,939	3,509
Provision for income taxes	(767)	(1,449)
Minority interests	(477)	(457)
Net income	$ 695	$ 1,603
Basic and diluted weighted average shares o utstanding	2,754	2,777
Basic and diluted earnings per share	$ 0.25	$ 0.58

See accompanying Notes to Condensed Consolidated Financial Statements.

LYNCH INTERACTIVE CORPORATION AND SUBSIDIAIRES
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Unaudited)
(in thousands, except share data)

	Shares of Common Stock Out-standing	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income
Balance at December 31, 2004	2,757,951	$ 0	$ 21,406	$ 13,735	$ 1,588
Net income for the period ..	--	--	--	695	--
Unrealized loss on available for sale securities, net	--	--	--	--	(93)
Comprehensive income ...					
Purchase of Treasury Stock .	(5,700)	--	--	--	--
Balance at March 31, 2005	2,752,251	$ 0	$ 21,406	$ 14,430	$ 1,495

See accompanying Notes to Consolidated Financial Statements.

LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(in thousands)

	Three Months Ended March 31, 2005	2004
Operating activities:		
Net Income	$ 695	$ 1,603
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,195	5,221
Equity in earnings of affiliated compani	(711)	(712)
Minority interests	477	457
Changes in operating assets and liabilities:		
Receivables	712	307
Accounts payable and accrued liabilitie	400	1,324
Other	619	(189)
Net cash provided by operating activities	7,387	8,011
Investing activities:		

Capital expenditures	(1,915)	(2,614)
Acquisition of business	(3,524)	(377)
Acquisition of subscrib	(22)	(91)
Acquisition of spectrum	(500)	--
Investment in and advances to affiliated entities	(62)	(63)
Distributions received from investments	1,714	821
Other	183	30
Net cash used in investing activities	(4,126)	(2,294)
Financing activities:		
Issuance of long term debt	2,272	949
Repayments of long term debt	(3,350)	(3,273)
Net proceeds (repayments) on lines of credit	1,187	79
Purchase of treasury stock	(179)	(138)
Other	(707)	(318)
Net cash used in financing activities	(777)	(2,701)
Net increase in cash and cash equivalents	2,484	3,016
Cash and cash equivalents at beginning of period	27,214	26,556
Cash and cash equivalents at end of period	$ 29,698	$ 29,572
Cash paid for:		
Interest expense	$ 2,764	$ 2,826
Income taxes	$ 676	$ 175

See accompanying Notes to Condensed Consolidated Financial Statements.

LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

A. Basis of Presentation

Lynch Interactive Corporation ("Interactive" or the "Company") consolidates the operating results of its subsidiaries (81%-100% owned at March 31, 2005, December 31, 2004 and March 31, 2004). All material intercompany transactions and balances have been eliminated. Investments in affiliates in which the Company does not have a majority voting control, but has the ability to significantly influence management decisions, are accounted for in accordance with the equity method. The Company accounts for the following affiliated companies on the equity basis of accounting: Coronet Communications Company (20% owned at March 31, 2005, December 31, 2004 and March 31, 2004), Capital Communications Company, Inc. (49% owned at March 31, 2005, December 31, 2004 and March 31, 2004; we note, however, that Interactive owns a convertible preferred stock which, if converted, would increase its ownership in Capital Communications to 50%), two cellular partnership operations in New Mexico (both 33% owned at March 31, 2005, December 31, 2004 and March 31, 2004), KMG Holdings

Group (37% owned since May 2004) and telecommunications operations in North Dakota, Iowa and New York (5% to 14% owned).

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Articles 10 and 11 of Regulation S-X. Accordingly, they are not audited and do not include all of the information and footnotes required for complete financial statements. The consolidated financial statements and footnotes included in this Form 10-Q should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2004. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended March 31, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Certain prior period amounts in the accompanying consolidated financial statements have been reclassified to conform to current period presentation.

B. Recently Issued Accounting Pronouncements

In December 2004, the FASB issued SFAS No.153, "Exchanges of Nonmonetary Assets", which eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No.153 will be effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not believe the adoption of SFAS No.153 will have a material impact on its consolidated financial statements.

In December 2004, the FASB issued SFAS No.123(R), "Share-Based Payment", which establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. This standard requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This eliminates the exception to account for such awards using the intrinsic method previously allowable under APB Opinion No.25. SFAS No.123(R) will be effective for interim or annual reporting periods beginning on or after June 15, 2005. The Company is currently evaluating the impact of the adoption of SFAS No.123(R) will have on its consolidated financial statements.

In March 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations" ("FIN47"), which clarifies that conditional asset retirement obligations are within the scope of SFAS No. 143, "Accounting for Asset Retirement Obligations." FIN 47 requires the Company to recognize a liability for the fair value of conditional asset retirement obligations if the fair value of the liability can be reasonably estimated. The Company does not believe that the adoption of FIN 47 will have a material impact on its financial statements.

C. Acquisitions and Dispositions

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, a 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. On May 5, 2005, the California Public Utilities Commission approved the transaction subject to various conditions that the Company expects to meet, at which point the acquisition will close.

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

On March 18, 2005, a subsidiary of the Company, Central Telcom Services, LLC, closed on an agreement with Precis Communications, LLC, to acquire a cable television assets for a purchase price of $3.5 million. The system has 2,411 cable subscribers located in Sanpete and Sevier Counties, Utah. The preliminary allocation of the purchase price included $0.4 million of goodwill and $0.4 million for subscriber lists and other intangibles.

D. Investments in Affiliated Companies

Interactive has equity investments in both broadcasting and telecommunications companies.

Summarized financial information for broadcasting companies accounted for by the equity method as of and for the three months ended March 31, 2005 and 2004 and as of December 31, 2004, is as follows:

Broadcasting Combined

	March 31, 2005	December 31, 2004	March 31, 2004
	(in thousands)		
Current assets	$ 5,273	$ 6,896	$ 5,213
Property, plant & equipment, intangibles & other	10,181	9,558	9,187
Total Assets	$ 15,454	$ 16,454	$ 14,400
Current liabilities	$ 2,636	$ 3,383	$ 3,115
Long term liabilities	16,587	16,751	15,857
Equity	(3,769)	(3,680)	(4,572)
Total liabilities & equity	$ 15,454	$ 16,454	$ 14,400
Revenues	$ 3,055		$ 3,490
Gross profit	750		1,256
Net income	(99)		354

A wholly owned subsidiary of the Company has a 20% investment in Coronet Communications Company ("Coronet"), which operates television station WHBF-TV, a CBS affiliate in Rock Island, Illinois. A

second wholly owned subsidiary of the Company has a 49% investment in Capital Communications Company, Inc. ("Capital"), which operates television station WOI-TV, an ABC affiliate in Des Moines, Iowa. At March 31, 2005, December 31, 2004 and March 31, 2004, the investment in Coronet was carried at a negative $0.6 million, $0.6 million and $0.8 million, respectively, due to the subsidiary's guarantee of $3.8 million of Coronet's third party debt. 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. Long-term debt of Coronet, at March 31, 2005, totaled $9.4 million payable quarterly through December 31, 2005 to a third party lender.

At March 31, 2005, December 31, 2004 and March 31, 2004, the investment in Capital is carried at zero as its share of net losses recognized to date have exceeded its net investment and the Company has no further commitment to Capital. The Company's shares in Capital have been pledged as security for Capital's long term debt.

Summarized financial information for telecommunications companies which includes the cellular telephone providers, spectrum license holders, and other telecommunication operations accounted for by the equity method as of and for the three months ended March 31, 2005 and 2004 and as of December 31, 2004 is as follows (in thousands):

	Telecommunications Combined		
	March 31, 2005	December 31, 2004	March 31, 2004
		(in thousands)	
Current assets	$33,330	$36,080	$29,425
Property, plant & equipment, intangibles & other	34,349	33,087	26,856
Total Assets	$67,679	$69,167	$56,281
Current liabilities	$22,812	$22,745	$22,322
Long term liabilities	7,028	5,900	8,938
Equity	37,839	40,522	25,021
Total liabilities & equity	$67,679	$69,167	$56,281
Revenues	$16,196		$12,306
Gross profit	7,139		5,475
Net income	3,945		3,295

Interactive owns a one-third interest in two cellular telephone providers in New Mexico: New Mexico RSA #3 and RSA #5. The Company's net investment in these partnerships was $5.4 million, $6.5 million and $4.8 million at March 31, 2005, December 31, 2004 and March 31, 2004, respectively and included in Investment in and advances to affiliated entities.

E. Indebtedness

Interactive maintains a short-term line of credit facility totaling $10.0 million through October 2004, which was reduced in steps to $5 million at March 31, 2005. Borrowings under this facility, included in Notes payable to banks, were $1.8 million, $1.1 million and zero at March 31, 2005, December 31, 2004 and March 31, 2004, respectively. Long-term debt consists of (all interest rates are at March 31, 2005) (in thousands):

	March 31, 2005	December 31, 2004
Rural Electrification Administration ("REA") and Rural Telephone Bank (`RTB") notes payable due quarterly through 2027 at fixed interest rates ranging from 2% to 7.5%. (5.1% weighted average, secured by assets of the telephone companies with a net book value of $150 million)	$56,100	$57,129
Bank Credit facilities utilized by certain telephone and telephone holding companies due from 2005 to 2016, $8.8 million at fixed interest rates averaging 8.3% and $61.7 million at variable interest rates averaging 5.7%.	70,497	70,402
Unsecured notes issued in connection with acquisitions through 2008, at fixed interest rates averaging 9.4%	38,983	38,983
Other	2,308	2,452
	167,888	168,966
Current maturities	(14,295)	(14,364)
	$ 153,593	$ 154,602

In March 2005, in conjunction with the acquisition of cable assets in Utah, a subsidiary of the Company borrowed $2.2 million from a bank at variable interest rates included in Bank Credit facilities above.

In April 2005, Interactive received a commitment letter for a new $10 million unsecured revolving credit facility , at 1.5% over prime, expiring in 2008, to replace the existing short-term line of credit facility. Such facility is subject to negotiation of terms and there can be no assurance that it will be completed.

F. Comprehensive Income

Other comprehensive income, net of tax, which consists of unrealized gains (losses) on available for sale securities, as of March 31, 2005, December 31, 2004 and March 31, 2004 are as follows (in thousands):

	Unrealized Gain (Loss)	Tax Effect	N
	(in thousands)		
Balance at December 31, 2004	$ 2,410	$ (822)	$
Unrealized losses on available for sale securities, net	(140)	47	
Balance at March 31, 2005	$ 2,270	$ (775)	$
Balance at March 31, 2004	$ 1,901	$ (648)	$

G. Treasury Stock Purchases

During the three months ended March 31, 2005, the Company purchased 5,700 shares of its common stock for treasury at an average investment of $31.53 per share.

H. Litigation

Taylor 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 by Rufus C. Taylor, III ("Taylor" or the "relator") 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 in February 2001. At the initiative of one of the defendants, the seal was lifted in January 2002. Under the False Claims Act, a private plaintiff called 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 Federal Communications Commission ("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 mandatory trebling under the statute, a report prepared for the relator in February 2005 alleges damages of approximately $91 million in respect of bidding credits, approximately $70 million in respect of government loans and approximately $206 million in respect of subsequent sales of licenses, in each case prior to trebling.

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 in July 2002. In September 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. In September 2003, the Court granted our motion to transfer the action. A scheduling conference was held in February 2004, at which time the judge approved a scheduling order and discovery commenced. In July 2004, the judge denied in part and granted in part our motion to dismiss. 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 defendents in order to enable them to conduct their defense. This motion was denied in May 2005 and defendants are considering appropriate responses. The preparation and filing of dispositive motions is expected to begin shortly. See "History of Lynch's "C" Block Activities" below.

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 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. As a lawyer who worked on many applications for FCC licenses, Taylor (the relator in this case) is doubtless 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. 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.

I. Potential MCI/WorldCom Recovery

During 2002, the Company wrote off all receivables associated with MCI/WorldCom ("MCI"), which had declared bankruptcy at that time. While Interactive has not received settlement from the bank of claims, it is currently estimated that Interactive could receive $0.3 million. Such amounts have not been included in the attached financial statements and income will only be recorded to the extent received.

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

This discussion should be read together with the Consolidated Financial 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.

- 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.

- 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.

- The economy- Unemployment, building starts, business bankruptcies and the overall health of the economy have a significant effect on demand for our services.

- 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.

- 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 Acto ("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.

- 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.

- 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.

- 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.

- 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.

- 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.

- 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:

- 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 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.

- 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.

- 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.

- Intrastate revenue and operating income at our Michigan telephone company will 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 to recover a portion of the revenue deficiency, by increasing local access rates, however, there is no assurance that it will be successful.

Three months ended March 31, 2005 compared to 2004

The following is a breakdown of revenues and operating costs and expenses:

	Three months ended March 31, 2005	2004	Increase (Decrease)
	(Unaudited)		
Revenues:			
Local access	$ 2,858	$ 2,889	(31)
Interstate access	9,695	9,338	357
Intrastate access	3,697	4,121	(424)
Other business	5,368	5,076	292
Total	21,618	21,424	194
Operating Cost and Expense:			
Cost of revenue	7,651	7,203	448
General and administrative costs at operations	3,423	3,139	284
Corporate office expenses	2,091	973	1,118
Depreciation and amortization	5,195	5,221	(26)
Total	18,360	16,536	1,824
Operating profit	$ 3,258	$ 4,888	$(1,630)

Total revenues in the 2005 first quarter increased $0.2 million, or 0.9%, to $21.6 million compared to $21.4 million in 2004. Local access revenue decreased by $31,000 resulting from a 3.4% decrease in access lines partially offset by the sale of additional features. The decrease in access lines is due to the increase in cell phone usage and reduction in second lines as customers switch from dial-up internet service to DSL. Interstate access revenue increased $0.4 million in 2005 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, and to a lesser extent, at our Michigan telephone company. Intrastate network access revenue decreased $0.4 million due to a loss of toll revenue for dial-up access to the internet at our Michigan telephone company, the gradual phase-out of a New York pool for small carriers, and a reduction of minutes of use at several of our companies. Other business revenues increased $0.3 million due to increased DSL penetration, and revenues from a small cable company in Utah that the Company acquired in February 2004.

Total costs and expenses increased by $1.8 million to $18.4 million in 2005. Costs of revenue increased $0.4 million, or 6.2%, due to additional operating costs related to the infrastructure development in Haviland and costs generated by the cable television operation acquired in February 2004. General and administrative costs incurred at the operations increased $0.3 million primarily due to professional fees with regard to local area calling in Michigan and increased audit and Sarbanes - Oxley implementation fees. Corporate office expenses increased $1.1 million resulting from $1.2 million of legal costs incurred defending the "qui tam" litigation in 2005 compared to $0.4 million in 2004. In addition, the Company incurred legal and consulting costs in conjunction with a shareholder proposal to deregister as a public company. Depreciation and amortization was relatively consistent in the two periods.

As a result of the above, operating profit in 2005 decreased by $1.6 million to $3.3 million compared to 2004.

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).

	Three months ended March 31, 2005	2004	Increase (Decrease)
	(Unaudited)		
EBITDA from operations	$ 10,544	$ 11,082	$ (538)
Corporate office expenses:			
Taylor litigation	(1,201)	(382)	(819)
Other	(890)	(591)	(299)
Corporate office expenses:	(2,091)	(973)	(1,118)
Total EBITDA	8,453	10,109	(1,656)
Depreciation and amortization	(5,195)	(5,221)	26
Operating profit	3,258	4,888	(1,630)
Investment income	793	728	65
Interest expense	(2,823)	(2,819)	(4)
Equity in earnings of affiliates	711	712	(1)
Income before income taxes and minority interest	$ 1,939	$ 3,509	(1,570)

Other Income (Expense)

In 2005, investment income increased by $0.1 million primarily due to an increase in CoBank patronage refunds and a $0.1 million retroactive dividend from Iowa Network Services. Such increases were offset by a $0.2 million gain on the sale of an investment in the 2004 period.

Interest expense was unchanged due primarily to lower average outstanding borrowings partially offset by higher interest rates.

Equity in earnings of affiliates was $0.7 million in both 2005 and 2004 reflecting consistent earnings of the Company's New Mexico cellular investments (RSA 3 and 5) in both periods.

Income Tax Provision

The income tax provision includes federal, as well as state and local taxes. The tax provision for 2005 and 2004, represent effective tax rates of 45.7% and 41.3%, 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.

Minority Interests

Minority interests decreased earnings by $0.5 million in both 2005 and 2004 reflecting the consistent earnings of the Company's New Mexico cellular investments.

Net Income

Net income in 2005 was $0.7 million, or $0.25 per share (basic and diluted), compared to a net income last year of $1.6 million, or $0.58 per share (basic and diluted). The Company has no dilutive instruments outstanding.

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.

The Parent Company's short-term line of credit facility, which expires August 31, 2005, has a maximum availability totaling $5.0 million, $3.2 million of which was available at March 31, 2005. In April 2005, Interactive received a commitment letter for a new $10 million unsecured revolving credit facility, at 1.5% over prime, expiring in 2008, to replace the existing short-term line of credit facility. Such facility is subject to negotiation of terms and there can be no assurance that it will be completed. If such new facility is not completed, management believes that it has various alternative means to obtain adequate resources to fund operations over the next twelve months.

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 March 31, 2005 for the periods shown, these contractual obligations and certain other financing commitments from banks and other financial institutions that provide liquidity:

	Payments Due by Period (In thousands)				
	Total	Less than 1 year	1 - 3 years	4 - 5 years	After 5 years
Long-term debt (a)	$167,888	$ 14,295	$ 65,666	$ 36,449	$ 51,478
Operating leases	1,275	277	469	225	304
Notes payable to banks	5,980	5,980			
Guarantees	3,750	3,750			
Total contractual cash obligations and commitments	$178,893	$ 24,302	$ 66,135	$ 36,674	$ 51,782

(a) Does not include interest payments on debt.

A subsidiary of the Company has guaranteed $3.8 million of an equity investees' total debt of $9.4 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 March 31, 2005, total debt (including notes payable to banks) was $173.9 million, an increase of $0.1 million from December 31, 2004. At March 31, 2005, there was $105.0 million of fixed interest rate debt outstanding averaging 7.0% and $68.9 million of variable interest rate debt averaging 5.8%. The debt at fixed interest rates includes $39.0 million of subordinated notes at interest rates averaging 9.4% 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 March 31, 2005, December 31, 2004 and March 31, 2004, substantially all of the subsidiaries' net assets are restricted.

Interactive has a high degree of financial leverage. As of March 31, 2005, 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 March 31, 2005, Interactive had current assets of $40.9 million and current liabilities of $39.3 million resulting in a working capital surplus of $1.6 million, compared to a surplus of $2.7 million at December 31, 2004.

Sources and Uses of Cash

Cash at March 31, 2005, was $29.7 million, an increase of $2.5 million compared to December 31, 2004. The majority of the cash is restricted by debt covenant to the subsidiary that generated it and is generally not available for transfer to the Parent Company. In 2005, net cash provided by operations of $7.4 million was used to invest in plant and equipment and to repay debt. The acquisition of cable assets in March 2005 was primarily funded with new borrowings.

Capital expenditures were $1.9 million in the first quarter of 2005, compared to $2.6 million in 2004 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 $11 million, most of which will be added to the RLEC rate bases.

On March 18, 2005, a subsidiary of the Company, Central Telcom Services, LLC, closed on an agreement with Precis Communications, LLC, to acquire a cable television assets for a purchase price of $3.5 million of which $2.2 million was financed with secured bank debt.

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 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 March 31, 2005, 72,700 shares had been purchased at an average cost of $32.26 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 March 31, 2005, 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 stockholders 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

Taylor 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 by Taylor 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 in February 2001. At the initiative of one of the defendants, the seal was lifted in January 2002. Under the False Claims Act, a private plaintiff called 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 mandatory trebling under the statute, a report prepared for the relator in February 2005 alleges damages of approximately $91 million in respect of bidding credits, approximately $70 million in respect of government loans and approximately $206 million in respect of subsequent sales of licenses, in each case prior to trebling.

Interactive strongly believes that this lawsuit is completely without merit and that relator's initial 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 in July 2002. In September 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. In September 2003, the Court granted our motion to transfer the action. A scheduling conference was held in February 2004, at which time the judge approved a scheduling order and discovery commenced. In July 2004, the judge denied in part and granted in part our motion to dismiss. 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 defendants in order to enable them to conduct their defense. This motion was denied in May 2005 and defendants are considering appropriate responses. The preparation and filing of dispositive motions is expected to begin shortly.

See also "H. Litigation - History of Lynch's C-Block Activities" above for a history of our involvement in Auction 5.

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.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements requires Interactive's management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, Interactive evaluates its estimates, including those related to revenue recognition, carrying value of its investments in spectrum entities and long-lived assets, purchase price allocations, and contingencies and litigation. Interactive bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Interactive believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

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

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

Annually, the Company tests goodwill and other intangible assets with indefinite lives for impairment. The Company screens for potential impairment by determining fair value for each reporting unit. We estimate the fair value of each reporting unit based on a number of subjective factors, including: (a) appropriate weighting of valuation approaches (income approach, market approach and comparable public company approach), (b) estimates of our future cost structure, (c) discount rates for our estimated cash flows, (d) selection of peer group companies for the public company approach, (e) required level of working capital, (f) assumed terminal value and (g) time horizon of cash flow forecasts.

We consider the estimate of fair value to be a critical accounting estimate because (a) a potential goodwill impairment could have a material impact on our financial position and results of operations and (b) the estimate is based on a number of highly subjective judgments and assumptions, the most critical of which is that the regulatory environment will continue in its current form.

Interactive tests its investments and other long-term non-regulated assets annually whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Significant judgment is required to determine if an impairment has occurred and whether such impairment is "other than temporary."

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

Recently Issued Accounting Pronouncements

In December 2004, the FASB issued SFAS No.153, "Exchanges of Nonmonetary Assets", which eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No.153 will be effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not believe the adoption of SFAS No.153 will have a material impact on its consolidated financial statements.

In December 2004, the FASB issued SFAS No.123(R), "Share-Based Payment", which establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. This standard requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This eliminates the exception to account for such awards using the intrinsic method previously allowable under APB Opinion No.25. SFAS No.123(R) will be effective for interim or annual reporting periods beginning on or after June 15, 2005. The Company is currently evaluating the impact of the adoption of SFAS No.123(R) will have on its consolidated financial statements.

In March 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations" ("FIN47"), which clarifies that conditional asset retirement obligations are within the scope of SFAS No. 143, "Accounting for Asset Retirement Obligations." FIN 47 requires the Company to recognize a liability for the fair value of conditional asset retirement obligations if the fair value of the liability can be reasonably estimated. The

Company does not believe that the adoption of FIN 47 will have a material impact on its financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Company is exposed to market risks relating to changes in the general level of U.S. interest rates. Changes in interest rates affect the amount of interest earned on the Company's cash equivalents and short-term investments (approximately $29.7 million at March 31, 2005 and $27.2 million at December 31, 2004). The majority of the Company's debt is fixed rate and the Company generally finances the acquisition of long-term assets by borrowing on a fixed long-term basis. The Company does not use derivative financial instruments for trading or speculative purposes. Management does not foresee any significant changes in the strategies used to manage interest rate risk in the near future, although the strategies may be reevaluated as market conditions dictate. As of March 31, 2005, the fair value of debt was approximately equal to its carrying value.

At March 31, 2005 and December 31, 2004, approximately $68.9 million and $67.2 million, respectively, or 40% and 39% of Interactive's long-term debt and notes payable bears interest at variable rates. Accordingly, the Company's earnings and cash flows are affected by changes in interest rates. Assuming the current level of borrowings for variable rate debt and assuming a one percentage point change in the 2005 average interest rate under these borrowings, it is estimated that Interactive's interest expense in the first quarter of 2005 would have changed by approximately $0.2 million. In the event of an adverse change in interest rates, management would likely take actions to further mitigate its exposure. However, due to the uncertainty of the actions that would be taken and their possible effects, no such actions are assumed. As of March 31, 2005, if the Company were to convert a significant portion of its variable interest rate debt into fixed interest rates, such conversion could have increased interest expense for the three month period by $0.5 million assuming that variable rates remain constant. Further, such analysis does not consider the effects of the change in the level of overall economic activity that could exist in such an environment.

ITEM 4. CONTROLS AND PROCEDURES

Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the "Act")) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures as of the end of the period covered by this report were designed and were functioning effectively to provide reasonable assurance that the information required to be disclosed by the Company in reports filed under the Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. The Company believes that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

During the period covered by this report, there have been no changes in our internal control over financial reporting that have materially affected, or is reasonably likely to materially affect, our financial statements.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Taylor 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 by Taylor 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 in February 2001. At the initiative of one of the defendants, the seal was lifted in January 2002. Under the False Claims Act, a private plaintiff called 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 mandatory trebling under the statute, a report prepared for the relator in February 2005 alleges damages of approximately $91 million in respect of bidding credits, approximately $70 million in respect of government loans and approximately $206 million in respect of subsequent sales of licenses, in each case prior to trebling.

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 in July 2002. In September 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. In September 2003, the Court granted our motion to transfer the action. A scheduling conference was held in February 2004, at which time the judge approved a scheduling order and discovery commenced. In July 2004, the judge denied in part and granted in part our motion to dismiss. Interactive and its subsidiaries remain parties to the litigation.

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Court for the District of Columbia to compel the FCC to provide certain information subpoenaed by defendants in order to enable them to conduct their defense. This motion was denied in May 2005 and defendants are considering appropriate responses. The preparation and filing of dispositive motions is expected to begin shortly. See "History of Lynch's "C" Block Activities" below.

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 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, Taylor (the relator in this case) is doubtless 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. 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 2. 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 Approx Value) May Ye Under
1/1/05 to 1/31/05	5,700	31.53	5,700	
2/1/05 to 2/28/05	--	--	--	
3/1/05 to 3/31/05	--	--	--	
Total	5,700	31.53	5,700	

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(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.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit 31.1 - Chief Executive Officer Section 302 Certification.
Exhibit 31.2 - Chief Financial Officer Section 302 Certification.
Exhibit 32.1 - Chief Executive Officer Section 906 Certification.
Exhibit 32.2 - Chief Financial Officer Section 906 Certification.

(b) Reports on Form 8-K during the quarter reported on:

- Current Report on Form 8-K filed January 19, 2005, under Item 5.02 announcing the election of Lawrence R. Moats to the Board of Directors.
- Current Report on Form 8-K filed March 1, 2005, under Item 8 reporting on the results of FCC Auction 58.
- Current Report on Form 8-K filed March 11, 2005, under Item 8 reporting the issuance of a press release to consider Going Dark.
- Current Report on Form 8-K filed March 22, 2005, under Item 8 reporting the issuance of a press release regarding the acquisition of a cable system in Utah and to provide additional information on Going Dark.

SIGNATURE

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

LYNCH INTERACTIVE CORPORATION
(Registrant)

/s/ Robert E. Dolan
Robert E. Dolan
Chief Financial Officer

May 16, 2005