

GRAY TELEVISION INC
Form 10-Q
August 12, 2010

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

(Mark one)

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2010 or**

**Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____ .**

**Commission file number 1-13796
Gray Television, Inc.**

(Exact name of registrant as specified in its charter)

Georgia

58-0285030

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

4370 Peachtree Road, NE, Atlanta, Georgia

30319

(Address of principal executive offices)

(Zip code)

(404) 504-9828

(Registrant's telephone number, including area code)

Not Applicable

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and small reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer
(do not check if a smaller reporting company)

Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

Common Stock, (No Par Value)
51,382,793 shares outstanding as of August 11, 2010

Class A Common Stock, (No Par Value)
5,753,020 shares outstanding as of August 11, 2010

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

GRAY TELEVISION, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)
(in thousands)

	June 30, 2010	December 31, 2009
Assets:		
Current assets:		
Cash	\$ 15,714	\$ 16,000
Trade accounts receivable, less allowance for doubtful accounts of \$826 and \$1,092, respectively	53,793	57,179
Current portion of program broadcast rights, net	3,153	10,220
Deferred tax asset	1,597	1,597
Prepaid and other current assets	3,056	1,788
 Total current assets	 77,313	 86,784
 Property and equipment, net	 138,654	 148,092
Deferred loan costs, net	13,322	1,619
Broadcast licenses	818,981	818,981
Goodwill	170,522	170,522
Other intangible assets, net	1,074	1,316
Investment in broadcasting company	13,599	13,599
Other	4,552	4,826
 Total assets	 \$ 1,238,017	 \$ 1,245,739

See notes to condensed consolidated financial statements.

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GRAY TELEVISION, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)
(in thousands)

	June 30, 2010	December 31, 2009
Liabilities and stockholders equity:		
Current liabilities:		
Trade accounts payable	\$ 3,827	\$ 6,047
Employee compensation and benefits	9,197	9,675
Accrued interest	10,953	13,531
Other accrued expenses	4,312	4,814
Interest rate hedge derivatives		6,344
Federal and state income taxes	4,122	4,206
Current portion of program broadcast obligations	8,317	15,271
Acquisition related liabilities	863	863
Deferred revenue	6,215	6,241
Current portion of long-term debt	5,011	8,080
 Total current liabilities	 52,817	 75,072
 Long-term debt, less current portion	 841,761	 783,729
Long-term accrued facility fee	26,139	18,307
Program broadcast obligations, less current portion	1,353	1,531
Deferred income taxes	141,387	142,204
Long-term deferred revenue	2,345	2,638
Long-term accrued dividends	10,777	18,917
Accrued pension costs	14,427	13,969
Other	1,972	2,366
 Total liabilities	 1,092,978	 1,058,733
 Commitments and contingencies (Note 8)		
 Preferred stock, no par value; cumulative; redeemable; designated 1.00 shares, issued and outstanding 0.39 and 1.00 shares, respectively (\$39,307 and \$100,000 aggregate liquidation value, respectively)		
	36,945	93,386
 Stockholders equity:		
Common stock, no par value; authorized 100,000 shares, issued 56,037 shares and 47,530 shares, respectively	479,641	453,824
Class A common stock, no par value; authorized 15,000 shares, issued 7,332 shares	15,321	15,321
Accumulated deficit	(318,911)	(303,698)
Accumulated other comprehensive loss, net of income tax benefit	(5,444)	(9,314)

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Treasury stock at cost, common stock, 4,655 shares	170,607	156,133
	(40,115)	(40,115)
Treasury stock at cost, Class A common stock, 1,579 shares	(22,398)	(22,398)
Total stockholders' equity	108,094	93,620
Total liabilities and stockholders' equity	\$ 1,238,017	\$ 1,245,739

See notes to condensed consolidated financial statements.

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GRAY TELEVISION, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(in thousands except for per share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Revenues (less agency commissions)	\$ 75,636	\$ 65,057	\$ 146,118	\$ 126,411
Operating expenses before depreciation, amortization and gain on disposal of assets, net:				
Broadcast	46,092	45,167	93,659	90,821
Corporate and administrative	3,837	3,592	6,759	7,638
Depreciation	7,931	8,253	15,906	16,514
Amortization of intangible assets	120	145	242	294
Gain on disposals of assets, net	(480)	(1,098)	(524)	(2,620)
	57,500	56,059	116,042	112,647
Operating income	18,136	8,998	30,076	13,764
Other income (expense):				
Miscellaneous income, net	19	1	58	13
Interest expense	(17,431)	(20,007)	(37,042)	(30,120)
Loss on early extinguishment of debt			(349)	(8,352)
Income (loss) before income taxes	724	(11,008)	(7,257)	(24,695)
Income tax expense (benefit)	190	(4,360)	(3,048)	(9,127)
Net income (loss)	534	(6,648)	(4,209)	(15,568)
Preferred dividends (includes accretion of issuance cost of \$3,952, \$301, \$4,253, and \$602, respectively)	6,453	4,051	11,004	8,101
Net loss available to common stockholders	\$ (5,919)	\$ (10,699)	\$ (15,213)	\$ (23,669)
Basic and diluted per share information:				
Net loss available to common stockholders	\$ (0.11)	\$ (0.22)	\$ (0.30)	\$ (0.49)
Weighted-average shares outstanding	54,453	48,506	51,525	48,498
Dividends declared per common share	\$	\$	\$	\$

See notes to condensed consolidated financial statements.

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GRAY TELEVISION, INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE
LOSS (Unaudited)

(in thousands except for number of shares)

	Class A Common Stock		Common Stock		Accumulated Deficit	Class A Treasury Stock		Common Treasury Stock		Accumulated Other Comprehensive Loss	Total
	Shares	Amount	Shares	Amount		Shares	Amount	Shares	Amount		
Balance at September 30, 2009	7,331,574	\$ 15,321	47,529,502	\$ 453,824	\$ (303,698)	(1,578,554)	\$ (22,398)	(4,654,750)	\$ (40,115)	\$ (9,314)	\$ 9,314
Net income					(4,209)						
Dividends, net of income tax										3,870	
Comprehensive income											
Issuance of common stock					(11,004)						(11,004)
Change in fair value of common stock:											
Change for issued stock			8,500,000	25,585							25,585
Employee stock plan			7,048	15							15
Share-based compensation				217							217
Balance at September 30, 2010	7,331,574	\$ 15,321	56,036,550	\$ 479,641	\$ (318,911)	(1,578,554)	\$ (22,398)	(4,654,750)	\$ (40,115)	\$ (5,444)	\$ 5,444

See notes to condensed consolidated financial statements.

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GRAY TELEVISION, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(in thousands)

	Six Months Ended	
	June 30,	
	2010	2009
Operating activities		
Net loss	\$ (4,209)	\$ (15,568)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	15,906	16,514
Amortization of intangible assets	242	294
Amortization of deferred loan costs	634	181
Amortization of notes original issue discount	225	
Amortization of restricted stock awards	116	122
Amortization of stock option awards	101	576
Write-off loan acquisition costs from early extinguishment of debt	349	8,352
Accrual of long-term facility fee	7,832	
Amortization of program broadcast rights	7,705	7,531
Payments on program broadcast obligations	(7,728)	(7,656)
Common stock contributed to 401(k) Plan	15	133
Deferred income taxes	(3,291)	(9,010)
Gain on disposal of assets, net	(524)	(2,620)
Pension expense net of contributions	463	752
Other	(386)	(311)
Changes in operating assets and liabilities:		
Receivables and other current assets	2,368	4,001
Accounts payable and other current liabilities	(3,278)	(7,306)
Accrued interest	(2,579)	4,392
Net cash provided by operating activities	13,961	377
Investing activities		
Purchases of property and equipment	(6,150)	(9,485)
Proceeds from asset sales	246	9
Equipment transactions related to spectrum reallocation, net	(72)	(131)
Payments on acquisition-related liabilities	(304)	(352)
Other	(18)	361
Net cash used in investing activities	(6,298)	(9,598)
Financing activities		
Proceeds from borrowings on long-term debt	358,010	
Repayments of borrowings on long-term debt	(303,273)	(4,531)
Deferred loan costs	(12,686)	(7,111)
Dividends paid, net of accreted preferred dividend	(14,892)	
Redemption of preferred stock	(60,693)	

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Proceeds from issuance of common stock	25,585	
Net cash used in financing activities	(7,949)	(11,642)
Net decrease in cash	(286)	(20,863)
Cash at beginning of period	16,000	30,649
Cash at end of period	\$ 15,714	\$ 9,786

See notes to condensed consolidated financial statements.

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Table of Contents**GRAY TELEVISION, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)****1. Basis of Presentation**

The accompanying condensed consolidated balance sheet as of December 31, 2009, which was derived from the audited financial statements as of December 31, 2009 of Gray Television, Inc. (we , us , our , Gray or the Company) our accompanying unaudited condensed consolidated financial statements as of and for the period ended June 30, 2010 have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, such financial statements do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In our opinion, all adjustments considered necessary for a fair statement have been included. Our operations consist of one reportable segment. For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2009 (the 2009 Form 10-K). Operating results for the three-month and six-month periods ended June 30, 2010 are not necessarily indicative of the results that may be expected for any future interim period or for the year ending December 31, 2010.

Seasonality

Broadcast advertising revenues are generally highest in the second and fourth quarters each year, due in part to increases in advertising in the spring and in the period leading up to and including the holiday season. In addition, broadcast advertising revenues are generally higher during even numbered years due to spending by political candidates, which spending typically is heaviest during the fourth quarter.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires our management to make estimates and assumptions that affect the amounts reported in the unaudited condensed consolidated financial statements and the notes to the unaudited condensed consolidated financial statements. Our actual results could differ from these estimates. Estimates are used for the allowance for doubtful accounts in receivables, valuation of goodwill and intangible assets, amortization of program rights and intangible assets, stock-based compensation, pension costs, income taxes, employee medical insurance claims, useful lives of property and equipment, contingencies and litigation.

Earnings Per Share

We compute basic earnings per share by dividing net income by the weighted-average number of common shares outstanding during the relevant period. The weighted-average number of common shares outstanding does not include unvested restricted shares. These shares, although classified as issued and outstanding, are considered contingently returnable until the restrictions lapse and are not included in the basic earnings per share calculation until the shares are vested. Diluted earnings per share is computed by including all potentially dilutive common shares issuable, including restricted stock and stock options in the diluted weighted-average shares outstanding calculation. The following table reconciles basic weighted-average shares outstanding to diluted weighted-average shares outstanding for the three-month and six-month periods ended June 30, 2010 and 2009 (in thousands):

		Three Months Ended		Six Months Ended	
		June 30,		June 30,	
		2010	2009	2010	2009
Weighted-average shares outstanding	basic	54,453	48,506	51,525	48,498
Stock options and restricted stock					
Weighted-average shares outstanding	diluted	54,453	48,506	51,525	48,498

Table of Contents**1. Basis of Presentation (Continued)***Earnings Per Share (Continued)*

For periods in which we reported losses, all potentially dilutive common shares are excluded from the computation of diluted earnings per share, since their inclusion would be antidilutive. Securities that could potentially dilute earnings per share in the future, but which were not included in the calculation of diluted earnings per share because their inclusion would have been antidilutive for the periods presented are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Potentially dilutive common shares outstanding at end of period:				
Employee stock options	1,152	1,926	1,152	1,926
Unvested restricted stock	66	100	66	100
Total	1,218	2,026	1,218	2,026

Accumulated Other Comprehensive Loss

Our accumulated other comprehensive loss balances as of June 30, 2010 and December 31, 2009 consist of adjustments to our derivative liability as follows (in thousands):

	June 30,	December
	2010	31,
		2009
Accumulated balances of items included in accumulated other comprehensive loss:		
Cumulative loss on derivatives, net of income tax	\$	\$ (3,870)
Pension liability adjustments, net of income tax	(5,444)	(5,444)
Accumulated other comprehensive loss	\$ (5,444)	\$ (9,314)

Property and Equipment

Property and equipment are carried at cost. Depreciation is computed principally by the straight-line method. Buildings, towers, improvements and equipment are generally depreciated over estimated useful lives of approximately 35 years, 20 years, 10 years and 5 years, respectively. Maintenance, repairs and minor replacements are charged to operations as incurred; and major replacements and betterments are capitalized. The cost of any assets sold or retired and the related accumulated depreciation are removed from the accounts at the time of disposition, and any resulting profit or loss is reflected in income or expense for the period.

Table of Contents**1. Basis of Presentation (Continued)***Property and Equipment (Continued)*

The following table lists components of property and equipment by major category (in thousands):

	June 30, 2010	December 31, 2009
Property and equipment:		
Land	\$ 23,052	\$ 23,046
Buildings and improvements	51,644	51,606
Equipment	295,491	291,682
	370,187	366,334
Accumulated depreciation	(231,533)	(218,242)
Total property and equipment, net	\$ 138,654	\$ 148,092

Recent Accounting Pronouncements

The following accounting pronouncements were recently issued by the Financial Accounting Standards Board (FASB) and we consider them relevant to our operations and the preparation of our financial reports.

In February 2010, the FASB issued FASB Accounting Standards Update 2010-09, *Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements*. Topic 855 removes the requirement for a U.S. Securities and Exchange Commission (SEC) filer to disclose a date in both issued and revised financial statements. Revised financial statements include financial statements revised as a result of either correction of an error or retrospective application of U.S. GAAP. This update was effective upon issuance for Gray. Our adoption of this update did not have a significant impact upon our financial statements.

In January 2010, the FASB issued FASB Accounting Standards Update 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. This update provides amendments to Topic 820 that provide for more robust disclosures about the (1) different classes of assets and liabilities measured at fair value, (2) valuation techniques and inputs used, (3) activity in Level 3 fair value measurements, and (4) transfers between Levels 1, 2, and 3. This update is effective for interim and annual reporting periods beginning after December 15, 2009 and we adopted this update on January 1, 2010. Our adoption of this update did not have a significant impact upon our financial statements.

Changes in Classifications

The classification of certain prior period amounts in the investing section of our accompanying unaudited condensed consolidated statement of cash flows have been changed in order to conform to the current year presentation.

Table of Contents**2. Long-term Debt and Accrued Facility Fee**

Our long-term debt and long-term accrued facility fee balances are as follows (dollars in thousands):

	June 30, 2010	December 31, 2009
Long-term debt including current portion:		
Senior credit facility excluding long-term accrued facility fee	\$ 488,536	\$ 791,809
10 ¹ / ₂ % senior secured second lien notes	365,000	
Total long-term debt at liquidation value	853,536	791,809
Less unamortized discount on 10 ¹ / ₂ % senior secured second lien notes	(6,764)	
Total long-term debt at recorded value	846,772	791,809
Long-term accrued facility fee	26,139	18,307
Total long-term debt and accrued facility fee at recorded value	\$ 872,911	\$ 810,116
Borrowing ability under our senior credit facility	40,000	31,681
First lien leverage ratio as defined in our senior credit facility:		
Actual (1)	5.35	na
Maximum allowed (1)	7.00	na

(1) The Company was not required to comply with this ratio prior to June 30, 2010.

Senior Credit Facility

Excluding accrued interest, the amount outstanding under our senior credit facility as of June 30, 2010 was \$514.7 million comprised of a term loan balance of \$488.5 million and a long-term accrued facility fee of \$26.1 million. Excluding accrued interest, the amount outstanding under our senior credit facility as of December 31, 2009 was \$810.1 million comprised of a term loan balance of \$791.8 million and a long-term accrued facility fee of \$18.3 million. Our long-term accrued facility fee is due and payable on December 31, 2014 coincident with the maturity date of our term loan. Under the revolving loan portion of our senior credit facility, the maximum borrowing availability, subject to covenant restrictions, was \$40.0 million and \$50.0 million as of June 30, 2010 and December 31, 2009, respectively. The amount that we can draw under our revolving loan is limited by the restrictive covenants in our senior credit facility. As of June 30, 2010 and December 31, 2009, we could have drawn \$40.0 million and \$31.7 million, respectively, of the maximum availability under the revolving loan. As of June 30, 2010 and December 31, 2009, we were in compliance with all covenants required under our debt agreements.

Amendment of Senior Credit Facility and Issuance of 10¹/₂% senior secured second lien notes due 2015 (the Notes)

Effective as of March 31, 2010, we amended our existing senior credit facility to provide for, among other things: (i) an increase in the maximum total net leverage ratio covenant under the senior credit facility through March 30, 2011 and (ii) a potential issuance of capital stock and/or senior or subordinated debt securities, which could include securities with a second lien security interest (the Replacement Debt). This amendment to the senior credit facility

also reduced the revolving loan commitment under the senior credit facility from \$50.0 million to \$40.0 million.

Pursuant to this amendment, from March 31, 2010 and until the date we completed an offering of Replacement Debt resulting in the repayment of not less than \$200.0 million of our term loan outstanding under the senior credit facility, (i) we were required to pay an annual incentive fee equal to 2.0%, which fee was eliminated upon the consummation of such offering and repayment, (ii) the annual facility fee remained at 3.0%, which fee would, following such repayment, be reduced to 1.25% per year, with a potential for further reductions in future periods, and (iii) we remained subject to a maximum total net leverage ratio, which ratio, following such repayment, would

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2. Long-term Debt and Accrued Facility Fee (Continued)

Amendment of Senior Credit Facility and Issuance of 10¹/₂% senior secured second lien notes due 2015 (the Notes) (Continued)

be replaced by a first lien leverage test, as described in the following paragraph. In addition, from and after such repayment, we would be required to comply with a minimum fixed charge coverage ratio of 0.90x to 1.0x.

The amendment also provided that upon the completion of an offering of Replacement Debt that resulted in the repayment of not less than \$200.0 million of our term loan outstanding under the senior credit facility, we would be, from the date of such repayment, subject to a maximum first lien leverage ratio covenant, which would replace our maximum total leverage ratio covenant. The covenant would range from 7.5x to 6.5x, depending upon the amount of any such repayment.

On April 29, 2010, we issued \$365.0 million aggregate principal amount of Notes. The Notes constituted Replacement Debt under the senior credit facility. The Notes were priced at 98.085% of par, resulting in gross proceeds to the Company of \$358.0 million. The Notes mature on June 29, 2015. Interest accrues on the Notes from April 29, 2010, and interest is payable semi-annually, on May 1 and November 1 of each year. The first interest payment date is November 1, 2010. We may redeem some or all of the Notes at any time after November 1, 2012 at specified redemption prices. We may also redeem up to 35% of the aggregate principal amount of the Notes using the proceeds from certain equity offerings completed before November 1, 2012. In addition, we may redeem some or all of the Notes at any time prior to November 1, 2012 at a price equal to 100% of the principal amount thereof plus a make whole premium, and accrued and unpaid interest. If we sell certain of our assets or experience specific kinds of changes of control, we must offer to repurchase the Notes.

The Notes and the guarantees thereof are secured by a second priority lien on substantially all of the assets owned by Gray and its subsidiary guarantors, including, among other things, all present and future shares of capital stock, equipment, owned real property, leaseholds and fixtures, in each case subject to certain exceptions and customary permitted liens (the Notes Collateral). The Notes Collateral also secures obligations under the Company's senior credit facility, subject to certain exceptions and permitted liens. The Company used a portion of the net proceeds from the sale of Notes to repay \$300.0 million in principal amount of term loans outstanding under its senior credit facility, to repay interest thereon and to pay certain fees due thereunder.

Table of Contents**2. Long-term Debt and Accrued Facility Fee (Continued)**

Amendment of Senior Credit Facility and Issuance of 10¹/₂% senior secured second lien notes due 2015 (the Notes)(Continued)

A summary of certain significant terms contained in our senior credit facility (i) before the March 31, 2010 amendment, (ii) as so amended, and (iii) as amended and after giving effect to the issuance of Notes and related repayment of \$300.0 million in principal amount of term loans outstanding under the senior credit facility is as follows:

Description	Prior to Amendment on March 31, 2010	As Amended and Prior to Issuance of Notes and Related Repayment of the Term Loan	As Amended and After Issuance of Notes and Related Repayment of the Term Loan
Annual interest rate on outstanding term loan balance	LIBOR plus 3.50% or BASE plus 2.50%	Same	Same
Annual interest rate on outstanding revolving loan balance	LIBOR plus 3.50% or BASE plus 2.50%	Same	Same
Annual facility fee rate	3.00% with a potential for reduction in future periods.	3.00% with a potential for reduction in future periods.	0.75% with a potential for reduction in future periods.
Annual incentive fee rate	None	2.00%	None
Annual commitment fee on undrawn revolving loan balance	0.50%	Same	Same
Revolving loan commitment	\$50 million	\$40 million	\$40 million
Maximum total net leverage ratio at:			
March 31, 2010 through June 29, 2010	7.00x	9.00x	Replaced with a first lien leverage test
June 30, 2010 through September 29, 2010	6.50x	9.50x	

September 30, 2010 through March 30, 2011	6.50x	9.75x	as described above.
March 31, 2011 and thereafter	6.50x	6.50x	
Minimum fixed charge coverage ratio	None	Same	0.90x to 1.00x
Maximum cash balance that can be deducted from total debt to calculate net debt in the total net leverage ratio (or first lien leverage test, as applicable)	\$10.0 million	Same	\$15.0 million

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2. Long-term Debt and Accrued Facility Fee (Continued)

Amendment of Senior Credit Facility and Issuance of 10¹/₂% senior secured second lien notes due 2015 (the Notes) (Continued)

Beginning April 30, 2010, all interest and fees accrued under the senior credit facility are payable in cash upon their respective due dates, with no portion of such accrued interest and fees being subject to deferral.

In order to obtain the foregoing amendment of our senior credit facility, we incurred loan issuance costs of approximately \$4.5 million, including legal and professional fees. We recorded a loss from early extinguishment of debt of \$0.3 million for the six-month period ended June 30, 2010. As of June 30, 2010, we had a deferred loan cost balance, net of accumulated amortization, of \$5.4 million related to the amendment of our senior credit facility.

In order to issue our Notes, we incurred issuance costs of approximately \$8.2 million, including legal and professional fees. As of June 30, 2010, we had a deferred loan cost balance, net of accumulated amortization, of \$8.0 million related to the issuance of our Notes.

3. Derivatives

Risk Management Objective of Using Derivatives

We are exposed to certain risks arising from business operations and economic conditions. We attempt to manage our exposure to a wide variety of business and operational risks principally through management of our core business activities. We attempt to manage economic risk, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources and duration of our debt financing and the use of interest rate swap agreements. Specifically, we enter into interest rate swap agreements to manage interest rate exposure with the following objectives:

managing current and forecasted interest rate risk while maintaining financial flexibility and solvency;

proactively managing our cost of capital to ensure that we can effectively manage operations and execute our business strategy, thereby maintaining a competitive advantage and enhancing shareholder value; and

complying with applicable covenant requirements and restrictions.

Cash Flow Hedges of Interest Rate Risk

In using interest rate derivatives, our objectives are to add stability to interest expense and to manage our exposure to interest rate movements. To accomplish these objectives, we primarily use interest rate swap agreements as part of our interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable rate amounts from a counterparty in exchange for our making fixed-rate payments over the life of the applicable agreement, without exchange of the underlying notional amount. Under the terms of our senior credit facility, we were required to fix the interest rate on at least 50.0% of the outstanding balance thereunder through March 19, 2010. From and after such date, we are no longer required to fix interest rates on any amounts outstanding thereunder.

During 2007, we entered into three swap agreements to convert \$465.0 million of our variable rate debt under our senior credit facility to fixed rate debt. These interest rate swap agreements expired on April 3, 2010, and they were our only derivatives in effect during the six-month period ended June 30, 2010. Upon entering into the swap agreements, we designated them as hedges of variability of our variable rate interest payments attributable to changes in three-month LIBOR, the designated interest rate. Therefore, these interest rate swap agreements were, prior to their respective expiration dates, considered cash flow hedges.

Table of Contents**3. Derivatives (Continued)***Cash Flow Hedges of Interest Rate Risk (Continued)*

Upon entering into a swap agreement, we documented our hedging relationships and our risk management objectives. Our swap agreements did not include written options. Our swap agreements were intended solely to modify the payments for a recognized liability from a variable rate to a fixed rate. Our swap agreements did not qualify for the short-cut method of accounting because the variable rate debt being hedged was pre-payable.

Hedge effectiveness was evaluated at the end of each quarter. We compared the notional amount, the variable interest rate and the settlement dates of the interest rate swap agreements to the hedged portion of the debt. Our swap agreements were highly effective at hedging our interest rate exposure.

During the period of each interest rate swap agreement, we recognized the swap agreements at their fair value as an asset or liability on our balance sheet. The effective portion of the change in the fair value of our interest rate swap agreements were recorded in accumulated other comprehensive income (loss). The ineffective portion of the change in fair value of the derivatives was recognized directly in earnings.

Amounts reported in accumulated other comprehensive income (loss) related to derivatives were reclassified to interest expense as the related interest payments were made on our variable rate debt.

Under these swap agreements, we received variable rate interest at LIBOR and paid fixed interest at an annual rate of 5.48%. The variable LIBOR was reset in three-month periods under the swap agreements. At our option, the variable LIBOR was reset in one month or three-month periods for the hedged portion of our variable rate debt.

The table below presents the fair value of our interest rate swap agreements as well as their classification on our balance sheet as of June 30, 2010 and December 31, 2009. We did not have any derivatives classified as assets as of June 30, 2010 or December 31, 2009. The fair values of the derivative instruments were estimated by obtaining quotations from the financial institutions that were counterparties to the instruments. The fair values are estimates of the net amount that we would have been required to pay on December 31, 2009 if the agreements had been transferred to other parties or cancelled on such dates. Amounts in the following table are in thousands.

Fair Values of Derivative Instruments

	As of June 30, 2010		As of December 31, 2009	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:				
Interest rate swap agreements	Current liabilities	\$	Current liabilities	\$6,344

Table of Contents**3. Derivatives (Continued)***Cash Flow Hedges of Interest Rate Risk (Continued)*

The following table presents the effect of our derivative financial instruments on our consolidated statements of operations for the three-month and six-month periods ended June 30, 2010 and 2009 (in thousands):

	Cash Flow Hedging Relationships for the			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Interest rate swap agreements:				
Liability at beginning of period	\$ (360)	\$ (20,451)	\$ (6,344)	\$ (24,611)
Effective portion of gains recognized in other comprehensive loss	6,531	8,156	18,624	13,933
Effective portion of losses recorded in accumulated other comprehensive loss and reclassified into interest expense	(6,171)	(4,611)	(12,280)	(6,228)
Portion of gains (losses) representing the amount of hedge ineffectiveness and the amount excluded from the assessment of hedge effectiveness and recorded as an increase (decrease) in interest expense		(696)		(696)
Liability at end of period	\$	\$ (17,602)	\$	\$ (17,602)

For the six-month period ended June 30, 2010, we recorded income on derivatives as other comprehensive income of \$3.9 million, net of a \$2.5 million income tax expense. For the six-month period ended June 30, 2009, we recorded income on derivatives as other comprehensive income of \$4.7 million, net of a \$3.0 million income tax benefit.

Credit-risk Related Contingent Features

We attempt to manage our counterparty risk by entering into derivative instruments with global financial institutions that we believe present a low risk of credit loss resulting from nonperformance. For the six-month period ended June 30, 2010, we had not recorded a credit value adjustment related to our interest rate swap agreements. These agreements expired on April 3, 2010.

Our interest rate swap agreements incorporated the covenant provisions of our senior credit facility. Failure to comply with the covenant provisions of the senior credit facility would have resulted in our being in default of our obligations under our interest rate swap agreements.

Table of Contents**4. Fair Value Measurement**

Fair value is the price that market participants would pay or receive to sell an asset or pay to transfer a liability in an orderly transaction. Fair value is also considered the exit price. We utilize market data or assumptions that market participants would use in pricing an asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable. We utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs are prioritized into a hierarchy that gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs that require assumptions to measure fair value (Level 3).

Recurring Fair Value Measurements

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the fair value of assets and liabilities and their placement within the fair value hierarchy levels. The following table sets forth our financial agreements, which were accounted for at fair value, by level within the fair value hierarchy as of June 30, 2010 and December 31, 2009 (in thousands):

Recurring Fair Value Measurements

	As of June 30, 2010			Total
	Level 1	Level 2	Level 3	
Liabilities:				
Interest rate swap agreements	\$	\$	\$	\$

	As of December 31, 2009			Total
	Level 1	Level 2	Level 3	
Liabilities:				
Interest rate swap agreements	\$	\$6,344	\$	\$6,344

Fair values of our interest rate swap agreements were based on estimates provided by the counterparties. Valuation of these items entailed a significant amount of judgment.

Table of Contents**4. Fair Value Measurement (Continued)***Non-Recurring Fair Value Measurements*

We have certain assets that are measured at fair value on a non-recurring basis and are adjusted to fair value only when the carrying values exceed their fair values. Included in the following table are the significant categories of assets measured at fair value on a non-recurring basis as of June 30, 2010 and December 31, 2009 and any impairment charges recorded for those assets in the six-month periods ended June 30, 2010 and 2009 (in thousands).

Non-Recurring Fair Value Measurements

	As of June 30, 2010				Impairment Loss for the Six Months Ended June 30,	
	Level	Level	Level 3	Total	2010	2009
	1	2				
Assets:						
Property and equipment, net	\$	\$	\$ 138,654	\$ 138,654	\$	\$
Program broadcast rights			4,161	4,161	172	114
Investment in broadcasting company			13,599	13,599		
Broadcast licenses			818,981	818,981		
Goodwill			170,522	170,522		
Other intangible assets, net			1,074	1,074		
Total	\$	\$	\$ 1,146,991	\$ 1,146,991	\$ 172	\$ 114

	As of December 31, 2009			
	Level	Level	Level 3	Total
	1	2		
Assets:				
Property and equipment, net	\$	\$	\$ 148,092	\$ 148,092
Program broadcast rights			11,265	11,265
Investment in broadcasting company			13,599	13,599
Broadcast licenses			818,981	818,981
Goodwill			170,522	170,522
Other intangible assets, net			1,316	1,316
Total	\$	\$	\$ 1,163,775	\$ 1,163,775

Fair value of our property and equipment is estimated by our engineers. Fair value of our investment in broadcasting company is based upon estimated future cash flows. Fair values of program broadcast rights, broadcast licenses, goodwill and other intangible assets, net, are subjected to impairment testing. Our program broadcast rights impairment charges were recorded as a broadcast operating expense in the respective periods.

Fair Value of Other Financial Instruments

The estimated fair value of other financial instruments is determined using the best available market information and appropriate valuation methodologies. Interpreting market data to develop fair value estimates involves considerable judgment. Accordingly, the estimates presented are not necessarily indicative of the amounts that we could realize in a current market exchange, or the value that ultimately will be realized upon maturity or disposition. The use of different market assumptions may have a material effect on the estimated fair value amounts.

Table of Contents**4. Fair Value Measurement (Continued)***Fair Value of Other Financial Instruments (Continued)*

The carrying amounts of the following instruments approximate fair value, due to their short term to maturity: (i) accounts receivable, (ii) prepaid and other current assets, (iii) accounts payable, (iv) accrued employee compensation and benefits, (v) accrued interest, (vi) other accrued expenses, (vii) dividends payable, (viii) acquisition-related liabilities and (ix) deferred revenue.

The carrying amount of our long-term debt, including the current portion and long-term accrued facility fee, was \$872.9 million and \$810.1 million, respectively, and the fair value was \$832.5 million and \$704.8 million, respectively as of June 30, 2010 and December 31, 2009. Fair value of our long-term debt, including the current portion and long-term accrued facility fee, is based on estimates provided by third party financial professionals as of June 30, 2010 and December 31, 2009.

5. Preferred Stock

As of June 30, 2010 and December 31, 2009, we had 393 shares and 1,000 shares of Series D Perpetual Preferred Stock outstanding, respectively. The Series D Perpetual Preferred Stock has a liquidation value of \$100,000 per share, for a total liquidation value of \$39.3 million and \$100.0 million as of June 30, 2010 and December 31, 2009 and a recorded value of \$36.9 million and \$93.4 million as of June 30, 2010 and December 31, 2009, respectively. The difference between the liquidation values and the recorded values was the unaccreted portion of the original issuance discount and issuance cost. Our accrued Series D Perpetual Preferred Stock dividend balances as of June 30, 2010 and December 31, 2009 were \$10.8 million and \$18.9 million, respectively.

On April 29, 2010, we repurchased approximately \$60.7 million in face amount of our Series D Perpetual Preferred Stock, and \$14.9 million in accrued dividends thereon, in exchange for \$50.0 million in cash, using net proceeds from the sale of Notes, and the issuance of 8.5 million shares of common stock.

Except for the payment of dividends on April 29, 2010, we have deferred the cash payment of our preferred stock dividends earned thereon since October 1, 2008. Because at least three consecutive cash dividend payments with respect to the Series D Perpetual Preferred Stock remain unfunded, the dividend rate has increased from 15.0% per annum to 17.0% per annum. Our Series D Perpetual Preferred Stock dividend began accruing at 17.0% per annum on July 16, 2009 and will accrue at that rate as long as at least three consecutive cash dividend payments remain unfunded.

While any Series D Perpetual Preferred Stock dividend payments are in arrears, we are prohibited from repurchasing, declaring and/or paying any cash dividend with respect to any equity securities having liquidation preferences equivalent to or junior in ranking to the liquidation preferences of the Series D Perpetual Preferred Stock, including our common stock and Class A common stock. We can provide no assurances as to when any future cash payments will be made on any accumulated and unpaid Series D Perpetual Preferred Stock cash dividends presently in arrears or that become in arrears in the future. The Series D Perpetual Preferred Stock has no mandatory redemption date but may be redeemed at the stockholders' option on or after June 30, 2015.

Table of Contents**6. Retirement Plans**

The following table provides the components of net periodic benefit cost for our pension plans for the three-month and six-month periods ended June 30, 2010 and 2009, respectively (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Service cost	\$ 883	\$ 774	\$ 1,766	\$ 1,551
Interest cost	640	550	1,280	1,100
Expected return on plan assets	(477)	(501)	(955)	(1,003)
Loss amortization	248	102	497	205
Net periodic benefit cost	\$ 1,294	\$ 925	\$ 2,588	\$ 1,853

During the six-month period ended June 30, 2010, we contributed \$2.1 million to our pension plans. During the remainder of the fiscal year ending December 31, 2010 (fiscal 2010), we expect to contribute an additional \$1.9 million to our pension plans.

7. Stock-based Compensation

We recognize compensation expense for share-based payment awards made to our employees and directors including stock options and restricted shares under our 2007 Long-Term Incentive Plan and the Directors' Restricted Stock Plan. The following table provides our stock-based compensation expense and related income tax benefit for the three-month and six-month periods ending June 30, 2010 and 2009, respectively (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Stock-based compensation expense, gross	\$ 62	\$ 345	\$ 217	\$ 698
Income tax benefit at our statutory rate associated with stock-based compensation	(24)	(135)	(85)	(272)
Stock-based compensation expense, net	\$ 38	\$ 210	\$ 132	\$ 426

Table of Contents**7. Stock-based Compensation (Continued)***Long-term Incentive Plan*

During the six-month periods ended June 30, 2010 and 2009, we did not grant any options to our employees to acquire our common stock. A summary of stock option activity related to our common stock for the six-month periods ended June 30, 2010 and 2009 is as follows (option amounts in thousands):

		Six Months Ended June 30,			
		2010			2009
		Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Common stock:					
Stock options outstanding	beginning of period	1,476	\$ 8.28	1,949	\$ 8.31
Options expired		(265)	\$ 10.10	(12)	\$ 12.37
Options forfeited		(59)	\$ 11.37	(11)	\$ 8.11
Stock options outstanding	end of period	1,152	\$ 8.29	1,926	\$ 8.29
Exercisable at end of period		1,142	\$ 7.70	643	\$ 9.87

As of June 30, 2010, the market price of our common stock was less than the exercise prices for all but 10,000 of our outstanding stock options. The total intrinsic value of these options was approximately \$3,100. For the six-month period ended June 30, 2010, we did not have any options outstanding for our Class A common stock.

Directors Restricted Stock Plan

During the six-month periods ended June 30, 2010 and 2009, we did not grant any shares of restricted stock to our directors. The unearned compensation resulting from previous grants is being amortized as an expense over the vesting period of the restricted common stock. The total amount of unearned compensation is equal to the market value of the shares at the date of grant, net of accumulated amortization.

Table of Contents**7. Stock-based Compensation (Continued)***Long-term Incentive Plan*

The following table summarizes our non-vested restricted shares during the six-month period ended June 30, 2010 and their weighted-average fair value per share as of their date of grant (shares in thousands):

	Number of Shares	Weighted- average Fair Value Per Share
Restricted Stock:		
Non-vested common restricted shares, December 31, 2009	66	\$6.36
Granted		
Vested		
Non-vested common restricted shares, June 30, 2010	66	\$6.36

8. Commitments and Contingencies*Legal Proceedings and Claims*

From time to time, we are or may become subject to legal proceedings and claims that arise in the normal course of our business. In our opinion, the amount of ultimate liability, if any, with respect to these actions, will not materially affect our financial position. However, the outcome of any one or more matters cannot be predicted with certainty, and the unfavorable resolution of any matter could have a material adverse effect on us.

Sports Marketing Agreement

On October 12, 2004, the University of Kentucky (UK) awarded a sports marketing agreement jointly to us and IMG Worldwide, Inc. (IMG) (the UK Agreement). The UK Agreement commenced on April 16, 2005 and has an initial term of seven years with the option to extend for three additional years.

On July 1, 2006, the terms of the agreement between IMG and us were amended. As amended, the UK Agreement provides that we will share in profits in excess of certain amounts specified by the agreement, if any, but not losses. The agreement also provides that we will separately retain all local broadcast advertising revenue and pay all local broadcast expenses for activities under the agreement. Under the amended agreement, IMG agreed to make all license fee payments to UK. However, if IMG is unable to pay the license fee to UK, we will then be required to pay the unpaid portion of the license fee to UK. As of June 30, 2010, the aggregate license fee to be paid by IMG to UK over the remaining portion of the full ten-year term (including the optional three year extension) of the agreement is approximately \$41.6 million. If we make advances on behalf of IMG, IMG is required to reimburse us for the amount paid within 60 days after the close of each contract year, which ends on June 30th. IMG has also agreed to pay interest on any advance at a rate equal to the prime rate. During the six-month period ended June 30, 2010, we did not advance any amounts to UK on behalf of IMG under this agreement. As of June 30, 2010, we do not consider the risk of non-performance by IMG to be high.

9. Goodwill and Intangible Assets

Our intangible assets are primarily comprised of network affiliations and broadcast licenses. We did not acquire any network affiliation agreements or broadcast licenses during the six-month period ended June 30, 2010. Upon renewal of such intangible assets, we expense all related fees as incurred. There were no triggering events that required a test of impairment of our goodwill or intangible assets during the six-month period ended June 30, 2010.

Table of Contents**10. Income Taxes**

For the three-month and six-month periods ended June 30, 2010 and 2009, our income tax expense (benefit) and effective tax rates were as follows (dollars in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Income tax expense (benefit)	\$190	\$(4,360)	\$(3,048)	\$(9,127)
Effective income tax rate	26%	40%	42%	37%

We estimate our income and differences between taxable income and recorded income on an annual basis. Our tax provision for each quarter is based upon these full year projections which are revised each reporting period. As a result of our refinancing activities that we completed in April of 2010, we revised our full-year 2010 tax estimates. The revisions to these estimates resulted in a decrease in tax expense during the three-month period ended June 30, 2010 of approximately \$0.1 million which reduced our effective tax rate for the three-month period ended June 30, 2010.

The effective income tax rate for the six-month period ended June 30, 2010 as compared to the six-month period ended June 30, 2009 increased primarily as a result of an increase in state income taxes.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Executive Overview

Introduction

The following analysis of the financial condition and results of operations of Gray Television, Inc. (we , us , our , Gray or the Company) should be read in conjunction with our unaudited condensed consolidated financial statements and related notes contained in this report and our audited consolidated financial statements and related notes contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009 (the 2009 Form 10-K).

Overview

We are a television broadcast company operating 36 television stations serving 30 markets. Seventeen of our stations are affiliated with CBS Inc. (CBS), ten are affiliated with the National Broadcasting Corporation, Inc. (NBC), eight are affiliated with the American Broadcasting Corporation (ABC), and one is affiliated with FOX Entertainment Group, Inc. (FOX). Our 17 CBS-affiliated stations make us the largest independent owner of CBS affiliates in the United States. In addition, we currently operate 39 digital second channels including one affiliated with ABC, four affiliated with FOX, seven affiliated with CW, 18 affiliated with Twentieth Television, Inc. (MyNetworkTV), two affiliated with Universal Sports Network and seven local news/weather channels in certain of our existing markets. We created our digital second channels to better utilize our excess broadcast spectrum. The digital second channels are similar to our primary broadcast channels; however, our digital second channels are affiliated with networks different from those affiliated with our primary broadcast channels. Our combined TV station group reaches approximately 6.3% of total United States households.

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