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LYNCH INTERACTIVE CORP

Form 10-K

March 31, 2003

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, 2002                      Commission file number 1-106  
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OR

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

For the transition period from    to  
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LYNCH INTERACTIVE CORPORATION  
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(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  
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10580  
-----

(Address of principal executive offices)

(Zip Code)

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

The aggregate market value of voting stock held by non-affiliates of the Registrant as of June 30, 2002 (based upon the closing price of the Registrant's Common Stock on the American Stock Exchange of \$30.50 per share) was \$65 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 2,790,651 as of March 24, 2003.

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### DOCUMENTS INCORPORATED BY REFERENCE:

Part III: Certain portions of Registrant's Proxy Statement for the 2003 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 are 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. Prior to the Spin Off, Interactive had no significant assets, liabilities or operations. As a successor to certain businesses of Lynch Corporation, Interactive became a diversified holding company with subsidiaries primarily engaged in multimedia and transportation services. 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. In January 2002, Interactive spun off its interest in The Morgan Group, Inc., its only services subsidiary, via a tax-free dividend to its shareholders of the stock of Morgan Group Holding Co., a corporation that was formed initially to serve as a holding company for Interactive's controlling

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interest in The Morgan Group, Inc., among other business purposes. In October 2002, the Morgan Group, Inc. filed for bankruptcy. As a result, the Company now operates in one business segment, multimedia, which consists of telecommunications, cable television and broadcasting. As used herein, Interactive includes subsidiaries.

### I. MULTIMEDIA

#### A. 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 competitive local exchange carrier service. From 1989 through 2002, Interactive has 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. As of December 31, 2002, total access lines were 53,619, 100% of which are served by digital switches.

The principal business of Interactive's telephone companies is to provide telecommunications services. These services fall into four major categories: local network, network access, long distance and other non-regulated telecommunications services. Toll service to areas outside franchised telephone service territory is furnished through switched and special access connections with intrastate and interstate long distance networks.

Interactive holds franchises, licenses and permits adequate for the conduct of its business in the geographic areas that it serves.

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.

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

#### Telecommunications Operations

|   |       |
|---|-------|
| Access lines (a) .....                    | ..... |
| % Residential .....                       | ..... |
| % Business .....                          | ..... |
| Internet Subscribers .....                | ..... |
| Security Customers .....                  | ..... |
| Cable Subscribers .....                   | ..... |
| <br>                                      |       |
| Total Multimedia Revenues                 |       |
| Telecommunications Operations             |       |
| Local Service .....                       | ..... |
| Network Access & Long Distance .....      | ..... |
| Non-Regulated & Other (b) .....           | ..... |
| <br>                                      |       |
| Total Telecommunications Operations ..... | ..... |
| Cable Television Operations .....         | ..... |

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Total Multimedia Revenues .....

Telephone Acquisitions. Interactive pursues an active program of acquiring operating telephone companies. From January 1, 1989 through December 31, 2002, 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:

| Company  | Year of Acquisition | Number of Access Lines Yr. of Acq. | Number of Access Lines 12/31/02 | Ownership Percentage |
|--|---------------------|------------------------------------|---------------------------------|----------------------|
| Western New Mexico Telephone Co.   | 1989                | 4,200                              | 6,966                           | 83.1                 |
| Inter-Community Telephone Co. (a)  | 1991                | 2,550                              | 2,616                           | 100.0                |
| Cuba City Telephone Co. & Belmont Telephone Co. ....                                   | 1991                | 2,200                              | 2,744                           | 81.0                 |
| Bretton Woods Telephone Co. ....   | 1993                | 250                                | 836                             | 100.0                |
| JBN Telephone Co. (b) ....   | 1993                | 2,300                              | 2,710                           | 98.0                 |
| Haviland Telephone Co. ....  | 1994                | 3,800                              | 3,856                           | 100.0                |
| Dunkirk & Fredonia Telephone Co. & Cassadaga Telephone Co. ....                        | 1996                | 11,100                             | 13,099                          | 100.0                |
| Upper Peninsula Telephone Co. ....   | 1997                | 6,200                              | 7,271                           | 100.0                |
| Central Scott Telephone Co. ....   | 1999                | 6,000                              | 6,264                           | 100.0                |
| Central Utah Telephone Co./Skyline Telephone Company/Bear Lake Telephone Company ..... | 2001                | 7,000                              | 7,257                           | 100.0                |

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. Recently, 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 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. 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 competitive local exchange carrier (CLEC) operations in certain

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nearby areas. Affiliates of nine of Interactive's telephone companies now offer Internet access service. At December 31, 2002, Internet access customers totaled 21,329 compared to 20,885 at December 31, 2001. Affiliates of four 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 the Buffalo, New York, market and two other western New York counties. Some of DFT's CLEC services are now being provided via an "unbundled network elements platform", which allows for increased margins over a resale CLEC business model. In addition, facilities-based services are continuing to be evaluated for DFT's CLEC business. Giant Communications also provides CLEC services to selected areas in Northeast Kansas.

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 6,500 alarm customers.

Affiliates of Inter-Community Telephone Company in North Dakota, and Western New Mexico Telephone Company in New Mexico have filed with the 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 Federal Communications Commission ("FCC") with respect to interstate telecommunications services.

For the 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.

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 Act"), which is the most substantial revision of communications law 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

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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.

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") between rural and non-rural companies. In several cases, the regulations for the price-cap (or non-rural) local exchange carriers have been or are being determined first, followed by separate proceedings for rate-of-return (or rural) companies. All of Interactive's telephone subsidiaries are rural, rate-of-return companies for interstate regulatory purposes. The rate-of-return designation is an election made by the carrier with the FCC. The price cap approach differs from traditional rate-of-return regulation by focusing primarily on the prices of communications services rather than the telephone companies' costs.

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. The FCC adopted permanent USF procedures for non-rural carriers effective January 1, 2000. The new Federal universal service support mechanism for non-rural carriers utilizes the FCC's synthesis cost proxy model with a hold-harmless provision. The hold-harmless provision originally ensured that the non-rural carrier receives at least as much USF as they had been receiving under the previous system. The hold-harmless support is being gradually phased out for non-rural carriers.

During 2001, the FCC completed three major regulatory proceedings related to rural LECs to provide a more stable, predictable source of interstate and USF revenues. In May 2001, the FCC adopted an order related to USF for rural carriers based on the Rural Task Force (RTF) recommendation. Such order 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. In May 2001, the FCC adopted the Separations Freeze Order in which the FCC stressed how freezing separations factors would bring stability and regulatory certainty to the separations process to avoid sudden cost shifts in a time of rapid market and technology changes. Finally, in October 2001, the FCC adopted the Multi-Association Group (MAG) Order, in which the FCC declared that some of the primary benefits are to provide certainty and stability for rate-of-return carriers and to encourage investment in rural America. The MAG Order reaffirmed that the 11.25% interstate rate-of-return was appropriate for rate-of-return carriers. In addition, the MAG Order increased the Subscriber Line Charges billed to end user customers effective January 2002 and created a new universal service support mechanism called the Interstate Common Line Support fund effective July 2002.

In November 2002 the FCC requested that the Federal-State Joint Board on Universal Service (Joint Board) review certain of the FCC rules relating to the high-cost universal service support mechanisms to ensure that the dual goals of preserving universal service and fostering competition continue to be fulfilled. The Joint Board initiated this review in February 2003. Interactive cannot predict the effects of the review of the FCC rules in this proceeding which could take over a year or more to complete.

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In addition, the FCC has an open docket regarding potential changes to intercarrier compensation. Some parties are advocating that the FCC eliminate the interstate access charges that local exchange carriers bill to interexchange companies and implement a policy where each local exchange carrier bills their own end user customers the costs to originate and terminate calls. Any changes made to intercarrier compensation for the interstate jurisdiction may also need to be adopted for the intrastate jurisdiction. Interactive cannot predict the potential changes that may be made to intercarrier compensation or the impact the changes might have on the operations of the company.

Interactive's local exchange carrier telephone operations do not have significant wireline competition at the present time. Because of the rural nature of their operations and related low population density, they are primarily high cost operations, which receive substantial Federal and state subsidies. However, the regulatory environment for LEC operations has begun to change. A principal purpose of the 1996 Act was to encourage competition in local telephone services. Although the 1996 Act reaffirmed the Federal policy of maintaining universal telephony service at fair and reasonable rates, the 1996 Act and related proceedings also promote competition and USF portability. Similar regulatory changes have also been initiated in many of the states in which Interactive operates.

Competition. All of Interactive's current telephone companies are monopoly wireline providers in their respective area for local telephone exchange service, except to a very limited extent in Iowa, but there can be no assurance that this will continue. As a result of the 1996 Act, FCC and state regulatory authority initiatives and judicial decisions, competition has been introduced into certain areas of the toll network wherein certain providers are attempting to bypass local exchange facilities 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 introduce more competition among providers of local services and reduce regulation. Regulatory authorities in certain states, including New York, have taken steps to promote competition in local telephone exchange service, by requiring certain companies to offer wholesale rates to resellers. A substantial impact is yet to be seen on Interactive's telephone companies. Interactive's subsidiaries do not expect bypass to pose a significant near-term competitive threat due to a limited number of high-volume customers they serve. In addition, cellular radio or similar radio-based wireless services, including personal communication services, and cable television and internet based services could provide an alternative local telephone exchange service as well as possible competition from electric companies.

Interactive's telephone companies, in the aggregate, own approximately 10,000 miles of cable and 1,000 miles of fiber optic cable. Substantially all of the telephone companies' properties are encumbered under mortgages and security interests. See Item 2. Properties

### B. Cable Television/Broadcasting

#### Cable Television

It is part of Interactive's strategy to own cable television systems, particularly in markets where Interactive is the telephone operator and adjacent areas.

CLR Video, L.L.C. - CLR Video, L.L.C., a 98% owned subsidiary of Interactive, is a provider of cable television in northeast Kansas with approximately 2,695 subscribers.

#### Broadcasting

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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 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 ("Capital") and convertible preferred stock, which when converted, would bring LEC-II's common share ownership to 50%. On March 1, 1994, Capital acquired the assets of WOI-TV for \$12.7 million. 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.

Based upon a multiple of ten times broadcast cash flow, plus cash, less debt, Interactive estimates its value in these stations at almost \$12 million as compared to the net book value of these investments of a negative \$0.8 million. It is not assured that the results of these stations will continue at the current level or that they could be sold at ten 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 generally provides 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. 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.

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



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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 markets.

Other sources of competition include community antenna television ("CATV") 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 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, such as multipoint distribution service owners, 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) prohibit ownership of a CATV system and television station in the same market; (iv) 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 (v) limit foreign ownership of FCC licenses under certain circumstances. See Regulatory Environment under A. above for a description of certain provisions of the 1996 Act including in particular those, which would remove the regulations over non-basic cable service in three years and permit telephone service providers to provide cable service. In calculating media ownership interests, The Company's interests may be aggregated under certain circumstances with certain other interests of Mr. Mario J. Gabelli, Vice 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.

### C. Personal Communications and Other Wireless Services.

Sunshine PCS Corporation. In February 2001, Interactive spun off its 49.9% interest in Sunshine PCS Corporation ("Sunshine") to its shareholders. Sunshine succeeded by merger to the assets and liabilities of Fortunet Communications, L.P. Sunshine holds 15 MHz PCS licenses in Tallahassee, Panama City and Ocala, Florida. Interactive currently holds the following interests in Sunshine: 10,000 shares of 7% preferred stock of Sunshine (dividends payable in kind through February 2006, and in cash thereafter) with a liquidation value of \$10.0 million, 12,500 shares of series A-1 preferred stock of Sunshine with no dividend and a liquidation value of \$12.5 million, 2,000 shares of series A-2 convertible preferred stock of Sunshine with no dividend and a liquidation value of \$2.0 million (which represent approximately 13.7% of the common equity on a fully diluted basis), and warrants expiring February, 2006 to purchase 4,300,000 shares of Class A Common Stock of Sunshine at \$0.75 per share (which represent approximately 29.5% of the common equity on a fully diluted basis). In addition, Interactive owns 294,218 shares of Sunshine's Class A Common Stock. The Company's total book basis in its Sunshine investment is \$3.4 million, its tax basis is approximately \$14.0 million and from inception Interactive has invested over \$21.0 million in Sunshine and its predecessors. Taking into account the

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series A-2 convertible preferred stock, the warrants and the shares held directly, Interactive beneficially owns 57.2% of the outstanding Class A Common Stock of Sunshine and 45.2% of the total outstanding shares of Sunshine. In September 2001, Sunshine met the FCC requirement that it provide service coverage to at least one-quarter of the population in its licensed areas. However, Sunshine does not presently have the funds necessary to fully build out the system necessary to provide commercial operations; moreover, obtaining financing from third parties is extremely difficult to obtain, because of the general downturn in the wireless industry and Sunshine's lack of operating history. Sunshine has disclosed that it would consider selling its licenses or entering into a joint venture with a company that provides service to a nearby area and then developing our licenses together. However, Sunshine has not yet adopted a business plan and there can be no assurance of Sunshine's ability to achieve any of its several business strategic options because of financial considerations. Moreover, because Sunshine has incurred losses since its inception and has not yet determined how to finance its operations, the latest report of its independent auditors contains an explanatory paragraph, which expresses substantial doubt as to Sunshine's ability to continue as a going concern. As of December 31, 2002, it has \$0.4 million in cash and for the year ended December 31, 2002, cash flow used in operations was \$0.6 million though steps are being taken to reduce that number in 2003.

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 (BTA) covering Las Cruces, New Mexico. Las Cruces is the principal city in the BTA, which covers a population of approximately 197,166 (as of the 1990 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.

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 7.5 MHz of a 10 MHz PCS license in the Logan, Utah, BTA, which has a population of approximately 102,702. 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 donated 20% of the net profits from any sale of the Logan license to the Church of Jesus Christ of Latter Day Saints.

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 at December 31, 2002 of 68,470, of which Interactive's proportionate share is 9,781.

RSA Cellular Interests. At December 31, 2002, Interactive owned 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 157,415. Equity in earnings from these two operations was \$0.9 million for the year ended December 31, 2002 on a combined basis and the combined book basis is \$2.4 million at December 31, 2002. Interactive is proportional share of these operations combined revenues, EBITDA and operating profits were \$2.0 million, \$1.2 million and \$0.9 million respectively, for the year ended December 31, 2002. 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. 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 is proportional share of

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their cash equivalents is \$0.8 million

In March 2002, Interactive sold its interest in New Mexico RSA 1 (North) for \$5.5 million to Verizon Wireless, and in connection therewith prepaid certain outstanding indebtedness to Verizon. As a result of such sale, Interactive reported a pre-tax gain of \$5.0 million in the first quarter of 2002.

Other Interests in Wireless Licenses. LPCSG also has an agreement with Bal/Rivgam LLC (in which an affiliate of the Vice Chairman 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% 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, \$5.0 million of which was loaned in 2001. 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 during 2002 for similar spectrum, which ended on September 18, 2002, 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, resulting in a net book value, at December 31, 2002, of \$0.7 million and the tax basis was \$6.2 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.

Interactive expects to continue to participate in the spectrum auctions being conducted by the FCC.

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 Sunshine, or other 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.

### III. 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) Western New Mexico Telephone Company's FCC licenses to operate point-to-point microwave systems; (4) licenses held by partnerships and corporations in which Western New Mexico Telephone Company and Inter-Community Telephone Company own minority interests to operate cellular telephone systems covering areas in New Mexico and North Dakota, (5) CLR Video's 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 359 employees at December 31, 2002, compared to 328 employees at December 31, 2001.

### IV. 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 2003 Annual Meeting of Shareholders. Such list sets forth the names and ages of all 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.

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| Name                      | Officers and Positions Held   |
|---------------------------|---|
| Mario J. Gabelli .....    | Vice Chairman since December 2002 and Chief Executive Officer since September 1999. From September 1999 to December 2002, Mr. Gabelli served as our Chairman. He is also the Vice Chairman (and from 1986 to August 2001 Chairman and Chief Executive Officer) of Lynch Corporation; Chairman, Chief Executive Officer, Chief Investment Officer and a director of Gabelli Asset Management Inc. and its predecessors (since November 1976) (and in connection with those responsibilities, he serves as 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 Gabelli Group Capital Partners, Inc., a private company |
| Frederic V. Salerno ..... | Chairman since December 2002. Mr. Salerno became a director of Interactive in August 2002. Prior to joining Interactive, Mr. Salerno was the Vice Chairman and Chief Financial Officer of Verizon Communications. Mr. Salerno, a trustee of the New York Inner-City Scholarship Fund and former Chairman of the Archdiocese of New York's Partnership for Quality Education Campaign, joined New York Telephone in 1965. He was named Vice President in 1983 when he managed the divestiture of the firm from the Bell System; and became President and Chief Executive Officer of NY Telephone in 1987   |
| Joseph C. Farina .....    | President and Chief Operating Officer since February 2003. Prior to joining Interactive, Mr. Farina was the Chief Operating Officer of Genuity Inc. from June 2000 to January 2003. Before that, Mr. Farina was the President and Chief Executive Officer of Bell Atlantic Data Solutions Group from 1998 to 2000   |
| Robert E. Dolan .....     | Chief Financial Officer and Controller (since September 1999); Chief Financial Officer (1992-2000) and Controller (1990-2000) of Lynch Corporation  |
| John Fikre .....          | Vice President--Corporate Development, General Counsel and Secretary (since August 2001); Associate, Willkie Farr & Gallagher (since August 1994)   |

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 3,400 square feet of office space from an affiliate of its Vice Chairman for its executive offices in Rye, New York. The lease expires at the end of 2007.

Western New Mexico Telephone Company owns a total of 16.9 acres at fourteen 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, Western owns five buildings with a total of 14,055

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square feet in which are located additional offices and storage facilities as well as a vehicle shop, a wood shop, and central office switching equipment. Smaller facilities, used mainly for storage and for housing central office switching equipment, with a total of 8,384 square feet, are located in Lordsburg, Reserve, Magdalena and five other localities. 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 38 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 3,317 miles of copper cable and 421 miles of fiber optic cable running through rights-of-way within its 15,000 square mile service area. All Western's properties described herein 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 utilized for its switching facilities. Inter-Community has 2,028 miles of copper cable and 226 miles of fiber optic cable. All of Inter-Community's properties described herein 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. In Madison, Wisconsin, Cuba City leases 900 square feet for administrative headquarters and financial functions. 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 346 miles of copper cable and 34 miles of fiber optic cable. All of Cuba City and Belmont's property described herein are encumbered under first mortgages held by the RUS and Rural Telephone Bank, respectively, and second mortgages held by Co-Bank. All of Inter-Community's properties described herein are encumbered under 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 1,186 miles of copper cable and 186 miles of fiber optic cable. All properties described herein are encumbered under mortgages held by the RUS.

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 22 small sites, which it uses for its cable receiving and transmission equipment. All properties described herein 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 1,213 miles of copper cable and 198 miles of fiber optic cable. All properties described herein are encumbered under a mortgage held by the RUS.

Dunkirk & Fredonia Telephone Company (including its subsidiaries) owns a total of approximately 16.4 acres at six locations in western New York. Its host central office switching equipment, administrative and commercial offices

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consisting of 18,297 square feet is located in Fredonia, New York. In addition, Dunkirk & Fredonia owns five other properties, including a service garage, a paging tower site, a small central office housing switching equipment, sales and service center in Jamestown, New York, and one rental property in Ashville, New York. Dunkirk & Fredonia also owns 345 miles of copper telephone cable and 65 miles of fiber optic cable. All properties described herein are encumbered under a mortgage held by RUS.

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 2,272 miles of copper cable and 152 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 3.5 acres of land at 6 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 25 miles of fiber optic cable. All of Central Scott's properties described herein are encumbered under mortgages held the First National Bank of Omaha.

Central Utah Telephone, Inc., and its subsidiaries own a total of 9.49 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 bldg. containing 14,400 square feet, 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, 5,245 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 867 miles of copper cable and 157 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.

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

Interactive and several other parties, including our Chief Executive Officer, 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 relator in this lawsuit is R.C. Taylor III, an individual who, to the best of our knowledge, has no relationship to any of the entities and affiliates that have been named parties in this litigation. Indeed at the time of his filings,

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and to the best of our knowledge, Mr. Taylor was a lawyer at Gardner, Carton & Douglas. Thereafter, we believe he was a lawyer with a Washington, D.C., law firm. We do not know his current status. We issued a press release dealing with this litigation on January 16, 2002.

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 spectrum auctions restricted to small businesses, as well as obtaining bidding credits in other spectrum auctions allocated to "small" and "very small" businesses. The lawsuit seeks to recover an unspecified amount of damages, which would be subject to mandatory trebling under the statute.

Interactive strongly believes that this lawsuit is completely without merit, 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 was formally served with the complaint on July 10, 2002. On September 19, 2002, Interactive 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, Interactive filed a reply in support of its motion to dismiss.

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

Not applicable.

### PART II

#### ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

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:

|      | 2002               |         |              |             |
|------|--------------------|---------|--------------|-------------|
|      | Three Months Ended |         |              |             |
|      | March 31           | June 30 | September 30 | December 31 |
|      | -----              | -----   | -----        | -----       |
| High | \$70.50            | \$54.50 | \$31.58      | \$28.50     |
| Low  | \$39.00            | \$24.50 | \$24.50      | \$22.80     |



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|      | 2001     |         |              |             |
|------|----------|---------|--------------|-------------|
|      | March 31 | June 30 | September 30 | December 31 |
|      | -----    | -----   | -----        | -----       |
| High | \$48.75  | \$63.99 | \$79.00      | \$69.99     |
| Low  | \$34.50  | \$40.00 | \$48.03      | \$43.00     |

At March 20, 2003, Interactive had 848 shareholders of record and the closing price of our Common Stock was \$23.05.

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. Interactive currently intends to retain its earnings, if any, for use in its business. Current and future financings may limit or prohibit the payment of dividends.

ITEM 6. SELECTED FINANCIAL DATA

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

|   | Years Ended December 31 |           |           |           |
|---|-------------------------|-----------|-----------|-----------|
|   | 1998                    | 1999      | 2000      | 2001      |
|   | -----                   | -----     | -----     | -----     |
| Revenues .....  | \$ 54,622               | \$ 59,011 | \$ 66,983 | \$ 79,000 |
| Operating profit(k) .....   | 14,650                  | 12,299    | 15,331    | 19,000    |
| Net financing activities (d) .....  | (7,973)                 | (8,789)   | (10,308)  | (11,000)  |
| Equity in earnings of affiliates .....  | 317                     | 1,057     | 1,669     | (3,000)   |
| Impairment of investment in Spinnaker Industries, Inc. Reserve for impairment of investment in spectrum license holders (e) ..... | --                      | --        | --        | (3,000)   |
| Gain on sale of subsidiary stock and other assets .....   | 2,709                   | --        | 4,187     | --        |
| Income (loss) before income taxes, minority interests, extraordinary item and operations of Morgan .....                          | 9,703                   | (10,839)  | 10,879    | 6,000     |
| (Provision) benefit for income taxes .....  | (4,453)                 | 2,478     | (4,971)   | (3,000)   |
| Minority interests .....  | (763)                   | (686)     | (877)     | --        |
| Income (loss) from continuing operations before Extraordinary item and operations of Morgan .....                                 | 4,487                   | (9,047)   | 5,031     | 2,000     |
| Extraordinary item (f) .....  | --                      | (160)     | --        | --        |
| Income (Loss) from operations of Morgan distributed to shareholders (i) .....   | 442                     | (9)       | (2,666)   | (1,000)   |

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|   |          |            |           |       |
|---|----------|------------|-----------|-------|
| Net income (loss) .....                           | =====    | =====      | =====     | ===== |
|   | \$ 4,929 | \$ (9,216) | \$ 2,365  | \$ 1  |
|   | =====    | =====      | =====     | ===== |
| Basic and diluted earnings                        |          |            |           |       |
| Per common share (g)                              |          |            |           |       |
| Income (loss) from continuing operations before   |          |            |           |       |
| Extraordinary item and operations of Morgan ..... | \$ 1.58  | \$ (3.21)  | \$ 1.78   | \$    |
| Extraordinary item .....                          | --       | \$ (0.06)  | --        |       |
| Income (loss) from operations of Morgan           |          |            |           |       |
| distributed to shareholders (j) .....             | \$ 0.16  | \$ (0.00)  | \$ (0.94) | \$ (  |
| Net income (loss) .....                           | \$ 1.74  | \$ (3.27)  | \$ 0.84   | \$    |

|   | -----      | -----      | December 31, (a) | ----- |
|---|------------|------------|------------------|-------|
|   | 1998       | 1999       | 2000             | ----- |
|   | -----      | -----      | -----            | ----- |
| Cash, securities and short-term investments ..... | \$ 26,498  | \$ 29,094  | \$ 26,900        | \$    |
| Total assets (l).....                             | \$ 212,705 | \$ 221,705 | \$ 217,742       | \$    |
| Long-term debt .....                              | \$ 126,183 | \$ 164,736 | \$ 162,304       | \$    |
| Shareholders' equity (h) .....                    | \$ 32,285  | \$ 20,211  | \$ 19,391        | \$    |

ITEM 7. 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

In January 2002, Interactive spun off its investment in The Morgan Group, Inc. ("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. Morgan Group Holding Co. is now a public company. Accordingly, the amounts for Morgan are reflected on a one-line basis in the consolidated financial statements as of December 31, 2001, and for the year then ended as "to be distributed to shareholders." Similarly, the prior years' financial statements have been restated to be comparable with the current year's presentations.

The narratives below reflect these changes in reporting and restatements of prior periods.

Year 2002 compared to 2001

Revenues

Revenues for the year ended December 31, 2002, increased by \$7.0 million to \$86.3 million from the year ended December 31, 2001. During the year ended December 31, 2001, Interactive recorded a \$2.8 million contingent administrative fee for services it had previously performed in an auction for wireless spectrum. Excluding this fee, revenues increased by \$9.7 million or 13%, attributable due to acquisitions and higher regulated telephone service

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revenues, and the provision of non-traditional telephone services such as: Internet, long distance service and local exchange carrier service. The acquisition of American Alarm Company (63.6% owned by Interactive), which occurred on November 30, 2001, contributed \$3.1 million to 2002 revenues as compared to \$0.3 million in 2001. On June 22, 2001, the Company acquired Central Utah Telephone Company. Prior to our acquisition, Central Utah recorded \$3.7 million of revenues in 2001, such amount excludes the effect of certain access lines that Central Utah acquired on April 6, 2001. Certain regulatory initiatives in some of the states, in which our companies operate, will reduce revenues at certain telecommunication operations in the near future. In addition, significant capital expenditures at certain operations will result in increased regulated revenues in the future.

### Operating Profit

Operating profit for the year ended December 31, 2002, decreased by \$0.8 million to \$19.2 million from the year ended December 31, 2001. The absence, in 2002, of the \$2.8 million in administration fee income, that was recorded in 2001, was a significant item effecting the variance. In addition, in accordance with Financial Accounting Standards ("SFAS") No. 142, Goodwill and Other Intangible Assets, effective January 1, 2002, the Company no longer amortized goodwill and other intangible assets, deemed to have indefinite lives. There was \$2.8 million of such amortization expense recorded during 2001. Also, during year ended December 31, 2002, the Company recorded \$0.9 million in allowance for doubtful accounts associated with the bankruptcies of MCI/Worldcom and Global Crossing. The bankruptcy filings may adversely impact the interstate revenues pools administered by the National Exchange Carrier Association ("NECA") of which all of the Company's telephone operating subsidiaries participate. If the Company's access settlements from NECA are reduced, the Company's operating results in 2003 could be materially affected. As noted above, in November 2001, the Company acquired American Alarm. At that time, \$4.0 million of the acquisition price was allocated to customer contracts, which for nine months of 2002 were amortized over 3 years. During the fourth quarter of 2002, based on Company specific experience, the amortization period was changed to 10 years. During 2002, the Company recorded \$1.2 million of amortization expense associated with these contracts and annual amortization is expected to be \$0.3 million in 2003. Overall, the inclusion of American Alarm reduced operating profit by \$0.7 million in 2002.

### EBITDA

EBITDA (Earnings before interest, taxes depreciation and amortization) for the year ended December 31, 2002, increased by \$0.3 million to \$38.6 million from the year ended December 31, 2001. EBITDA is presented because it is a widely accepted financial indicator of value and ability to incur and service debt. 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 difference between EBITDA and operating profit is depreciation and amortization of \$17.4 million and \$18.5 million for the years ended December 31, 2002 and 2001, respectively. The absence, in 2002, of the \$2.8 million in administration fee income, that was recorded in 2001, was a significant item effecting the variance. Also, during year ended December 31, 2002, the Company recorded \$0.9 million in allowance for doubtful accounts associated with the bankruptcies of MCI/Worldcom and Global Crossing. Subject to the bankruptcy results, a percentage of this allowance may be recovered in 2003 and beyond. On June 22, 2001, the Company acquired Central Utah Telephone

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Company. Prior to our acquisition, Central Utah recorded \$1.8 million of EBITDA in 2001, such amount excludes the effect of certain access lines that Central Utah acquired on April 6, 2001. As noted above, in November 2001, the Company acquired American Alarm which contributed \$0.5 million to 2002.

### Other Income (Expense)

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 during 2002 for similar spectrum, which ended on September 18, 2002, 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), resulting in a net book value, at December 31, 2002, of \$0.7 million.

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).

As discussed below, during 2001, the Company provided for the impairment of \$3.2 million representing its entire investment in 1,000,000 Common Shares of Spinnaker Industries Inc. On November 13, 2001, Spinnaker announced that it had commenced voluntary proceedings under Chapter 11 of the U.S. Bankruptcy Code for the purpose of facilitating and accelerating its financial restructuring. In late March 2002, all assets of Spinnaker were sold and equity holders received no value.

For the year December 31, 2002 investment income was down by \$1.1 million from the previous year due to lower levels of treasury rates, in which the Company invests the predominant amount of its liquid assets. In addition, 2001's investment income included approximately \$1.0 million of gains in connection with the Company's investment in Tremont Advisers, Inc. All of the Company's interest in Tremont was sold in October 2001 when Tremont was acquired by Oppenheimer Funds, Inc. at a price of \$19.00 per share. Offsetting these 2001 gains, there was higher dividend income in 2002 from the Company's ownership of bank stocks.

Interest expense decreased from 2001 to 2002 by \$0.9 million due primarily to reduced interest rates, lower levels of borrowings and the absence, in 2002, of a collateral fee \$0.6 million associated with a Put on the Company's convertible debt outstanding. Offsetting these decreases, interest expense increased during 2002 from 2001 due to the full year effect of debt incurred for the acquisitions of Central Utah and American Alarm. In November 2002, the Company reacquired its Convertible Note issued to Cascade Investments LLC, there was \$0.7 million of interest expense and other costs associated with this note in 2002.

### Income Tax Provision

The income tax provision includes federal as well as state and local taxes. The tax provision for the years ended December 31, 2002 and 2001, represent effective tax rates of 45.0% and 51.9%, respectively. The causes of the difference from the federal statutory rate are principally the effect of state income taxes, including the effect of earnings and losses attributable to different state jurisdictions, and the amortization of non-deductible goodwill in 2001.

### Minority Interests

Minority interests decreased earnings by \$1.0 million for the year December 31,

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2002 and \$0.7 million for the year ended December 31, 2001. The Change was principally due to minority interest associated with the gain from the sale of New Mexico RSA 1 (North) offset by net losses at American Alarm for which there is a 36.4% minority ownership.

### Income From Continuing Operations

The Company recorded income from continuing operations for the year ended December 31, 2002 of \$3.8 million, \$1.34 per share (basic and diluted), as compared to income from continuing operations for the same period last year of \$2.5 million, or \$0.90 per share (basic and diluted). The following were the significant causes of the variance: (1) the absence of the administrative fee in 2002 reduced net income by \$1.7 million, (2) the absence of the reserve for impairment in Spinnaker increased net income by \$2.1 million, (3) the gain in 2002 on the sale of New Mexico RSA # 1 (North) increased net income by \$2.5 million, (4) the provision for impairment of spectrum license holders reduced net income in 2002 by \$3.6 million and (5) the amortization of goodwill prior to the adoption by the Company of the non-amortization provision SFAS 142 which decreased 2001 net income by \$2.4 million.

Year 2001 compared to 2000

### Revenues

2001 total revenues were \$79.3 million, an increase of \$12.3 million, or 18.4%, from the \$67.0 million recorded in 2000. Revenues grew primarily due to the recognition, in the third quarter of 2001, of an administrative fee of \$2.8 million; the acquisition of Central Utah Telephone Company, Inc. and its subsidiaries, and Central Telecom Services, L.L.C., a related entity which were acquired on June 23, 2001, which combined contributed \$4.8 million in revenues and, to a lesser extent, the growth in both regulated telecommunications services and provisions of non-traditional telephone services such as: Internet, long distance service and competitive local exchange carrier and the acquisition of American Alarm on November 30, 2001. During the third quarter of 2001, the Company recorded an administration fee of \$2.8 million for services provided to a related entity in a Federal Communication Commission auction for spectrum to be used for the provision of personal communications services. The auction was conducted in 1999 and the fee was based on the entity's gain on the sale of licenses acquired.

### Operating Profit

Operating profit for 2001 increased to \$20.0 million from \$15.3 million reported for 2000, an increase of \$4.7 million. This increase in operating profits is principally attributable to the inclusion the results of operations of Central Utah from the date of acquisition and the \$2.8 million administrative fee.

### EBITDA

Earnings before interest, taxes, depreciation and amortization ("EBITDA") increased to \$38.3 million in 2001 from \$31.0 million in 2000, an increase of \$7.3 million, or 23.3%. EBITDA is presented because it is widely accepted financial indicator of value and ability to incur and service debt. EBITDA is not a substitute for operating income in accordance with generally accepted accounting principles. The Company utilizes the EBITDA metric for valuing potential acquisitions. The difference between EBITDA and Operating Profit is

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depreciation and amortization of \$18.3 million and \$15.8 million for the years ended December 31, 2002 and 2001. Of the \$7.3 million increase in EBITDA, \$2.6 million of the increase was due to the acquisition of Central Utah Telephone Company. In addition, during 2001, the Company recorded \$2.8 million of administrative fee income. The remaining increase was primarily due to the increase in regulated operations and reduced losses by the Company's CLEC operations.

### Other Income (Expense)

Investment income was approximately \$2.9 million in 2001 compared to investment income of \$3.3 million in 2000. The lower level of investable securities was the primary cause of the decrease in investment income.

Interest expense increased by \$0.4 million to \$13.9 million in 2001 compared to \$13.5 million in 2000. The increase is due primarily to the acquisition of Central Utah on June 23, 2001 (\$0.9 million) offset by higher debt levels at lower average interest rates on the variable debt, the restructuring of the Company's Convertible Note discussed below, and the absence of the amortization of the put premium associated with the Company's Convertible Note for the duration of 2000.

During 2001, the Company recorded approximately \$0.9 million of equity in earnings of affiliated entities compared to \$1.7 million in 2000. The decrease of \$0.8 million was primarily due to a net gain of \$0.7 million in 2000 on the sale of cellular towers at two of the Registrant's cellular telephone company investments.

On February 25, 2000, Omnipoint acquired through a merger, all of the outstanding shares of East/West Communications, Inc. At the time of the merger, Interactive held a redeemable preferred stock of East/West Communications, Inc. with a liquidation value of \$8.7 million, including payment in kind of dividends to date. In accordance with its terms, the preferred stock was redeemed at its liquidation value and as a result, Registrant recorded a pre-tax gain of \$4.2 million in the year ended December 31, 2000.

The Company owned 1,000,000 shares of Spinnaker Industries, Inc. common stock. As described in the Notes to the accompanying financial statements, the Company accounts for this investment under the provision of Statement of Financial Accounting Standards No. 115 "Investment and Debt and Equity Securities." Under the provision of this standard, the Company records this investment at its publicly traded market price at the end of each accounting period and records the change in unrealized gains (loss) in that period's comprehensive income. In addition, under the provisions of this statement, if the quoted market indicated by that valuation is below the Company's basis, management is required to consider if the decline in value is other than temporary and, if so determined, write down the investment to its publicly traded value by recording the loss in the Statement of Operations. As of December 31, 2000, the basis of the Spinnaker shares was \$3.2 million, or \$3.19 per share. At December 31, 2001, the quoted market price of these shares was \$0 per share. During the year ended December 31, 2000, Spinnaker recorded a loss from continuing operations of \$17.7 million. Losses of \$5.2 million and \$2.8 million were recorded for the years ended December 31, 1999 and 1998, respectively. In the nine months ended September 30, 2001, Spinnaker recorded a net loss of \$53.9 million, including \$41.2 million of restructuring and asset impairment reserves related to the close of its Spinnaker Coating facility in Westbrook, Maine. On October 15, 2001, Spinnaker Industries announced that it would not be making that day's scheduled interest payment with regard to its 10 3/4% Senior Notes and it was actively engaged in discussion with a majority of the holders of those notes for the purpose of negotiating a consensual restructuring of its indebtedness. On November 13, 2001, Spinnaker announced that it has commenced voluntary proceedings under Chapter 11 of the U.S. Bankruptcy Code for the purpose of facilitating and

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accelerating its financial restructuring. Spinnaker also announced that it had reached agreement, subject to Bankruptcy Court approval, with its existing lenders to provide up to \$30 million in debtor-in possession financing, which Spinnaker believes will allow it to continue operating its business in the ordinary and customary manner. There has been no quoted price since the stock at December 31, 2002. The Company believes that the decline in quoted value is other than temporary and, accordingly, has recorded a loss of \$3.2 million during 2001 to write down its investment in Spinnaker to \$0 at December 31, 2001. In late March 2002, all assets of Spinnaker were sold and equity holders received no value.

### Tax Provision

The 2001 tax provision of \$3.5 million includes federal, state and local taxes and represents an effective rate of 51.9% versus 45.7% effective tax rate of \$5.0 million in 2000. The causes of the difference from the federal statutory rate are principally the effect of state income taxes, including the effect of earnings and losses attributable to different state jurisdictions, and the amortization of non-deductible goodwill. Beginning on January 1, 2002, the Company will no longer be amortizing goodwill in its results of operations. As a result, the Company's effective tax rate will be lower in the future.

### Minority Interest

Minority interest was a reduction to earnings of \$0.7 million in 2001 and \$0.9 million in 2000. The reduction in net earnings in 2001 at telephone operations in which there is a minority ownership was the cause of the variance between years.

### Income from Continuing Operations

Income from continuing operations was \$2.5 million (\$0.90 per diluted share) in 2001 compared to income from continuing operations of \$5.0 million (\$1.78 per diluted share) in 2000, net income for the year ended December 31, 2001 was \$1.1 million, or \$0.41 per diluted share, as compared to a net income of \$2.4 million, or \$0.84 per diluted share for the year ended December 31, 2000. In 2001, the recording of the administrative fee noted above and the results of Central Utah were offset by lower investment income, higher interest expense and the impairment of the Spinnaker shares. The most significant item affecting the swing in earnings was the gain on the redemption of the East/West preferred stock (\$2.5 million, net of income tax provision) in 2000.

### LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2002, Lynch Interactive Corporation had current assets of \$37.1 million and current liabilities of \$49.9 million. Working capital was a deficit \$12.8 million as compared to a deficit \$8.9 million at December 31, 2001. This increase in the deficit was principally the result of the reclassification from long-term to current of \$6.4 million of long-term debt which is due in December, 2003. During 2003, the Company expects to extend the maturity of certain debt instruments and refinance other debt instruments thereby issuing additional long-term debt, and reducing the negative working capital though there is no assurance that the Company can accomplish this.

Cash at December 31, 2002, was \$23.3 million about the same as the previous year. During the year ended December 31, 2002, the net cash provided by operations of \$25.5 million was used to invest in plant and equipment and repay debt. The Company used \$7.6 million of restricted cash at December 31, 2001, as part of the repurchase of \$10.5 million of convertible debt. In addition, during the year ended December 31, 2002, the Company generated \$3.0 million of cash proceeds for the sale of a minority interest in a cellular operation and issued

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\$7.1 million in long-term debt.

Capital expenditures were \$23.8 million in 2002 and \$20.5 million in 2001. Anticipated capital expenditures in 2003 are approximately \$20 million. External financing is currently in place for approximately \$7 million of these expenditures. The remainder will be financed from internal sources. \$20 million in capital expenditures are expected to be made in 2004.

Subsequent to December 31, 2002, the Company issued \$3.3 million of long-term debt through the refinancing of Lynch Telephone Corporation III.

On November 29, 2002, Interactive repurchased from Cascade Investment, LLC, the remaining outstanding \$10 million in principal amount of its convertible notes pursuant to a previously negotiated put arrangement. The repurchase price was at 105% of the principal amount was funded by the balance in the restricted cash account.

On March 26, 2003, the Company issued a press release and filed a Current Report on Form 8-K disclosing a planned offering of certain securities to its shareholders which is expected to be completed in 2003.

At December 31, 2002, total debt (including notes payable to banks) was \$189.5 million, a decrease of \$14.0 million from December 31, 2001. At December 31, 2002, there was \$124.7 million of fixed interest rate debt outstanding averaging 7.1% and \$64.8 million of variable interest rate debt averaging 4.4%. Of the debt at fixed interest rates, there is \$34.5 million of subordinated notes at a 10% interest rate issued to sellers as part of the acquisition.

Interactive has a short-term line of credit facility, which expires August 31, 2003, with maximum availability totaling \$10.0 million all of which was outstanding at December 31, 2002. The Company is pursuing various financing alternatives including 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 that this line of credit facility will be renewed in August 2003. 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.

In general, the long-term debt facilities at subsidiaries are secured by substantially all of the Company's property, plant and equipment, receivables and common stock of certain subsidiaries and contain certain covenants restricting distribution to Lynch Interactive. At December 31, 2001 and 2002, substantially all of the subsidiaries' net assets are restricted.

A subsidiary of the Company has guaranteed \$3.8 million of an equity investees' total debt of \$10.1 million.

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, 2002, 32,115 shares had been purchased at an average cost of \$36.95 per share. Subsequent to year-end, an additional 2,000 shares have been acquired at an average cost of \$25.60 per share.

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.

Interactive has a high degree of financial leverage. As of December 31, 2002,



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the ratio of total debt to equity was 8.4 to 1. Certain subsidiaries also have high debt to equity ratios. In addition, the debt at subsidiary companies contains restrictions on the amount of funds that can be transferred to the respective parent of the subsidiaries.

The Company has a need for resources primarily to fund future long-term growth initiatives. The Company considers various alternative long-term financing sources: debt, equity, or sale of an investment asset. While management expects 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 these contractual obligations for the periods shown:

|                                    | Payments Due by Period<br>(In thousands) |                     |             |             |       |
|------------------------------------|--|---------------------|-------------|-------------|-------|
|                                    | Total                                    | Less than<br>1 year | 1 - 3 years | 4 - 5 years | A     |
| Long-term Debt (a) .....           | \$176,621                                | \$ 18,272           | \$ 39,181   | \$ 48,285   | \$    |
| Operating Leases .....             | 1,337                                    | 352                 | 566         | 419         | -     |
|                                    | -----                                    | -----               | -----       | -----       | ----- |
| Total Contractual Cash Obligations | \$177,958                                | \$ 18,624           | \$ 39,747   | \$ 48,704   | \$    |
|                                    | =====                                    | =====               | =====       | =====       | ===== |

The company has certain financing commitments from banks and other financial institutions that provide liquidity. The following table summarizes the expiration of these commitments for the periods shown:

|  | Amount of Commitment Expiration<br>Per Period<br>(In thousands) |                     |             |       |
|--|---|---------------------|-------------|-------|
|  | Total<br>Amounts<br>Committed                                   | Less than<br>1 year | 1 - 3 years | 4 -   |
| Other Commercial Commitments                           | -----   | -----               | -----       | ----- |
| Lines of Credit .....                                  | \$12,882  | \$12,882            | --          | --    |
| Standby Letter of Credit (Notes payable to Banks)..... | --  | --                  | --          | --    |
| Guarantees .....                                       | 3,750   | --                  | --          | --    |
| Standby Repurchase Obligations                         | --  | --                  | --          | --    |

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|                                |          |          |       |
|--------------------------------|----------|----------|-------|
| Other Commercial Commitments . | --       | --       | --    |
|                                | -----    | -----    | ----- |
| Total Commercial Commitments . | \$16,632 | \$12,882 | --    |
|                                | =====    | =====    | ===== |

A subsidiary of the Company has guaranteed \$3.8 million of an equity investees' total debt of \$10.1 million.

The Company has initiated an effort to monetize certain of its assets, including selling a portion or all of certain investment in certain of its operating entities. These may include minority interest in network affiliated television stations and 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. In March 2002, the Company sold its 20.8% interest in the New Mexico cellular property, RSA #1 (North) to Verizon Wireless for \$5.5 million and repaid certain outstanding indebtedness to Verizon. (See Note 5 in the accompanying financial statements)

### Critical Accounting Policies and Estimates

#### General

Interactive's discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires Interactive 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 the 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.

#### Revenue Recognition

The principal business of Interactive's telephone companies is to provide telecommunications services. These services fall into four major categories: local network, network access, long distance and other non-regulated telecommunications services. Toll service to areas outside franchised telephone service territory is furnished through switched and special access connections with intrastate and interstate long distance networks.

Local service revenues are derived from providing local telephone exchange services. Local service revenues are based on rates filed with various state telephone regulatory bodies.

Revenues from long distance network services are derived from providing certain long distance services to the Company's local exchange customers and are based on rates filed with various state regulatory bodies.

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Revenue from intrastate access is generally billed monthly in arrears based on intrastate access rates filed with various state regulatory bodies. Interactive recognizes revenue from intrastate access service based on an estimate of the amounts billed to interexchange carriers in the subsequent month. Estimated revenues are adjusted monthly as actual revenues become known.

Revenue from interstate access 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 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.

Other ancillary revenues derived from the provision of directory advertising and billing and collection services are billed monthly based on rates under contract.

### Purchase Price Allocation/Test for Impairment of Goodwill and Other Indefinite-lived Intangible Assets

Interactive's business development strategy is to expand its existing operations through internal growth and acquisition. From 1989 through 2001, the Company has acquired twelve 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 for impairment using the two-step process prescribed in SFAS No. 142. The first step is a screen for potential impairment, while the second step measures the amount of impairment, if any. The Company performed its transitional impairment tests of goodwill and other indefinite lived intangible assets as of January 1, 2002 and the first of its required annual tests as of October 1, 2002 and determined that there were no impairments at that time.

### Depreciation and Amortization

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 June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement obligations. This standard provides accounting guidance for legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction or development and (or) normal operation of that asset. According to the standard, the fair value of an asset retirement obligation (ARO liability) should be recognized in the period in which (1) a legal obligation to retire a long-lived asset exists and (2) the fair value of the obligation based on retirement cost and settlement date is reasonably

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estimable. Upon initial recognition of the ARO liability, the related asset retirement cost should be capitalized by increasing the carrying amount of the related long-lived asset. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. Under FCC mandated accounting practices, the Company is prohibited from complying with the provisions of SFAS 143 at this time.

### ITEM 7A. 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 \$23.4 million at December 31, 2002 and \$31.2 million at December 31, 2001). The Company generally finances the debt portion of the acquisition of long-term assets with fixed rate, long-term debt. The Company generally maintains the majority of its debt as fixed rate in nature 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.

At December 31, 2002, approximately \$64.8 million, or 34% of Interactive's long-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 2002 average interest rate under these borrowings, it is estimated that Interactive's 2002 interest expense would have changed by approximately \$0.5 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, the analysis assumes no such actions. In addition, if the Company were to convert a significant portion of its assets variable interest rate debt into fixed interest, at current time such could increase interest expense by \$1.5 million levels. Further, the analysis does not consider the effects of the change in the level of overall economic activity that could exist in such an environment.

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See Item 15(a).

### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

## PART III

### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this Item 10 is included under the caption "Executive Officers of the Registrant" in Item 1 hereof and included under the captions "Election of Directors" and "Section 16(a) Reporting" in Registrant's Proxy Statement for its Annual Meeting of Shareholders for 2003, which information is incorporated herein by reference.

### ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item 11 is included under the captions "Compensation of Directors," "Executive Compensation," "Executive Compensation and Benefits Committee Report on Executive Compensation" and "Performance Graph" in Registrant's Proxy Statement for its Annual Meeting of Shareholders for 2003, which information is incorporated herein by reference.

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### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this Item 12 is included under the caption "Security Ownership of Certain Beneficial Owners and Management," in the Registrant's Proxy Statement for its Annual Meeting of Shareholders for 2003, which information is included herein by reference.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this Item 13 is included under the caption "Executive Compensation", and "Transactions with Certain Affiliated Persons" in the Registrant's Proxy Statement for its Annual Meeting of Shareholders for 2003, which information is included herein by reference.

### ITEM 14. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures.

Our chief executive officer and chief financial officer have evaluated the effectiveness of the Registrant's disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) of the Securities Exchange Act of 1934 (the "Act")) as of a date within 90 days of the filing date of this annual report (Evaluation Date). They have concluded that, as of the Evaluation Date, the Registrant's disclosure controls and procedures were adequate and effective to ensure that information required to be disclosed by the Registrant in the reports that it files or submits under the Act is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the Securities and Exchange Commission.

(b) Changes in internal controls.

There were no significant changes in the Registrant's internal controls or in other factors that could significantly affect these controls subsequent to the Evaluation Date, nor were there any significant deficiencies or material weaknesses in these controls requiring corrective actions.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENTS, SCHEDULES AND REPORTS ON FORM 8-K

(a)(1) The following documents are filed as part of this Form 10-K Annual Report: Financial Statements:

Reports of Independent Auditors and the following Financial Statements of the Company are included herein:

Consolidated Balance Sheets - December 31, 2001 and 2002 Consolidated Statements of Operations - Years ended December 31, 2000, 2001 and 2002 Consolidated Statements of Shareholders' Equity - Years ended December 31, 2000, 2001 and 2002 Consolidated Statements of Cash Flows - Years ended December 31, 2000, 2001 and 2002 Notes to Consolidated Financial Statements

(a)(2) Financial Statement Schedules:

Schedule I - Condensed Financial Information of Registrant  
Schedule II - Valuation and Qualifying Accounts

(a)(3) Exhibits: See the Exhibit Index on pages 51 through 53

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All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required under the related instructions, or are inapplicable, and therefore have been omitted.

See Page 2 above re Forward Looking Information.

(b) Reports on Form 8-K:

Current Report on Form 8-K filed on November 29, 2002.

(c) Exhibits: The following Exhibits listed in the Exhibit Index are filed with this Form 10-K Annual Report:

3.2 Amended By-laws of Registrant

23 Consents of Siepert & Co., L.L.P. for use of:

- Report of Siepert & Co., L.L.P. on the financial statements of Cuba City Telephone Exchange Company for the year ended December 31, 2002 and 2001
- Report of Siepert & Co., L.L.P. on the financial statements of Belmont Telephone Company for the year ended December 31, 2002 and 2001
- Report of Siepert & Co., L.L.P. on the financial statements of Upper Peninsula Telephone Company for the year ended December 31, 2002 and 2001
- Report of Siepert & Co., L.L.P. on the financial statements of Lynch Michigan Telephone Holding Company for the year ended December 31, 2001 and 2000

24 Powers of Attorney

99.1 Report of Independent Auditors

- Report of Siepert & Co., L.L.P. on the financial statements of Cuba City Telephone Exchange Company for the year ended December 31, 2002 and 2001
- Report of Siepert & Co., L.L.P. on the financial statements of Belmont Telephone Company for the year ended December 31, 2002 and 2001
- Report of Siepert & Co., L.L.P. on the financial statements of Upper Peninsula Telephone Company for the year ended December 31, 2002 and 2001
- Report of Siepert & Co., L.L.P. on the financial statements of Lynch Michigan Telephone Holding Company for the year ended December 31, 2001 and 2000

99.2 Chief Executive Officer Section 906 Certification

99.3 Chief Financial Officer Section 906 Certification

(d) Financial Statement Schedules: Financial Statement Schedules are listed in response to Item 15(a)(2)

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## REPORT OF INDEPENDENT AUDITORS

Shareholders and Board of Directors  
Lynch Interactive Corporation

We have audited the accompanying consolidated balance sheets of Lynch Interactive Corporation (the "Company") and subsidiaries as of December 31, 2001 and 2002, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2002. Our audits also included the financial statement schedules listed in the index at Item 15(a). These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits. We did not audit the following: the financial statements of Cuba City Telephone Exchange Company and Belmont Telephone Company, indirect wholly-owned subsidiaries of Lynch Interactive Corporation, which statements reflect total assets of \$4,347,000 and \$4,372,000 as of December 31, 2001 and 2002, respectively, and total revenues of \$2,076,000, \$2,139,000 and \$2,117,000 for each of the three years in the period ended December 31, 2002; the financial statements of Upper Peninsula Telephone Company, an indirect wholly-owned subsidiary of Lynch Interactive Corporation, which statements reflect total assets of \$26,720,000 as of December 31, 2002 and total revenues of \$10,986,000 for the year then ended; and the financial statements of Lynch Michigan Telephone Holding Corporation, an indirect wholly-owned subsidiary of Lynch Interactive Corporation, which statements reflect total assets of \$33,147,000 as of December 31, 2001 and total revenues of \$11,246,000 for the year then ended. Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included in the consolidated financial statements and financial statement schedules for Cuba City Telephone Exchange Company and Belmont Telephone Company in 2000, 2001 and 2002, Upper Peninsula Telephone Company in 2002 and Lynch Michigan Telephone Holding Corporation in 2001, is based solely on the reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lynch Interactive Corporation and subsidiaries at December 31, 2001 and 2002, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, based on our audits and the reports of other auditors, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

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As discussed in Note 1 to the consolidated financial statements, in 2002, the Company changed its method of accounting for goodwill and other intangible assets.

/s/ Ernst & Young LLP

Stamford, Connecticut  
March 14, 2003

### LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

|  | December 31,   |            |
|--|----------------|------------|
|  | 2001           | 2002       |
|  | (In Thousands) |            |
| ASSETS   |                |            |
| CURRENT ASSETS:  |                |            |
| Cash and cash equivalents .....  | \$ 23,664      | \$ 23,356  |
| Restricted cash .....  | 7,569          | --         |
| Receivables, less allowances of \$424 and<br>\$316, respectively .....                 | 9,963          | 8,916      |
| Material and supplies .....  | 3,373          | 3,351      |
| Prepaid expenses and other current assets .....  | 1,757          | 1,451      |
| Current assets of Morgan Group Holding Co. ....<br>distributed to shareholders .....   | 12,757         | --         |
|  | 59,083         | 37,074     |
| TOTAL CURRENT ASSETS .....   |                |            |
| PROPERTY, PLANT AND EQUIPMENT:   |                |            |
| Land .....   | 840            | 807        |
| Buildings and improvements .....   | 10,858         | 12,741     |
| Machinery and equipment .....  | 178,110        | 195,015    |
|  | 189,808        | 208,563    |
| Accumulated Depreciation .....   | (74,419)       | (88,201)   |
|  | 115,389        | 120,362    |
| EXCESS OF COST OVER FAIR VALUE OF NET ASSETS   |                |            |
| ACQUIRED, NET (GOODWILL) .....   | 60,889         | 60,884     |
| INVESTMENTS IN AND ADVANCES TO AFFILIATED ENTITIES                                     | 14,277         | 9,343      |
| OTHER ASSETS .....   | 19,469         | 17,684     |
| NON CURRENT ASSETS OF MORGAN GROUP HOLDING CO ...<br>DISTRIBUTED TO SHAREHOLDERS ..... | 10,241         | --         |
|  | \$ 279,348     | \$ 245,347 |
|  | \$ 279,348     | \$ 245,347 |
| TOTAL ASSETS .....   |                |            |



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See accompanying notes

LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

|  | December 31,   |            |
|--|----------------|------------|
|  | 2001           | 2002       |
|  | (In Thousands) |            |
| LIABILITIES AND SHAREHOLDERS' EQUITY   |                |            |
| CURRENT LIABILITIES:   |                |            |
| Notes payable to banks .....   | \$ 10,336      | \$ 12,882  |
| Trade accounts payable .....   | 921            | 1,638      |
| Accrued interest payable .....   | 1,579          | 384        |
| Accrued liabilities .....  | 15,700         | 16,682     |
| Convertible debt .....   | 10,000         | --         |
| Current maturities of long-term debt .....   | 18,126         | 18,272     |
| Current liabilities of Morgan Group Holding Co. .<br>distributed to shareholders .....   | 11,281         | --         |
|  | -----          | -----      |
| TOTAL CURRENT LIABILITIES .....  | 67,943         | 49,858     |
| <br>   |                |            |
| LONG-TERM DEBT .....   | 165,076        | 158,349    |
| DEFERRED INCOME TAXES .....  | 6,844          | 6,621      |
| OTHER LIABILITIES .....  | 887            | 736        |
| MINORITY INTEREST .....  | 6,120          | 7,151      |
| NON CURRENT LIABILITIES AND MINORITY<br>INTERESTS OF MORGAN GROUP HOLDING CO .....   | 7,961          | --         |
| DISTRIBUTED TO SHAREHOLDERS .....  |                |            |
| COMMITMENTS AND CONTINGENCIES (Note 13)  |                |            |
| SHAREHOLDERS' EQUITY   |                |            |
| COMMON STOCK, \$0.0001 PAR VALUE-10,000,000<br>SHARES AUTHORIZED; 2,824,766 ISSUED; 2,820,051<br>and 2,792,651 outstanding ..... | --             | --         |
| ADDITIONAL PAID-IN CAPITAL .....   | 21,406         | 21,406     |
| RETAINED EARNINGS .....  | 1,800          | 1,879      |
| ACCUMULATED OTHER COMPREHENSIVE INCOME .....   | 1,542          | 534        |
| TREASURY STOCK, 4,715 and 32,115 shares, at cost .....   | (231)          | (1,187)    |
|  | -----          | -----      |
|  | 24,517         | 22,632     |
|  | -----          | -----      |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY .....   | \$ 279,348     | \$ 245,347 |
|  | =====          | =====      |

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See accompanying notes

LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

|  | Years Ended Decem        |           |
|--|--------------------------|-----------|
|  | 2000                     | 2001      |
|  | (In Thousands, except pe |           |
| SALES AND REVENUES .....   | \$ 66,983                | \$ 79,352 |
| COSTS AND EXPENSES:  |                          |           |
| Multimedia cost of sales .....   | 48,477                   | 57,019    |
| Selling and administrative .....   | 3,175                    | 2,348     |
| OPERATING PROFIT .....   | 15,331                   | 19,985    |
| Other income (expense):  |                          |           |
| Investment income .....  | 3,260                    | 2,862     |
| Interest expense .....   | (13,568)                 | (13,936)  |
| Equity in earnings of affiliated companies .....   | 1,669                    | 932       |
| Impairment of investment in Spinnaker Industries, Inc. ....  | --                       | (3,194)   |
| Provision for impairment of investment in spectrum license ..  | --                       | --        |
| holders  |                          |           |
| Gain on sales of subsidiary stock and other assets .....   | 4,187                    | --        |
|  | (4,452)                  | (13,336)  |
| INCOME BEFORE INCOME TAXES, MINORITY INTERESTS, AND OPERATIONS<br>OF THE MORGAN GROUP, INC. ("MORGAN") DISTRIBUTED TO<br>SHAREHOLDERS .....  | 10,879                   | 6,649     |
| Provision for income taxes .....   | (4,971)                  | (3,454)   |
| Minority interests .....   | (877)                    | (661)     |
| INCOME FROM CONTINUING OPERATIONS<br>BEFORE OPERATIONS OF MORGAN DISTRIBUTED<br>TO SHAREHOLDERS .....  | 5,031                    | 2,534     |
| LOSS FROM OPERATIONS OF MORGAN DISTRIBUTED<br>TO SHAREHOLDERS NET OF INCOME TAXES OF<br>\$2,451, \$(166) and \$0, RESPECTIVELY, AND MINORITY<br>INTERESTS OF \$2,133, \$603, and \$868, RESPECTIVELY ..... | (2,666)                  | (1,386)   |
| NET INCOME .....   | \$ 2,365                 | \$ 1,148  |

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|   |           |           |
|---|-----------|-----------|
| Basic and diluted weighted average shares outstanding ..... | 2,823,000 | 2,821,000 |
|   | =====     | =====     |
| BASIC AND DILUTED EARNINGS (LOSS) PER SHARE:                |           |           |
| INCOME BEFORE OPERATIONS OF MORGAN DISTRIBUTED              |           |           |
| TO SHAREHOLDERS .....                                       | \$ 1.78   | \$ 0.90   |
| LOSS FROM OPERATIONS OF MORGAN DISTRIBUTED TO               |           |           |
| SHAREHOLDERS .....  | (0.94)    | (0.49)    |
|   | -----     | -----     |
| NET INCOME .....  | \$ 0.84   | \$ 0.41   |
|   | =====     | =====     |

See accompanying notes.

LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
(In Thousands, Except Share Data)

|   | Shares of<br>Common<br>Stock<br>Outstanding | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Compre-<br>hensive<br>Income |
|---|---|-----------------|----------------------------------|----------------------|--|
|   | -----                                       | -----           | -----                            | -----                | -----  |
| Balance at December 31, 1999                              | 1,412,183                                   | \$ 0            | \$ 21,404                        | \$ (1,713)           | \$ 7,240   |
| Two-for-one stock split ....                              | 1,412,183                                   | --              | --                               | --                   | --   |
| Net income for the period ..                              | --  | --              | --                               | 2,365                | --   |
| Unrealized loss on available<br>for sale securities ..... | --  | --              | --                               | --                   | (4,699)  |
| Reclassification adjustment                               | --  | --              | --                               | --                   | (480)  |
| Comprehensive income .....                                | --  | --              | --                               | --                   | --   |
| Adjustment relating to<br>acquisition .....               | --  | --              | --                               | --                   | (566)  |
| Cost  |   |                 |                                  |                      |  |
| Purchase of treasury stock .                              | (2,700)                                     | --              | --                               | --                   | --   |
|   | -----                                       | -----           | -----                            | -----                | -----  |
| Balance at December 31, 2000                              | 2,821,666                                   | 0               | 21,404                           | 652                  | 1,495  |
| Net income for the period ..                              | --  | --              | --                               | 1,148                | --   |
| Unrealized loss on available<br>for                       |   |                 |                                  |                      |  |
| sale securities .....                                     | --  | --              | --                               | --                   | (1,688)  |
| Reclassification adjustment                               | --  | --              | --                               | --                   | 1,735  |
| Comprehensive income ...                                  | --  | --              | --                               | --                   | --   |
| Issuance of Treasury Shares                               | 185   | --              | 2                                | --                   | --   |
| Purchase of Treasury Stock .                              | (1,800)                                     | --              | --                               | --                   | --   |

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|  |           |      |           |          |          |
|--|-----------|------|-----------|----------|----------|
| Balance at December 31, 2001                         | 2,820,051 | \$ 0 | \$ 21,406 | \$ 1,800 | \$ 1,542 |
| Dividend of shares of Morgan Group Holding Inc. .... | --        | --   | --        | (1,794)  | --       |
| Net income for the period ..                         | --        | --   | --        | 1,873    | --       |
| Unrealized loss on available for .....               | --        | --   | --        | --       | (780)    |
| sale securities, net                                 |           |      |           |          |          |
| Reclassification adjustment                          | --        | --   | --        | --       | (228)    |
| Comprehensive income ...                             | --        | --   | --        | --       | --       |
| Purchase of Treasury Stock .                         | (27,400)  | --   | --        | --       | --       |
| Balance at December 31, 2002                         | 2,792,651 | \$ 0 | \$ 21,406 | \$ 1,879 | \$ 534   |

See accompanying notes.

LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

|  | Years Ended Dec |          |
|--|-----------------|----------|
|  | 2000            | 2001     |
|  | (In Thousand)   |          |
| OPERATING ACTIVITIES   |                 |          |
| Net income .....   | \$ 2,365        | \$ 1,148 |
| Depreciation and amortization .....                                      | 15,797          | 18,283   |
| Unrealized gain on trading securities .....                              | (479)           | --       |
| Net proceeds from sale of trading securities .....                       | --              | 2,066    |
| Minority interests .....   | 877             | 661      |
| Equity in Earnings of affiliated companies .....                         | (1,669)         | (932)    |
| Provision for impairment of investment in spectrum license holders ..... | --              | --       |
| Gain on redemption of East/West preferred stock .....                    | (4,125)         | --       |
| Gain on sale of cellular partnership .....                               | --              | --       |
| Impairment of investment in Spinnaker Industries, Inc. ....              | --              | 3,194    |
| Gain on sale of securities .....   | (909)           | (198)    |
| Deferred income taxes .....  | (2,101)         | (724)    |
| Non-cash items and changes in operating assets and liabilities           |                 |          |
| from operations of Morgan Group Holding Co. to be distributed to         |                 |          |
| shareholders .....   | 3,539           | 1,032    |
| Assets transferred in settlement of litigation .....                     | --              | 415      |
| Changes in operating assets and liabilities, net of effects of           |                 |          |
| acquisitions:  |                 |          |
| Trade accounts receivable .....  | (834)           | (1,082)  |
| Trade accounts payable and accrued liabilities .....                     | 2,850           | (629)    |
| Other .....  | (658)           | 1,326    |
| Other .....  | (1,034)         | (212)    |
| NET CASH PROVIDED BY OPERATING ACTIVITIES .....                          | 13,619          | 24,348   |

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|  |           |           |
|--|-----------|-----------|
| INVESTING ACTIVITIES   |           |           |
| Acquisition (total cost less debt assumed and cash equivalents acquired):                              |           |           |
| Central Utah Telephone Company .....   | --        | (6,914)   |
| American Alarm Company .....   | --        | (3,085)   |
| Investment in Personal Communications Services   |           |           |
| Partnerships, net .....  | (7,988)   | (186)     |
| Proceeds from redemption of East/West preferred stock .....  | 8,712     | --        |
| Proceeds from sale of cellular partnership .....   | --        | --        |
| Capital expenditures .....   | (17,208)  | (20,533)  |
| Proceeds from sale of securities .....   | 1,563     | 494       |
| Cash received from liquidation of partnership .....  | --        | 550       |
| Investing activities of operations of Morgan Group Holding Co. to be distributed to shareholders ..... | (104)     | (2,718)   |
| Other .....  | 896       | 1,276     |
|  | -----     | -----     |
| NET CASH USED IN INVESTING ACTIVITIES .....  | (14,129)  | (31,116)  |
|  | -----     | -----     |
| FINANCING ACTIVITIES   |           |           |
| Issuance of long-term debt .....   | 13,489    | 30,847    |
| Payments to reduce long-term debt .....  | (16,021)  | (24,499)  |
| Net borrowings, lines of credit .....  | 1,062     | 6,003     |
| Purchase of Treasury stock .....   | (132)     | (88)      |
| Financing activities of operations of Morgan Group Holding Co. to be distributed to shareholders ..... | (769)     | 439       |
| Other .....  | 208       | 465       |
|  | -----     | -----     |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES .....  | (2,163)   | 13,167    |
|  | -----     | -----     |
| Net increase (decrease) in cash and cash equivalents .....   | (2,673)   | 6,399     |
| Cash and cash equivalents at beginning of year .....   | 27,507    | 24,834    |
|  | -----     | -----     |
| Cash and cash equivalents at end of year .....   | \$ 24,834 | \$ 31,233 |
|  | =====     | =====     |

See accompanying notes .

LYNCH INTERACTIVE CORPORATION AND SUBSIDIARIES  
Notes to Consolidated Financial Statements  
December 31, 2002

1. Accounting and Reporting Policies

Organization

On September 1, 1999, Lynch Corporation distributed 100 percent of the outstanding shares of common stock of its wholly-owned subsidiary, Lynch Interactive Corporation, to the then holders of record of Lynch's common stock ("Spin-Off"), in the form of a tax-free distribution. As part of the Spin-Off, Interactive received one million shares of common stock of Spinnaker Industries, Inc. representing an approximately 13.6% equity ownership interest (and an approximate 2.5% voting interest) and Interactive also assumed certain short-term and long-term debt obligations of Lynch Corporation.

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Interactive and Lynch have entered into certain agreements governing various ongoing relationships, including the provision of support services and a tax allocation agreement. The tax allocation agreement provides for the allocation of tax attributes to each company as if it had actually filed with the respective tax authority. At the time of the Spin-Off, the employees of the corporate office of Lynch became the employees of Interactive and for a period of time thereafter, Interactive began providing certain support services to Lynch. The Company charged a management fee for these services to Lynch Corporation amounting to approximately \$265,000 in 2000 and \$208,000 in 2001. In September 2001, Interactive stopped charging this management fee to Lynch since the services were no longer being provided.

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 of the stock of Morgan Group Holding Co., a corporation that was initially formed to serve as a holding company for Interactive's, among other business purposes, controlling interest in Morgan. Morgan Group Holding Co. is now a public company. Accordingly, the amounts for Morgan are reflected on a one-line basis in the consolidated financial statements as of December 31, 2001 and for the year then ended as amounts "to be distributed to shareholders." Similarly, the prior years' financial statements have been restated to be comparable with the current year's presentation.

### Basis of Presentation

The accompanying financial statements represent the consolidated accounts of Interactive which primarily consists of its telephone (81%-100% owned during each of the three years ended December 31, 2002), cable television (60% at December 31, 2000 and 100% owned at December 31, 2001 and December 31, 2002) and security (64% owned from date of acquisition of American Alarm on November 30, 2001) subsidiaries. All material intercompany transactions and balances have been eliminated. Investments in affiliates in which the Company does not have a majority voting control are accounted for in accordance with the equity method. The Company accounts for the following affiliated companies on the equity basis of accounting:

The Company's public utility subsidiaries are regulated by both the Federal Communications Commission (FCC) and various state commissions. These subsidiaries follow the accounting prescribed by the Uniform System of Accounts of the FCC and the state commissions and Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation." Where applicable, this accounting recognizes the economic effects of rate regulation by recording costs and a return on investment as such amounts are recovered through rates authorized by regulatory authorities.

Coronet Communications Company (20% owned at December 31, 2002), Capital Communications Company, Inc. (49% owned at December 31, 2002), Fortunet Communications, L.P. (49.9% owned through February 2001), and the telecommunications operations in New Mexico, Iowa and New York (5% to 21% owned at December 31, 2002).

The shares of Spinnaker Industries, Inc., in which the company owned 2.5% of the voting power and 13.6% of the common equity, are accounted for in accordance with Statements of Financial Accounting Standards (SFAS) No. 115 "Investment in Debt and Equity Securities." On November 13, 2001, Spinnaker announced that it has commenced voluntary proceedings under Chapter 11 of the U.S. Bankruptcy Code for the purpose of facilitating and accelerating its financial restructuring. On January 9, 2002, both classes of Spinnaker's stock were de-listed from the American Stock Exchange. The Company believed at December 31, 2001, that the decline in quoted value was other than temporary and, accordingly, recorded a loss of \$3.2 million during 2001 to write down its investment in Spinnaker to \$0

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at December 31, 2001. In late March 2002, all assets of Spinnaker were sold and the equity holders received no value.

### Use of Estimates/Reclassifications

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 effect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Certain prior year amounts in the accompanying consolidated financial statements have been reclassified to conform to current year presentation.

### Cash Equivalents

Cash equivalents consist of highly liquid investment with a maturity of three months or less when purchased.

At December 31, 2001 and 2002, assets of \$14.6 million and \$12.4 million, which are classified as cash and cash equivalents, are invested in United States Treasury money market funds for which affiliates of the Company serve as investment managers to the respective funds.

At December 31, 2001, the Company has segregated \$7.6 million of U.S. Treasury Bills in a separate account and pledged this account as collateral on a letter of credit that secured the Company's obligation under a put (option to sell) on certain of the Company's debt. (See Note 6-Notes Payable and Long-term Debt).

### Marketable Securities

Marketable securities consist principally of common stocks. At December 31, 2001 and 2002, Interactive's investment in marketable securities, which had carrying values of \$3.8 million and \$2.3 million, respectively, were classified as available-for-sale. Trading and available-for-sale securities are stated at fair value with unrealized gains or losses on trading securities included in earnings and unrealized gains or losses on available-for-sale securities included in equity and as a component of comprehensive income (loss). Unrealized gains (losses) on available-for-sale securities were (\$8.1 million), (\$3.0 million), and (\$1.3 million) for the years ended December 31, 2000, 2001 and 2002, respectively. The changes in unrealized gains in each of the periods presented, net of tax, have been included in the Consolidated Statements of Shareholder's Equity, as "Accumulated other comprehensive income."

The cost of marketable securities sold is determined on the specific identification method. Realized gains included in investment income were \$0.9 million, \$1.4 million and \$0.4 million for the years ended December 31, 2000, 2001 and 2002, respectively.

### Accounts Receivable

Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends, and other information. Receivable balances are reviewed on an aged basis and account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is doubtful.

### Property, Plant and Equipment

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Property, plant and equipment are recorded at cost and include expenditures for additions and major improvements. Maintenance and repairs are charged to operations as incurred. Depreciation is computed for financial reporting purposes using the straight-line method over the estimated useful lives of the assets, which range from 3 to 35 years. For income tax purposes, accelerated depreciation methods are used.

When a portion of the Company's depreciable property, plant and equipment relating to its telephone operations business is retired, the gross book value of the assets, including cost of disposal and net of any salvage value, is charged to accumulated depreciation, in accordance with the Company's regulated accounting procedures.

### Excess of Cost Over Fair Value of Net Assets Acquired, Net (Goodwill)

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective for fiscal years beginning after December 15, 2001. Statement 141 required that the purchase method of accounting be used for all business combinations initiated after September 30, 2001. Statement 141 also includes guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations completed after June 30, 2001. Statement 142 prohibits the amortization of goodwill and assets with indefinite lives. Statement 142 requires that these assets be reviewed for impairment at least annually. Intangible assets with finite lives will continue to be amortized over their estimated useful lives.

The Company tests goodwill for impairment using the two-step process prescribed in SFAS No. 142. The first step is a screen for potential impairment, while the second step measures the amount of impairment, if any. The Company performed its transitional impairment tests of goodwill and indefinite lived intangible assets as of January 1, 2002 and the first of its required annual tests October 1, 2002 and determined that there were no impairments at that time.

The application of the non-amortization provisions of Statement No. 142 increased Income from continuing operations for the year ended December 31, 2002 by approximately \$2.5 million (\$0.89 per basic and diluted share) whereas the similar amortization charge for the years ended December 31, 2001 and 2000 were approximately \$2.4 million (\$0.85 per basic and diluted share) and \$2.1 million (\$0.74 per basic share), respectively.

The following table discloses what the effects of the non-amortization of goodwill and indefinite lived intangible assets would be for income and per share amounts for the periods displayed:

|   | Year Ended |    |
|---|------------|----|
|   | 2000       |    |
| As reported:  |            |    |
| Income before operation of Morgan distributed to Shareholders ..... | \$ 5,031   | \$ |
| Loss from operations of Morgan distributed to Shareholders .....    | (2,666)    |    |
| Net Income (loss) .....   | \$ 2,365   | \$ |

Adjustment from non-amortization Continuing operations net of income taxes



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|   |          |       |
|---|----------|-------|
| of \$300, \$296, and \$0, and minority interest<br>of \$76, \$74, and \$0, respectively .....   | \$ 2,079 | \$    |
| Operations of Morgan, net of income taxes of<br>\$244, \$0, and \$0 and minority interestsof<br>\$173, \$185 and \$0, respectively..... | \$ 217   | \$    |
| As adjusted:  |          |       |
| Income (loss) from continuing operations .....  | \$ 7,110 | \$    |
| Income (loss) from operations of Morgan .....   | (2,449)  |       |
|   | -----    | ----- |
| Net income .....  | \$ 4,661 | \$    |
|   | =====    | ===== |
| Basic and diluted earnings per share  |          |       |
| Income (loss) from continuing operations .....  | \$ 2.52  | \$    |
| Income (loss) from operations of Morgan .....   | (0.87)   |       |
|   | -----    | ----- |
| Net Income (loss) .....   | \$ 1.65  | \$    |
|   | =====    | ===== |

The following tables display the details of goodwill and intangible assets as of the dates shown.

|  | December 31,  |               |
|--|---------------|---------------|
|  | -----<br>2001 | 2002<br>----- |
| Subscriber Lists: Intangible Assets subject to<br>amortization |               |               |
| Asset .....  | \$7,194       | \$7,284       |
| Accumulated Amortization .....                                 | \$ 986        | \$2,370       |

|                            | Year Ended December 31, |        |               |
|----------------------------|-------------------------|--------|---------------|
|                            | -----<br>2000           | 2001   | 2002<br>----- |
| Total amortization expense | \$-                     | \$ 189 | \$1,384       |

|   | -----<br>2003 | 2004  | 2005  | 2006  | 2007 |
|---|---------------|-------|-------|-------|------|
| Estimated aggregate amortization<br>expense by year ..... | \$552         | \$552 | \$547 | \$547 | \$   |

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|  | December 31, |          |
|--|--------------|----------|
|  | 2001         | 2002     |
| Intangible assets not subject to amortization: |              |          |
| Goodwill .....                                 | \$60,889     | \$60,884 |
| Cellular licenses                              | \$ 1,650     | \$ 1,650 |

### Revenues

Multimedia revenues include local and intrastate telephone company service revenues, which are subject to review and approval by state public utility commissions, and long distance network revenues, which are based upon charges to long distance carriers through a tariff filed by the National Exchange Carriers Association with the Federal Communications Commission. Revenues are based on cost studies for the Company's exchanges, and have been estimated pending completion of final cost studies. Estimated revenue is adjusted to actual upon the completion of the cost studies.

Sales of communications products represent a separate earnings process and are recognized when products are delivered and accepted by customers. For each transaction involving both the installation and activations of service and the sale of equipment, the Company has allocated revenues based on fair value for the service element and the residual method for all other elements of the transaction.

### Earnings (Loss) Per Share

Basic earnings (loss) per common share amounts are based on the average number of common shares outstanding during each period, excluding the dilutive effects of options, warrants, and convertible securities. Diluted earnings per share reflect the effect, where dilutive, of options, warrants and convertible securities, using the treasury stock and if converted methods as applicable.

### Comprehensive Income

The Company follows the provisions of SFAS No. 130, "Reporting Comprehensive Income" that requires unrealized gains or losses on the Registrant's available-for-sale securities to be included as a separate component of Shareholder Equity and in other comprehensive income (loss).

### Segment Information

The Company follows the provisions of SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information." SFAS No. 131 requires disclosure of selected financial and descriptive information for each operating segment based on management's internal organizational decision-making structure. Additional information is required on a company-wide basis for revenues by product or service, revenues and identifiable assets by geographic location and information about significant customers. Subsequent to the spin-off of Morgan, the Company has only one reportable segment - multimedia - see Note 14.

### Stock Based Compensation

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Historically, the Company applies the disclosure only provisions of SFAS No. 123, Accounting for Stock Based Compensation. In the three years ended December 31, 2002, the Company had provided pro forma data with regard to its consolidated subsidiary, The Morgan Group, Inc., such disclosure is no longer required as Morgan is being treated as a discontinued operations. SFAS No. 123 establishes a fair value method of accounting and reporting standards for stock based compensation plans. However, as permitted by SFAS No. 123, Company elected to continue to apply provision of Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" and related interpretations in accounting for its equity awards. Under APB No. 25, if the exercise price of the Company's employee stock options was not less than the market price of the underlying stock on the date of grant, no compensation expense is recognized. As the Company has had no options outstanding during any of the three years ended December 31, 2002, the disclosure practices of SFAS 123 are not applicable. The Company is required to disclose the pro forma net income (loss) and net income (loss) per share as if the fair value method defined in SFAS No. 123 had been applied to all grants.

### Issuance of Stock by Subsidiary and Investees

Changes in the Company's equity in a subsidiary or an investee caused by issuances of the subsidiary's or investees' stock are accounted for as gains or losses where such issuance is not part of a broader reorganization.

### Fair Value of Financial Instruments

Cash and cash equivalents, trade accounts receivable, short-term borrowings, trade accounts payable and accrued liabilities are carried at cost which approximates fair value due to the short-term maturity of these instruments. The carrying amount of the Company's borrowings under its revolving line of credit approximates fair value, as the obligations bear interest at a floating rate. The fair value of other long-term obligations approximates cost based on borrowing rates for similar instruments.

### Recent Issued Accounting Pronouncements

Effective January 1, 2002, we adopted SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. This standard supersedes SFAS No. 121 and the provisions of APB Opinion No. 30, "Reporting the Results of Operations- Reporting the Effects of Disposal of a Setment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," with regard to reporting the effects of a disposal of a segment of a business. SFAS No. 144 establishes a single accounting model for assets to be disposed of by sale and addresses several SFAS No. 121 implementation issues. The adoption of SFAS No. 144 did not have a material effect on our results of operations or financial position.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement obligations." This standard provides accounting guidance for legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction or development and (or) normal operation of that asset. According to the standard, the fair value of an asset retirement obligation (ARO liability) should be recognized in the period in which (1) a legal obligation to retire a long-lived asset exists and (2) the fair value of the obligation based on retirement cost and settlement date is reasonably estimable. Upon initial recognition of the ARO liability, the related asset retirement cost should be capitalized by increasing the carrying amount of the related long-lived asset. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. We are currently evaluating the impact, if any, this new standard will have on our future results of operations or financial position.

### 2. Spin-off of Morgan

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On July 12, 2001, the Company made an additional \$2.0 million investment in Morgan, which increased its equity ownership from 55.6% to 70.2% and its voting control from 68.59% to 80.8%.

In January 2002, Interactive spun off its interest in The Morgan Group, Inc., its only services subsidiary, via a tax-free dividend to its shareholders of the stock of Morgan Group Holding Co., a corporation that was formed to serve as a holding company for Interactive's controlling interest in The Morgan Group, Inc. Morgan Group Holding Co. is now a public company.

As a result, the Company's services segment, which consisted solely of the operations of Morgan, is being reported as operations to be distributed to shareholders. Accordingly, operating results of Morgan have been segregated from continuing operations and reported as a separate line item in the Statements of Operations.

Interactive has restated its prior year financial statements to present the operating results of Interactive on a comparable basis. Morgan's net sales were \$101.2 million, and \$128.4 million for the years ended December 31, 2001 and 2000, respectively.

The net assets of Morgan included in the accompanying consolidated balance sheets as of December 31, 2001, consist of the following (in thousands):

|   |          |
|---|----------|
| Cash and cash equivalents .....   | \$ 1,017 |
| Accounts receivable, net .....  | 6,322    |
| Prepays and other (includes restricted cash of \$2.6 million) .....                   | 5,418    |
|   | -----    |
| Current assets to be distributed to shareholders .....                                | \$12,757 |
|   | =====    |
| <br>  |          |
| Property, plant and equipment, net .....  | \$ 3,385 |
| Excess of cost over net fair value of net assets acquired, net .....                  | 6,256    |
| Other assets .....  | 600      |
|   | -----    |
| Non-current assets to be distributed to shareholders .....                            | \$10,241 |
|   | =====    |
| <br>  |          |
| Notes payable .....   | \$ 580   |
| Accounts payable .....  | 4,505    |
| Accrued liabilities .....   | 6,027    |
| Current portion of long term debt .....   | 169      |
|   | -----    |
| Current liabilities to be distributed to shareholders .....                           | \$11,281 |
|   | =====    |
| <br>  |          |
| Long term debt .....  | \$ 13    |
| Other liabilities .....   | 4,078    |
| Deferred income taxes .....   | 1,671    |
| Minority interest .....   | 2,199    |
|   | -----    |
| Non-current liabilities and minority interest to be distributed to shareholders ..... | \$ 7,961 |
|   | =====    |

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### 3. Acquisitions and Dispositions

#### Acquisitions

On June 22, 2001, Lynch Telephone Corporation X, a subsidiary of Interactive, acquired Central Utah Telephone, Inc. and its subsidiaries, and Central Telcom Services, LLC, a related entity, for approximately \$8.0 million in cash and \$7.6 million in notes. The Company recorded approximately \$11.0 million of goodwill, which was being amortized over 25 years, through December 31, 2001 (see Note 1).

This acquisition was accounted for as a purchase, and accordingly, the assets acquired and liabilities assumed were recorded at their estimated fair market values on the date of acquisition. The operating results of the acquired companies are included in the Statements of Operations from their respective acquisition dates.

The following unaudited consolidated pro forma information shows the results of the Company's operations presented as if the Central Utah acquisition and the distribution of Morgan were made at the beginning of 2000. The unaudited pro forma information is not necessarily indicative of the results of operations that would have occurred had the transactions been made at these dates nor is it necessarily indicative of future results of operations.

|   | Year Ended December 31, |          |
|---|-------------------------|----------|
|   | 2000                    | 2001     |
|   | (Unaudited)             |          |
| Sales .....   | \$71,705                | \$82,129 |
| Income (loss) from continuing operations<br>before extraordinary item ..... | \$ 5,361                | \$ 2,491 |
| Net income (loss) .....   | 5,361                   | 2,491    |
| Basic and diluted earnings per share:                                       |                         |          |
| Net income (loss) .....   | \$ 1.90                 | \$ 0.88  |

### 4. Wireless Communications Services

On February 22, 2001, Interactive spun-off to its shareholders 2,800,000 of Sunshine PCS Corporation ("Sunshine") Class A Common Stock. Sunshine was formed just prior to the spin-off through the merger of Sunshine with Fortunet Communications Limited Partnership and Interactive converted its 49.9% partnership interest in Fortunet into 3,000,000 shares of Class A Common Stock of Sunshine representing 49.9% of Sunshine's common equity interest. As part of the merger, Interactive exchanged \$85 million of subordinated notes of Fortunet into \$16.1 million (face value) of subordinated notes in Sunshine, Interactive's carrying value in these notes was \$3.4 million at December 31, 2001. In addition prior to the spin-off, in exchange for \$250,000, Interactive acquired 10,000 shares of preferred stock in Sunshine with an aggregate liquidation preference of \$10.0 million and warrants to purchase 4,300,000 shares of Sunshine Class A Common Stock at \$0.75 per share. Sunshine owns three 15 MHz personal communications services ("PCS") licenses in Tallahassee, Panama City and Ocala,

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Florida, areas covering a total population of 960,000 (based on 2000 census data). During 2002, as part of a rights offering to its shareholders by Sunshine, Interactive acquired an additional 58,824 shares of Sunshine's Class A Common Stock at \$1.00; per share. Prior to the rights offering, Interactive loaned Sunshine \$550,000. This amount, plus interest of \$12,000, was repaid by Sunshine with a portion of the proceeds of the rights offering.

Also during 2002, Interactive exchanged subordinated notes of Sunshine with a principal in the amount of \$18.5 million into two classes of preferred stock. Interactive received 12,500 shares of Sunshine's A-1 preferred stock which has a total liquidation value of \$12.5 million and 2,000 shares of Sunshine's A-2 convertible preferred stock which has a liquidation value of \$2.0 million and is convertible into 2.0 million shares of Sunshine Class A Common Stock. The book value of Interactive's investment is \$3.4 million, therefore, there was no impact on the carrying value of the investment in Sunshine as a result of this restructuring.

During 2000, Interactive invested in four limited liability companies, which participated in four separate auctions. In the paging auction, Betapage Communications, L.L.C. acquired 24 licenses at a net cost of \$77,000; Interactive owns 49.9% of Betapage's equity. In the 39 MHz auction, PTPMS Communications, L.L.C. acquired 22 licenses for a net cost of \$1.5 million; Interactive has loans to PTPMS of \$1.4 million and owns 49.9% of PTPMS equity. In the Guard Band auction, PTPMS II Communications, L.L.C. acquired three licenses at a net cost of \$6.3 million; Interactive has loans to PTPMS II of \$6.1 million, and owns 49.9% of PTPMS II is equity. In a FCC auction conducted during 2002 for similar spectrum, which ended on September 18, 2002, 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, resulting in a net book value, at December 31, 2002, of \$0.7 million.

In the C&F Block PCS Reauction ("Auction 35"), which ended on January 26, 2001, Theta Communications, LLC acquired one license at a net cost of \$4.0 million. During the year ended December 31, 2001, \$5.0 million of loans from Interactive to Theta were returned. Lynch Interactive owns 10% of Theta and has committed to fund a portion of the remaining license cost. An affiliate of Interactive also has invested in Theta.

During 2002, the FCC provided all participants in Auction 35, the option of withdrawing their high bid exchange for a return of all monies on deposit. Theta withdrew its bid on the licenses it acquired. All remaining monies were returned by the FCC and distributed to other owners.

During 2002, a wholly owned subsidiary of Interactive acquired eight licenses in the Lower MHz Auction at a total cost of \$1.1 million.

On February 25, 2000, Omnipoint Incorporated acquired, through a merger, all of the outstanding shares of East/West Communications, Inc. At the time of the merger, the Registrant held a redeemable preferred stock of East/West Communications, Inc. with a liquidation value of \$8.7 million, including payment in kind of dividends to date. In accordance with its terms, the preferred stock was redeemed at its liquidation value and as a result, Interactive recorded a pre-tax gain of \$4.2 million in the first quarter of 2000.

During the third quarter of 2001, the Company recorded an administration fee of \$2.8 million for services provided to an entity, in which an affiliate of the Chairman of the Company has a minority investment in a Federal Communications Commission conducted auction for spectrum to be used for the provision of personal communications services. The auction was conducted in 1999 and the fee was based on the entity's realization of the licenses acquired. This fee is included in the "Sales and Revenues" in the Consolidated Statement of

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Operations.

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 Sunshine, or other 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.

### 5. Investments in Affiliated Companies

Lynch Entertainment, L.L.C. ("LENCO"), 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. Lynch Entertainment Corporation II ("LENCO II"), a 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 December 31, 2001 and 2002, LENCO's investment in Coronet was carried at a negative \$946,000 and a negative \$791,000, respectively, due to LENCO's guarantee of \$3.8 million of Coronet's third party debt. Long-term debt of Coronet, at December 31, 2002, totaled \$10.1 million due to a third party lender which is due quarterly through December 31, 2005.

At December 31, 2001 and 2002, LENCO II's investment in Capital is carried at zero as its share of net losses recognized to date have exceeded its net investment. LENCO II also owns \$10,000 of Preferred Stock B of Capital, which is convertible at any time into the Common Stock of Capital in a sufficient amount to bring LENCO II's ownership to 50%.

Subsidiaries of Lynch Telephone Corporation own minority positions in two partnerships providing cellular service to three Rural Service Areas ("RSAs") in New Mexico. Adjusting for the minority positions in non wholly-owned and wholly-owned subsidiaries, Lynch Telephone Corporation's net equity interest in the two RSA's is as follows: RSA #3 - 21.1%, and RSA #5 - 17.0%. Lynch Telephone Corporation's net investment in these partnerships is \$2.6 million at December 31, 2001 and \$2.4 million at December 31, 2002. In January 2002, the Company sold its interest in RSA #1 (North) for \$5.5 million (\$3.0 million in cash and \$2.5 million in satisfaction of a note payable to the acquiror), and recorded a pre-tax gain of approximately \$5.0 million.

Undistributed earnings of companies accounted for using the equity method that are included in consolidated retained earnings are \$1.0 million and \$1.2 million at December 31, 2001 and 2002, respectively.

Summarized financial information for companies accounted for by the equity method as of and for the years ended December 31, is as follows:

| Combined Information |      |      |
|----------------------|------|------|
| 2000                 | 2001 | 2002 |

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|  | (In Thousands) |          |          |
|--|----------------|----------|----------|
| Current assets .....                             | \$10,955       | \$11,139 | \$20,283 |
| Property, plant & equipment, intangibles & other | \$41,899       | \$44,606 | \$39,109 |
| Total Assets .....                               | \$52,854       | \$55,745 | \$59,392 |
| Current liabilities .....                        | \$ 6,651       | \$ 5,720 | \$13,002 |
| Long term liabilities .....                      | \$36,628       | \$36,641 | \$29,938 |
| Equity .....                                     | \$ 7,755       | \$10,359 | \$16,452 |
| Total liabilities & equity .....                 | \$52,854       | \$55,745 | \$59,392 |
| Revenues .....                                   | \$37,442       | \$39,837 | \$56,216 |
| Gross profit .....                               | \$11,306       | \$18,636 | \$18,285 |
| Net income .....                                 | \$ 4,679       | \$ 4,712 | \$10,790 |

6. Notes Payable to Banks and Long-term and Convertible Debt

Long-term debt represents borrowings by specific entities, which are subsidiaries of Interactive.

December 31  
2001

(In Thousands)

Long-term debt consists of (all interest rates are at December 31, 2002):

Rural Electrification Administration (REA) and Rural Telephone Bank (RTB) notes payable in equal quarterly installments through 2027 at fixed interest rates ranging from 2% to 7.5% (4.9% weighted average), secured by

|   |            |    |
|---|------------|----|
| assets of the telephone companies of \$150 million .....  | \$ 55,499  | \$ |
| Bank credit facilities utilized by certain telephone and telephone holding companies through 2016, \$30.4 million at fixed interest rates averaging 7.9% and \$49.7 million at variable interest rates averaging 4.3% ..... | 87,127     |    |
| Unsecured notes issued in connection with acquisitions through 2008, all at fixed interest rates averaging 10% (costs held by management operations on subsequent companies) .....  | 34,512     |    |
| Other .....   | 6,064      |    |
|   | 183,202    |    |
| Current maturities .....  | (18,126)   | (  |
|   | \$ 165,076 | \$ |

REA debt of \$10.8 million bearing interest at 2% has been reduced by a purchase price allocation of \$1.7 million reflecting an imputed interest rate of 5%. Unsecured notes issued in connection with the telephone company acquisitions are predominantly held by members of management of the telephone operating companies.



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The parent company of Interactive maintains a \$10.0 million short-term line of credit facility, which expires in August 2003. Borrowings under this line at December 31, 2001 and 2002 were \$7.6 million and \$10.0 million, respectively. Management expects that such line will be renewed by its expiration date although there are no assurances that this will be accomplished.

In general, the long-term debt facilities are secured by substantially all of the Company's property, plant and equipment, receivables and common stock of certain subsidiaries and contain certain covenants restricting distributions to Lynch Interactive. At December 31, 2001 and 2002, substantially all the subsidiaries' net assets are restricted.

On December 12, 1999, Interactive completed the private placement of a \$25 million 6% five-year unsecured, convertible subordinated note, convertible into Interactive common stock at \$42.50 per share, (adjusted for subsequent 2 for 1 stock split). At that time, to assist the Company with the private placement to Cascade Investment LLC ("Cascade"), the Chairman and CEO of the Company, agreed to give the acquirer of the note, a one-time option to sell the note to him at 105% of the principal amount thereof. The exercise period was from November 15, 2000 to December 1, 2000. Under generally accepted accounting principles relating to significant shareholders, during 2000, Interactive recorded \$1.25 million in interest expense to recognize the 5% premium incorporated in the option to sell. This option to sell is secured by a bank letter of credit. The Company agreed to reimburse the Chairman for the cost of the letter of credit (approximately \$160,000) plus his counsel fees in connection with the option to sell agreement and obtaining the letter of credit.

In January 2001, the above option to sell agreement was amended. As amended, Cascade had the right to sell up to \$15 million of the note back to the Chairman at any time prior to January 31, 2001 and the right to sell the remaining \$10 million of the notes between November 15 and December 1, 2002. The option to sell was at 105% of principal amount sold plus accrued and unpaid interest. As a condition to modifying and extending the option to sell, the Company entered into an agreement with its Chairman whereby it will pay for and acquire, on the same terms and conditions, any portion of the note sold by Cascade under this option. During January 2001, Cascade exercised this option with regard to the \$15 million of the notes and on February 14, 2001, the Company paid \$15.9 million to Cascade, including 5% premium plus accrued and unpaid interest in exchange for \$15.0 million of the note held by Cascade.

The option to sell the remaining \$10 million was secured by a collateralized letter of credit in which, for a period of time, a portion of the collateral was provided by an affiliate of the Vice Chairman. The company agreed to pay all legal fees, letter of credit fees and a 10% per annum collateral fee on the amount of collateral provided by the affiliate which at December 31, 2001 was valued at \$3.0 million. The Company expensed \$0.2 million and \$0.8 million in 2000 and 2001 relating to this agreement. Amounts payable at 2001 was \$0.3 million. The Company can replace the collateral at any time and the fees would be eliminated thereafter. As of December 31, 2001, the company had replaced \$7.5 million of the escrow collateral securing the above noted letter of credit by segregating \$7.5 million of U.S. Treasury Bills in a separate account and pledging this account to the issuers of the letter of credit. Subsequent to December 31, 2001, the remaining collateral of \$3.0 million was replaced by the Company. In November, 2002, Cascade exercised its ability to demand payment on the remaining \$10.0 million in notes and such payment was made plus the \$0.5 million premium. During the year ended December 31, 2002, the Company's total expense, interest and fees, associated with the \$10.0 million was \$0.7 million, of this amount \$0.1 million was paid to an affiliate of the Vice Chairman.

On January 31, 2001, a subsidiary of the Company borrowed \$27.0 million on a long-term basis, secured by the stock of Western New Mexico Telephone Company.

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\$15.9 million of the proceeds were used to acquire the Convertible Note of the Company owned by Cascade. The loan is to be repaid in equal monthly installments over twelve years beginning in April 2001, bearing interest at either the bank's prime rate or LIBOR plus 2.5%, or at the Company's option, it can be fixed for its term. The stock of Western New Mexico Telephone Company had previously been used to secure the acquisition facility, the balance of which was \$7.9 million prior to repayment in December 2000.

In January, 2003, a subsidiary of the Company borrowed \$3.0 million on a long term basis secured by the stock of Cuba City Telephone Exchange and Belmont Telephone Company.

The Company has a need for resources primarily to fund future long-term growth initiatives. The Company considers various alternative long-term financing sources: debt, equity, or sale of an investment asset. While management expects 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.

On March 26, 2003, the Company issued a press release and filed a Current Report on Form 8-K disclosing a planned rights offering of certain securities to its shareholders which is expected to be completed in 2003.

Cash payments for interest were \$12.0 million, \$14.6 million and \$14.0 million for the years ended December 31, 2000, 2001 and 2002, respectively. During the year ended December 31, 2000, 2001 and 2002, the Company capitalized interest of \$0.4 million, \$0.3 million and \$0.2 million respectively.

Aggregate principal maturities of long-term debt at December 31, 2002 for each of the next five years are as follows: 2003--\$18.3 million, 2004--\$27.4 million, 2005--\$11.7 million, 2006--\$37.9 million and 2007--\$10.4 million.

### 7. CLR Video, L.L.C.

At December 31, 2000, the Company owned a 60% interest in CLR Video, L.L.C., a provider of cable television services in northeast Kansas. In conjunction with the settlement of two pending lawsuits during 2001, CLR distributed certain of its assets to the holders of the remaining 40% interest in exchange for their interest in CLR and cash.

### 8. Related Party Transactions

Interactive leases its corporate headquarters from an affiliate of its Vice Chairman. The lease was renewed in December 2002 for five years and calls for an annual payment of \$103,000 including utilities. Prior to the renewal the annual payment was \$70,000. In addition, expenses relating to administrative support, transportation, and communications (approximately \$124,000, \$104,000 and \$104,000 for the years ended December 31, 2000, 2001 and 2002, respectively) are paid to an affiliate of its Vice Chairman. See Notes 1, 4 and 6 for additional references to related party transactions.

During 2000, in settlement of the fee for performance of services in connection with an acquisition, the Company transferred to an affiliate of the Vice Chairman of Interactive its stock ownership in Lynch Capital Corporation. Lynch Capital Corporation is a broker dealer that recorded revenues of \$6,000 and a net loss of \$16,000 in 2000. The Company recorded a \$61,000 pre-tax gain from this transfer in 2000.

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9. Shareholder's Equity

Subsequent to the spin-off by Lynch, the Board of Directors of Lynch Interactive authorized the purchase of up to 100,000 shares of its common stock. Through December 31, 2002, 32,115 shares have been purchased at an average cost of \$36.95 per share. Subsequent to year-end, the Company has purchased an additional 2,000 shares at an average cost of \$25.60 per share.

A two-for-one stock split was affected through a distribution to its shareholders of one share of Registrant's Common Stock for each share of Common Stock owned. The record date was August 28, 2000 with a distribution date of September 11, 2000. All shares and per share amounts have been adjusted to reflect the split.

Subsequent to December 31, 2002, the Company issued stock options to its newly hired President and Chief Operating Officer, covering 55,000 shares. The exercise prices are as follows: 20,000 at \$26.06 (market price at date of grant), 20,000 at \$36.06 and 15,000 at \$46.06. These options vest at one year, three years and four years from February 10, 2003. The Company is considering accounting for these options under the provisions of SFAS 123.

10. Income Taxes

Interactive files consolidated income tax returns with its subsidiaries for federal income tax purposes. Separate returns and in some cases consolidated returns, of subsidiary entities are filed with other governing authorities.

Deferred income taxes for 2001 and 2002 are provided for the temporary differences between the financial reporting bases and the tax bases of the Company's assets and liabilities. Cumulative temporary differences at December 31, 2001 and 2002 are as follows:

|  | Dec. 31, 2001 |           | Dec.  |
|--|---------------|-----------|-------|
|  | Deferred Tax  |           | Deffe |
|  | Asset         | Liability | Asset |
| -----  |               |           |       |
| (In Thousands)                                     |               |           |       |
| Fixed assets revalued under purchase               |               |           |       |
| accounting and tax over book depreciation .....    | \$ --         | \$ 7,283  | \$ -- |
| Discount on long-term debt .....                   | --            | 734       | 350   |
| Basis difference in subsidiary and affiliate stock | --            | 828       | --    |
| Unrealized gains on marketable securities .....    | --            | 2,153     | --    |
| Partnership tax losses in excess of book losses .. | --            | (4,547)   | --    |
| Other reserves and accruals .....                  | --            | 393       | --    |
| Other .....  | --            | --        | --    |
|  | -----         | -----     | ----- |
| Total deferred income taxes .....                  | --            | 6,844     | 350   |
| Valuation Allowance .....                          | --            | --        | (350) |
|  | -----         | -----     | ----- |
|  | \$ --         | \$ 6,844  | \$ -- |
|  | =====         | =====     | ===== |

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The provision (benefit) for income taxes before extraordinary item is summarized as follows:

|                        | 2000     | 2001     | 2002     |
|------------------------|----------|----------|----------|
| -----                  |          |          |          |
| (In Thousands)         |          |          |          |
| Current payable taxes: |          |          |          |
| Federal .....          | \$ 5,728 | \$ 3,438 | \$ 3,016 |
| State and local.....   | 1,344    | 740      | 510      |
|                        | -----    | -----    | -----    |
|                        | 7,072    | 4,178    | 3,526    |
| Deferred taxes:        |          |          |          |
| Federal .....          | (1,891)  | (671)    | 15       |
| State and local .....  | (210)    | (53)     | 383      |
|                        | -----    | -----    | -----    |
|                        | (2,101)  | (724)    | 398      |
|                        | -----    | -----    | -----    |
|                        | \$ 4,971 | \$ 3,454 | \$ 3,924 |
|                        | =====    | =====    | =====    |

A reconciliation of the provision (benefit) for income taxes before extraordinary item and the amount computed by applying the statutory federal income tax rate to income before income taxes, minority interest, and extraordinary item follows:

|   | 2000     | 2001     | 2002     |
|---|----------|----------|----------|
| -----   |          |          |          |
| (In Thousands)                                |          |          |          |
| Tax at statutory rate .....                   | \$ 3,673 | \$ 2,261 | \$ 2,963 |
| Increases (decreases):                        |          |          |          |
| State and local taxes, net of federal benefit | 779      | 453      | 589      |
| Amortization of non-deductible goodwill ..... | 880      | 596      | --       |
| Other .....                                   | (361)    | 144      | 372      |
|   | -----    | -----    | -----    |
|   | \$ 4,971 | \$ 3,454 | \$ 3,924 |
|   | =====    | =====    | =====    |

Net cash payments for income taxes were \$4.9 million, \$4.9 million and \$3.2 million for the years ended December 31, 2000, 2001 and 2002, respectively.

### 11. Accumulated Other Comprehensive Income

Balances of accumulated other comprehensive income, net of tax, which consists of unrealized gains (losses) on available for sale of securities at December 31, 2001 and 2002 are as follows (in thousands):

|                                    | Unrealized<br>Gain(Loss) | Tax Effect | Net      |
|------------------------------------|--------------------------|------------|----------|
| -----                              |                          |            |          |
| Balance at December 31, 2001 ..... | \$ 2,599                 | \$(1,057)  | \$ 1,542 |
| Reclassification adjustment .....  | (374)                    | 146        | (228)    |

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|  |         |          |        |
|--|---------|----------|--------|
| Change in unrealized gains (losses), net | (1,310) | 530      | (780)  |
|  | -----   | -----    | -----  |
| Balance at December 31, 2002 .....       | \$ 915  | \$ (381) | \$ 534 |
|  | =====   | =====    | =====  |

12. Employee Benefit Plans

Interactive maintains several defined contribution plans at its telephone subsidiaries and corporate office. Interactive's contributions under these plans, which vary by subsidiary, are based primarily on the financial performance of the business units and employee compensation. Total expense of these plans for the years ended December 31, 2000, 2001 and 2002 was \$0.9 million, \$0.9 million and \$1.0 million, respectively.

At the Registrant's Annual Meeting on May 11, 2000, the shareholders approved a Principal Executive Bonus Plan. No amounts were recognized under this program for the years ended December 31, 2000 and 2001 and \$0.3 million was recorded in 2002.

In addition, three of the Company's telephone subsidiaries participate in a multi-employer defined benefit plan, which is administrated by a telephone industry association. Under this plan accumulated benefits and plan assets are not determined or allocated separately by individual employees. Accordingly, such data is not currently available. Total expenses of these plans were \$0.1 million for each of the three years in the period ended December 31, 2002.

13. Commitments and Contingencies

Interactive is a party to routine litigation incidental to its business. Management believes that the ultimate resolution of these matters will not have a material adverse effect on the combined liquidity, financial position or results of operations of Lynch Interactive.

The Company leases certain land, buildings computer equipment, computer software, and network services equipment under non-cancelable operating leases that expire in various years through 2007. Certain leases have renewal options and escalation clauses. Rental expense under operating leases was \$0.4 million, \$0.3 million and \$0.3 million for years ended December 31, 2000, 2001 and 2002 respectively. The table below shows minimum lease payments due under non-cancelable operating leases at December 31, 2002.

|                  | Years Ended December 31, |           |           |           |           |
|------------------|--------------------------|-----------|-----------|-----------|-----------|
|                  | 2003                     | 2004      | 2005      | 2006      | 2007      |
| Operating leases | \$352,000                | \$306,000 | \$260,000 | \$214,000 | \$205,000 |

Additionally, Interactive and several other parties, including the Company's Chief Executive Officer, 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. Although the complaint was filed under seal with the court on February 14, 2001, and the seal was lifted on January 11, 2002, the defendants have yet to be formally served with the complaint. 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

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relator receives a statutory bounty from the government's litigation proceeds if he is successful.

The relator in this lawsuit is R.C. Taylor III, who is allegedly an attorney specializing in telecommunications law. 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 spectrum auctions restricted to small businesses, as well as obtaining bidding credits in other spectrum auctions allocated to "small" and "very small" businesses. The lawsuit seeks to recover an unspecified amount of damages, which would be subject to mandatory trebling under the statute.

Interactive strongly believes that this lawsuit is completely without merit and will have no material adverse effect on the Company's financial condition or results of operations, 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, the Company cannot predict the ultimate outcome of the litigation, nor can the Company predict the effect that the lawsuit or its outcome will have on our business, plan of operation, financial condition or results of operations.

#### 14. Segment Information

As a result of the decision to spin off its investment in Morgan (see Note 2), the Company is engaged in one business segment: multimedia. All businesses are located domestically, and substantially all revenues are domestic. The Company's operations include local telephone companies, a cable TV company, investment in PCS entities and investment in two network-affiliated television stations. The Company's primary operations are located in the states of Iowa, Kansas, Michigan, New Hampshire, New Mexico, New York, North Dakota, Utah, and Wisconsin. 74% of the Company's telephone customers are residential. The remaining customers are businesses.

EBITDA (before corporate allocation) is equal to operating profit before interest, taxes, depreciation, amortization and allocated corporate expenses. EBITDA is presented because it is a widely accepted financial indicator of value and ability to incur and service debt. EBITDA is not a substitute for operating income or cash flows from operating activities in accordance with accounting principles generally accepted in the United States.

Operating profit is equal to revenues less operating expenses, including unallocated general corporate expenses, and excluding interest and income taxes. The Company allocates a portion of its general corporate expenses to its operating segment. Such allocation was \$1.3 million for each of the years ended December 31, 2000, 2001 and 2002. Identifiable assets of the operating segment are the assets used by the segment in its operations excluding general corporate assets. General corporate assets are principally cash and cash equivalents, short-term investments and certain other investments and receivables.

|                                      | Years Ended December |           |
|--------------------------------------|----------------------|-----------|
|                                      | 2000                 | 2001      |
|                                      | (In thousands)       |           |
| Sales and revenues .....             | \$ 66,983            | \$ 79,352 |
| EBITDA (before corporate allocation) |                      |           |
| Operations .....                     | 34,699               | 41,274    |

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|  |            |            |     |
|--|------------|------------|-----|
| Unallocated corporate expense .....  | (3,671)    | (3,006)    |     |
|  | -----      | -----      | --- |
| Consolidated total .....   | \$ 31,028  | \$ 38,268  | \$  |
|  | =====      | =====      | ==  |
| Operating Profit   |            |            |     |
| Operations .....   | \$ 17,531  | \$ 21,534  | \$  |
| Corporate expense, net .....   | (2,200)    | (1,549)    |     |
|  | -----      | -----      | --- |
| Consolidated total .....   | \$ 15,331  | \$ 19,985  | \$  |
|  | =====      | =====      | ==  |
| Depreciation and amortization  |            |            |     |
| Operations .....   | \$ 15,781  | \$ 18,268  | \$  |
| General corporate .....  | 16         | 15         |     |
|  | -----      | -----      | --- |
| Consolidated total .....   | \$ 15,797  | \$ 18,283  | \$  |
|  | =====      | =====      | ==  |
| Capital expenditures   |            |            |     |
| Operations .....   | \$ 17,196  | \$ 20,524  | \$  |
| General corporate .....  | 12         | 9          |     |
|  | -----      | -----      | --- |
|  | \$ 17,208  | \$ 20,533  | \$  |
|  | =====      | =====      | ==  |
| Total assets (excludes total assets of Morgan Group Holding Co. ..<br>of \$22,668, \$22,998 and \$0, respectively) |            |            |     |
| Operations .....   | \$ 211,562 | \$ 247,034 | \$  |
| General corporate .....  | 6,180      | 9,316      |     |
|  | -----      | -----      | --- |
| Consolidated total .....   | \$ 217,742 | \$ 256,350 | \$  |
|  | =====      | =====      | ==  |
| Operating profit for reportable segments .....   | \$ 15,331  | \$ 19,985  | \$  |
| Other profit or loss:  |            |            |     |
| Investment income .....  | 3,260      | 2,862      |     |
| Interest expense .....   | (13,568)   | (13,936)   |     |
| Equity in earnings of affiliated companies .....   | 1,669      | 932        |     |
| Reserve for impairment of investment in PCS license holders ....   | --         | --         |     |
| Gain on sales of subsidiary and affiliate stock and other assets   | 4,187      | --         |     |
| Impairment of Spinnaker Industries, Inc. ....  | --         | (3,194)    |     |
|  | -----      | -----      | --- |
| Income (loss) before income taxes, minority interest and<br>operations of Morgan .....                             | \$ 10,879  | \$ 6,649   | \$  |
|  | =====      | =====      | ==  |

Substantially, all long-lived assets are attributable to Multimedia operations.

15. Quarterly Results of Operations (Unaudited)

|                          | 2001-Three Months Ended (a)              |           |                  |                 |
|--------------------------|--|-----------|------------------|-----------------|
|                          | March 31                                 | June 30   | September 30 (b) | December 31 (d) |
|                          | -----                                    |           |                  |                 |
|                          |  |           |                  |                 |
|                          | -----                                    |           |                  |                 |
|                          | (In thousands, except per share amounts) |           |                  |                 |
| Sales and revenues ..... | \$ 17,209                                | \$ 17,451 | \$ 23,934        | \$ 20,758       |

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|  |         |          |          |            |
|--|---------|----------|----------|------------|
| Operating profit .....                       | 3,649   | 4,230    | 8,365    | 3,741      |
| Income (loss) from continuing operations (c) | 610     | 971      | 1,785    | (832)      |
| Net Income (Loss) .....                      | \$ 309  | \$ 1,319 | \$ 1,595 | \$ (2,075) |
| Basic and diluted earnings per share (b):    |         |          |          |            |
| Income (loss) from continuing operations (e) | \$ 0.22 | \$ 0.34  | \$ 0.63  | \$ (0.30)  |
| Net income (loss) .....                      | \$ 0.11 | \$ 0.47  | \$ 0.57  | \$ (0.74)  |

2002-Three Months Ended (g)

|   | March 31 (e) | June 30   | September 30 (f) | December 31 |
|---|--------------|-----------|------------------|-------------|
| (In thousands, except for per share amounts)                |              |           |                  |             |
| Sales and revenues .....                                    | \$ 20,974    | \$ 21,098 | \$ 22,983        | \$ 21,098   |
| Operating profit .....                                      | 5,244        | 4,457     | 5,891            | 3,741       |
| Income (loss) from continuing operations (e)                | 4,273        | 905       | (1,872)          | (832)       |
| Net income (loss) .....                                     | \$ 2,385     | \$ 905    | \$ (1,872)       | \$ (2,075)  |
| Basic and diluted earnings per share (b):                   |              |           |                  |             |
| Basic: Income (loss) from continuing operations (c) .....   | \$ 1.52      | \$ 0.32   | \$ (0.67)        | \$ (0.30)   |
| Diluted: Income (loss) from continuing operations (e) ..... | \$ 1.45      | \$ 0.32   | \$ (0.67)        | \$ (0.30)   |
| Basic: Net Income (loss) .....                              | \$ 0.85      | \$ 0.32   | \$ (0.67)        | \$ (0.74)   |
| Diluted: Net Income (loss) .....                            | \$ 0.83      | \$ 0.32   | \$ (0.67)        | \$ (0.74)   |

16. Earnings (Loss) Per Share

Basic and dilutive earnings per share are based on the average weighted number of shares outstanding. On December 13, 1999, Lynch Interactive issued a \$25 million 6% convertible promissory note, which was convertible into 588,235 shares of the Company's common stock. In January 2001, \$15 million of the note was repaid. The remaining \$10 million convertible note was convertible into 235,294 shares of the Company's common stock. In November, 2002 the remaining \$10 million was repaid. This security was excluded from the calculation of dilutive earnings (loss) per share in all periods presented, since assuming conversion would have been anti-dilutive.

SCHEDULE I - CONDENSED FINANCIAL INFORMATION OF REGISTRANT  
 LYNCH INTERACTIVE CORPORATION  
 CONDENSED STATEMENT OF OPERATIONS

| Years Ended December 31, |      |      |
|--------------------------|------|------|
| 2000                     | 2001 | 2002 |
| (In Thousands)           |      |      |



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|   |          |          |          |
|---|----------|----------|----------|
| Interest, Dividends & Gains on Sale of Marketable Securities                  | \$ 278   | \$ 891   | \$ 169   |
| Interest and Other Income from Subsidiaries .....                             | 280      | 313      | --       |
|   | -----    | -----    | -----    |
| TOTAL INCOME .....  | 558      | 1,204    | 169      |
| Cost and Expenses:  |          |          |          |
| Unallocated Corporate Administrative Expense .....                            | 2,248    | 1,549    | 1,936    |
| Interest Expense .....  | 4,115    | 4,612    | 1,620    |
|   | -----    | -----    | -----    |
| TOTAL COST AND EXPENSES .....   | 6,363    | 6,161    | 3,556    |
|   | -----    | -----    | -----    |
| LOSS BEFORE INCOME TAXES AND EQUITY IN<br>INCOME (LOSS) OF SUBSIDIARIES ..... | (5,805)  | (4,957)  | (3,386)  |
| Income Tax Benefit .....  | 1,974    | 1,685    | 1,151    |
| Equity in Income (Loss) of Subsidiaries .....                                 | 8,862    | 5,806    | 5,996    |
| Loss from operations of Morgan - Net .....                                    | (2,666)  | (1,386)  | (1,888)  |
|   | -----    | -----    | -----    |
| NET INCOME .....  | \$ 2,365 | \$ 1,148 | \$ 1,873 |
|   | =====    | =====    | =====    |

NOTES TO CONDENSED FINANCIAL STATEMENTS

NOTE A - BASIS OF PRESENTATION

In the parent company's financial statements, the Company's investment in subsidiaries is stated at cost plus equity in undistributed earnings of the subsidiaries.

NOTE B - DIVIDENDS FROM SUBSIDIARIES

No dividends were received from subsidiaries in any period.

NOTE C - LONG-TERM DEBT

Lynch Interactive Corporation ("Interactive") was spun-off from Lynch Corporation on September 1, 1999. Interactive has a note payable to a subsidiary, with a principal amount of \$8.0 million at December 31, 2002, at a fixed interest rate of 6% per annum, due in 2004. The note is convertible, at the subsidiary's option, into common stock of Lynch Corporation (1 share) and Interactive (2 shares) with a combined exercise price of \$120 per share.

NOTE D - SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR ADDITIONAL INFORMATION.

NOTE E - PRIOR REPORTING PERIODS ARE RECLASSIFIED TO CONFORM WITH CURRENT YEAR REPORTING PRESENTATIONS

SCHEDULE I - CONDENSED FINANCIAL INFORMATION OF REGISTRANT  
LYNCH INTERACTIVE CORPORATION

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CONDENSED BALANCE SHEETS

|   | Years Ended December 31, |          |
|---|--------------------------|----------|
|   | 2001                     | 2002     |
|   | -----                    |          |
|   | (In Thousands)           |          |
| ASSETS  |                          |          |
| CURRENT ASSETS  |                          |          |
| Cash and Cash Equivalents .....                                       | \$ 62                    | \$ 133   |
| Restricted Cash .....   | 7,569                    | --       |
| Deferred Income Taxes .....   | 85                       | 85       |
| Other current assets .....  | 158                      | 63       |
|   | -----                    | -----    |
|   | 7,874                    | 281      |
| OFFICE EQUIPMENT (Net) .....  | 24                       | 13       |
| OTHER ASSETS (Principally Investment in and Advances to Subsidiaries) | 84,543                   | 43,242   |
|   | -----                    | -----    |
| TOTAL ASSETS .....  | \$92,441                 | \$43,536 |
|   | =====                    | =====    |
| LIABILITIES AND SHAREHOLDERS' EQUITY                                  |                          |          |
| CURRENT LIABILITIES .....   | \$21,778                 | \$10,929 |
| LONG TERM DEBT .....  | 44,100                   | 7,995    |
| DEFERRED CREDITS .....  | 2,046                    | 1,980    |
| TOTAL SHAREHOLDERS' EQUITY .....                                      | 24,517                   | 22,632   |
|   | -----                    | -----    |
| Total Liabilities and Shareholders' Equity .....                      | \$92,441                 | \$43,536 |
|   | =====                    | =====    |

SCHEDULE I - CONDENSED FINANCIAL INFORMATION OF REGISTRANT  
 LYNCH INTERACTIVE CORPORATION  
 CONDENSED STATEMENT OF CASH FLOWS

|  | Years Ended December 31, |      |      |
|--|--------------------------|------|------|
|  | 2000                     | 2001 | 2002 |
|  | -----                    |      |      |
|  | (In Thousands)           |      |      |

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|  |            |            |            |
|--|------------|------------|------------|
| Cash Provided by (Used In) Operating Activities .....        | \$ (1,355) | \$ (3,924) | \$ (2,298) |
|  | -----      | -----      | -----      |
| INVESTING ACTIVITIES:  |            |            |            |
| Investment and Advances to Brighton Communications           | 843        | (12,861)   | 3,497      |
| Proceeds from sale of securities .....                       | --         | 1,679      | --         |
| Purchase of securities .....                                 | --         | --         | (158)      |
|  | -----      | -----      | -----      |
| NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES          | 843        | (11,182)   | 3,339      |
|  | -----      | -----      | -----      |
| FINANCING ACTIVITIES:  |            |            |            |
| Net Borrowings Under:  |            |            |            |
| Lines of Credit .....  | --         | 7,700      | 2,400      |
| Issuance of Long Term Debt .....                             | 171        | 27,784     | --         |
| Repayment of Long Term Debt .....                            | --         | (15,121)   | (10,008)   |
| Purchase of Treasury Stock .....                             | --         | (88)       | (931)      |
| Other .....  | (132)      | 11         | --         |
|  | -----      | -----      | -----      |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES          | 39         | 20,286     | (8,539)    |
|  | -----      | -----      | -----      |
| TOTAL INCREASE (DECREASE) CASH AND CASH<br>EQUIVALENTS ..... | (473)      | 5,180      | (7,498)    |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR .....         | 2,924      | 2,451      | 7,631      |
|  | -----      | -----      | -----      |
| CASH AND CASH EQUIVALENTS AT END OF YEAR .....               | \$ 2,451   | \$ 7,631   | \$ 133     |
|  | =====      | =====      | =====      |

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

LYNCH INTERACTIVE CORPORATION  
YEARS ENDED DECEMBER 31, 2000, 2001 AND 2002

| COLUMN A<br>DESCRIPTION                       | COLUMN B<br>BALANCE AT<br>BEGINNING<br>OF PERIOD | COLUMN C - ADDITIONS<br>CHARGED TO<br>COSTS AND<br>EXPENSES | COLUMN D<br>DEDUCTIONS<br>DESCRIBE | COLUMN E<br>BALANCE A<br>END OF<br>PERIOD |
|---|--|---|------------------------------------|---|
|   |  |   |                                    |   |
| Year Ended December 31, 2002                  |  |   |                                    |   |
| Allowance for Uncollectible<br>Accounts ..... | \$ 424,000                                       | \$1,037,000   | \$                                 | \$ 316,0                                  |
|   |  |   | \$1,145,000 (A)                    |   |

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|                              |            |            |               |               |            |
|------------------------------|------------|------------|---------------|---------------|------------|
| Year Ended December 31, 2001 |            |            |               |               |            |
| Allowance for Uncollectible  |            |            |               |               |            |
| Accounts .....               | \$ 155,000 | \$ 276,000 | \$ 22,000 (B) | \$ 29,000 (A) | \$ 424,000 |
| Year Ended December 31, 2000 |            |            |               |               |            |
| Allowance for Uncollectible  |            |            |               |               |            |
| Accounts .....               | \$ 102,000 | \$ 123,000 | \$ 0          | \$ 70,000 (A) | \$ 155,000 |

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and 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

By: /s/ Robert E. Dolan

-----  
 ROBERT E. DOLAN  
 Chief Financial Officer (Principal  
 Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature   | Capacity  | Date           |
|---|---|----------------|
| *s/ Mario J. Gabelli<br>-----<br>MARIO J. GABELLI       | Vice Chairman of the Board of<br>Directors and Chief Executive<br>Officer (Principal Executive Officer) | March 28, 2003 |
| *s/ Frederic V. Salerno<br>-----<br>FREDERIC V. SALERNO | Chairman of the Board of<br>Directors   | March 28, 2003 |
| *s/ Paul J. Evanson<br>-----<br>PAUL J. EVANSON         | Director  | March 28, 2003 |

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|   |   |                |
|---|---|----------------|
| *s/ John C. Ferrara<br>-----<br>JOHN C. FERRARA                     | Director  | March 28, 2003 |
| *s/ Daniel R. Lee<br>-----<br>DANIEL R. LEE                         | Director  | March 28, 2003 |
| *s/ David C. Mitchell<br>-----<br>DAVID C. MITCHELL                 | Director  | March 28, 2003 |
| *s/ Salvatore Muoio<br>-----<br>SALVATORE MUOIO                     | Director  | March 28, 2003 |
| *s/ Vincent S. Tese<br>-----<br>VINCENT S. TESE                     | Director  | March 28, 2003 |
| /s/ Robert E. Dolan<br>-----<br>ROBERT E. DOLAN                     | Chief Financial Officer<br>Principal Financial<br>and Accounting Officer) | March 28, 2003 |
| *s/ Robert E. Dolan<br>-----<br>ROBERT E. DOLAN<br>Attorney-in-fact |   |                |

CERTIFICATIONS

I, Mario J. Gabelli, certify that:

1. I have reviewed this annual report on Form 10-K of Lynch Interactive Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

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3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 31, 2003

/s/ Mario J. Gabelli

-----  
MARIO J. GABELLI,  
Chief Executive Officer of  
Lynch Interactive Corporation

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I, Robert E. Dolan, certify that:

1. I have reviewed this annual report on Form 10-K of Lynch Interactive Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

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- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 31, 2003

/s/ Robert E. Dolan  
-----

ROBERT E. DOLAN,  
Chief Executive Officer of  
Lynch Interactive Corporation

### EXHIBIT INDEX

| Exhibit No.<br>----- | Description<br>-----  |
|----------------------|---|
| 2                    | Separation Agreement(1)   |
| 3.1                  | Amended and Restated Certificate of Incorporation of Registrant (1)   |
| 3.2                  | Amended By-laws of Registrant+  |
| 4.1                  | Mortgage, Security Agreement and Financing Statement among Haviland Telephone Company, Inc., the United States of America and the Rural Telephone Bank(1)   |
| 4.2                  | Restated Mortgage, Security Agreement and Financing Statement between Western New Mexico Telephone Company, Inc. and the United States of America(1)  |
| 10                   | (a) Partnership Agreement dated March 11, 1987, between Lombardo Communications, Inc. and Lynch Entertainment Corporation (incorporated by reference to Exhibit 10(e) of the Lynch Corporation("Lynch")'s Annual Report on Form 10-K for the year ended December 31, 1987). |
| 10                   | (b) Lynch Corporation 401(k) Savings Plan (incorporated by reference to Exhibit 10(b) to Lynch's Form 10-K for the year ended December 31, 1995).   |
| 10                   | (c) Shareholders Agreement among Capital Communications Company, Inc., Lombardo Communications, Inc. and Lynch Entertainment Corporation II (incorporated by reference to Exhibit 10 of Lynch's Form 8-K,   |



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dated March 14, 1994).

- 10 (d) (i) Loan Agreement, dated as of November 6, 1995, between Lynch PCS Corporation A and Aer Force Communications L.P. (now Fortunet Wireless, L.P.) (plus four similar loan agreements with Fortunet Wireless, L.P.) (incorporated by reference to Exhibit 10(w) to Lynch's Form 10-K for the year ended December 31, 1995).
- 10 (d) (ii) Amendment No. 1 to the Loan Agreement, dated as of November 6, 1995, referred to in 10(d) (i) incorporated by reference to Exhibit 10(a) to Lynch's Form 10-Q for quarter ended March 31, 1996).
- 10 (e) (i) Letter Agreement, dated as of August 12, 1996, between Rivgam Communicators, L.L.P. and Lynch PCS Corporation G (incorporated by reference to Exhibit 10(u) (ii) to Lynch's Form 10-K for the year ended December 31, 1996).
- 10 (f) (ii) Letter Agreement dated as of December 16, 1998, between Rivgam Communicators, L.L.P. and Lynch PCS Corporation G (incorporated by reference in Exhibit 10(u) (iv) to Lynch's Form 10-K for the year ended December 31, 1998).
- 10 (f) Letter Agreement between Lynch PCS Corporation G and Bal/Rivgam, L.L.C. (incorporated by reference to Exhibit 10(x) to Lynch's Form 10-Q for the Quarter ended September 30, 1997).
- 10 (g) Letter Agreement, dated January 20, 1998, between Lynch PCS Corporation G and BCK/Rivgam, L.L.C. (incorporated by reference to Exhibit 10(y) to Lynch's Form 10-K for the year ended December 31, 1997).
- 10 (h) 2000 Stock Option Plan (incorporated by reference to the Exhibit to Registrant's Proxy Statement dated April 18, 2000).
- 10 (i) Lease Agreement between Lynch and Gabelli Funds, Inc. (incorporated by reference to Exhibit 10(a) (a) to Lynch's Form 10-Q for the Quarter ended March 31, 1998).
- 10 (j) Letter Agreement dated November 11, 1998, between Registrant and Gabelli & Company, Inc. (incorporated by reference to Exhibit 10(c) (c) to Lynch Form 10-K for the year ended December 31, 1998).
- 10 (l) Agreement and Plan of Merger dated as of May 25, 1999, among Central Scott Telephone Company, Brighton Communications Corporation and Brighton Iowa Acquisition Corporation (schedules omitted) (incorporated by reference to Exhibit 10.1 to Lynch's Form 8-K dated July 16, 1999).
- 10 (m) Separation and Distribution Agreement, dated as of January 18, 2002, by and among Lynch Interactive Corporation, Morgan Group Holding Co. and The Morgan Group, Inc.(2)

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- 10 (n) Employment Agreement, dated as of August 1, 2001, between John Fikre and Lynch Interactive Corporation(2)
- 21 Subsidiaries of Registrant(2)
- 23 Consents of Siepert & Co., L.L.P. for use of: +
- Report of Siepert & Co., L.L.P. on the financial statements of Cuba City Telephone Exchange Company for the year ended December 31, 2002 and 2001
  - Report of Siepert & Co., L.L.P. on the financial statements of Belmont Telephone Company for the year ended December 31, 2002 and 2001
  - Report of Siepert & Co., L.L.P. on the financial statements of Upper Peninsula Telephone Company for the year ended December 31, 2002 and 2001
  - Report of Siepert & Co., L.L.P. on the financial statements of Lynch Michigan Telephone Holding Company for the year ended December 31, 2001 and 2000
- 24 Powers of Attorney+
- 99.1 Report of Independent Auditors+
- Report of Siepert & Co., L.L.P. on the financial statements of Cuba City Telephone Exchange Company for the year ended December 31, 2002 and 2001
  - Report of Siepert & Co., L.L.P. on the financial statements of Belmont Telephone Company for the year ended December 31, 2002 and 2001
  - Report of Siepert & Co., L.L.P. on the financial statements of Lynch Michigan Telephone Holding Corporation for the year ended December 31, 2002 and 2001
  - Report of Siepert & Co., L.L.P. on the financial statements of Lynch Michigan Telephone Holding Company for the year ended December 31, 2001 and 2000
- 99.2 Chief Executive Officer Section 906 Certification+
- 99.3 Chief Financial Officer Section 906 Certification+
- + Filed herewith.
- (1) Incorporated by reference to the exhibits to the Registrant's Registration Statement on Form 10A-1.
- (2) Incorporated by reference to the exhibits to the Registrant's Annual Report on Form 10-K Report for the fiscal year ended December 31, 2001.

The Exhibits listed above have been filed separately with the Securities and Exchange Commission in conjunction with this Annual Report on Form 10-K or have

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been incorporated by reference into this Annual Report on Form 10-K. Lynch Interactive Corporation will furnish to each of its shareholders a copy of any such Exhibit for a fee equal to Lynch Interactive Corporation's cost in furnishing such Exhibit. Requests should be addressed to the Office of the Secretary, Lynch Interactive Corporation, 401 Theodore Fremd Avenue, Rye, New York 10580.