

ACME COMMUNICATIONS INC

Form 10-K

April 01, 2003

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**FORM 10-K**

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ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
Commission File Number: 000-27105

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**ACME COMMUNICATIONS, INC.**

(Exact name of registrants as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

33-0866283  
(I.R.S. Employer  
Identification No.)

2101 E. Fourth Street, Suite 202 A  
Santa Ana, California, 92705  
(714) 245-9499

(Address and Telephone number of Principal Executive Offices)

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Securities registered pursuant to Section 12(b) of the Act: None

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

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
Common Stock, par value \$.01 per share	Nasdaq National Market

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, and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of 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.

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

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The aggregate market value of the voting stock held by non-affiliates of the registrant, computed on the basis of \$7.35 per share, the price at which shares last sold, as of the last business day of the registrant's most recently completed second fiscal quarter (June 28, 2002), was \$78,514,743.

As of March 28, 2003, there were 16,750,000 shares of registrant's common stock outstanding.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Proxy Statement to be filed pursuant to Regulation 14A relating to the 2003 Annual Meeting of Stockholders are incorporated by reference in Part III.

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**ANNUAL REPORT ON FORM 10-K**

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\* Items incorporated by reference to our Proxy Statement to be filed pursuant to Regulation 14A relating to the 2002 Annual Meeting of Stockholders.

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***Forward-looking Statements***

*This Annual Report on Form 10-K includes forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. In some cases, you can identify forward-looking statements by terminology such as may, will, intend, could, expect, anticipate, believe, predict, potential might or continue or the negative of such terms or other comparable Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our and the television broadcast industry's actual results, levels of activity, performance, achievements and prospects to be materially different from those expressed or implied by such forward-looking statements. These risks, uncertainties and other factors include those identified under Risk Factors in this Annual Report on Form 10-K. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this Annual Report on Form 10-K might not occur.*

*We do not undertake any obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this Annual Report on Form 10-K. In addition, we make no representation with respect to any materials available on the Internet, including materials available on our website.*

***PART I***

**Item 1. Business**

ACME Communications, Inc. (the Company or we ) owns and operates nine broadcast television stations in medium-sized markets across the United States. Eight of these television stations are network affiliates of The WB Television Network and one station is a network affiliate of UPN. These nine stations broadcast in markets that cover in aggregate approximately 3.7% of the total U.S. television households. We are the fourth largest WB Network affiliated group in the country. Mr. Kellner, our Chairman and Chief Executive Officer, is also a founder of and Chairman and Chief Executive Officer of The WB Network, and was President of Fox Broadcasting Company from its inception in 1986 through 1993.

On December 27, 2002, we announced that we had entered into agreements to sell two of our stations, KPLR-TV serving the St. Louis marketplace and KWBP-TV, serving the Portland, Oregon marketplace, to subsidiaries of Tribune Company for an aggregate all-cash consideration of \$275 million. We completed these transactions on March 21, 2003. In accordance with generally accepted accounting principles ( GAAP ), we have accounted for the results of these two stations as discontinued operations and our remaining nine stations represent our continuing operations.

Since our formation in 1997, we have focused primarily on acquiring independently-owned stations, under-performing stations and construction permits for new stations in markets that we believe have the growth potential and demographic profile to support a successful WB Network affiliate. We believe that medium-sized markets provide advantages such as fewer competitors and lower operating costs compared to large markets. Our strategy is to capitalize on these advantages and to grow our revenues and cash flow with an emphasized focus on local sales. Since we centralize many of our stations' administrative functions and primarily provide entertainment programming, our station general managers are able to focus on increasing sales and improving operating margins. Additionally, since many of the stations we own are in markets where the Federal Communications Commission allows dual ownership of broadcast television stations ( duopoly ), our long-term strategy also includes acquiring such second stations.

Like The WB Network, we target our programming at younger audiences, in particular, young adults, teens and kids. We believe that these younger audiences are a growing and increasingly important demographic target for advertisers, and that our affiliation with The WB Network affords us a significant competitive advantage over other network affiliated television broadcasters in attracting these younger audiences. Since its launch in 1995 and through the 2001 / 2002 season, The WB Network was the only English-language broadcast network in the United States to increase its audience share in these key target demographic groups. To build and retain our audience share during non-network hours, we also acquire the broadcast rights to popular syndicated programming that we believe complements The WB Network programming. In addition, we broadcast local and regional sports programming in selected markets and provide local news and weather updates in our morning news show. We believe this programming enhances our ability to sell advertising time to local and regional advertisers and increase audience awareness of our newly launched stations.

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### **Programming**

Our programming includes:

The WB Network prime time programming (at eight of our nine stations)

Kids WB! (at eight of our nine stations);

syndicated programming;

*The Daily Buzz*, a three-hour morning news program we produce for our station group; and

local programming.

*Prime Time Programming.* In prime time, The WB Network is currently ranked number one among female teens and, based on the average age of their viewers, is the youngest broadcast network today. Prime time programming includes: *7th Heaven, Smallville, Gilmore Girls, Charmed, Dawson's Creek, Reba, and Sabrina: The Teenage Witch*. When The WB Network began broadcasting in 1995, it provided two hours of prime time programming per week. The WB Network is currently providing 15 hours of prime time programming Sunday through Friday.

*Kids WB! Programming.* The WB Network launched Kids WB! in September 1995 with three hours of programming on Saturdays, and currently provides 13 hours of kids programming Monday through Saturday. Kids WB! programming includes *Yu-Gi-Oh, Static Shock, Pokémon, The Mummy* and *Jackie Chan Adventures*.

*Syndicated Programming.* In addition to The WB Network programming, our stations air syndicated programs. Generally, our most profitable programming time periods are those immediately before and after The WB Network programming. Consequently, during these time periods, we air programs that are targeted to the audiences similar in demographics as those that watch The WB Network prime time programs. These syndicated programs include *That 70's Show, Everybody Loves Raymond, Will and Grace, Judge Judy, King of the Hill, Drew Carey* and *Spin City*. We have secured future broadcast rights for certain of our stations to *King of Queens, Malcolm in the Middle, Friends* (second cycle) and other shows. We have multi-year contracts to air most of our syndicated programming.

*Local Programming.* Several of our stations also air certain regional and local sporting events of local interest, which we believe helps increase local awareness of our stations and expands our advertiser base. In addition, we air local weather and news updates at all of our stations during *The Daily Buzz* (see below), our weekday morning news program.

*The Daily Buzz.* In September 2002, we launched *The Daily Buzz*, a three-hour (6:00 - 9:00 a.m. Eastern / Pacific Time) morning news show. The show is aired on all of our stations and is also sold to The WB 100+ Cable Group (which airs on cable in more than 100 small markets across the country) and to a few other middle-market broadcasters. The show is produced at our station facilities in Dayton, Ohio, and in addition to traditional news, weather and sports related stories, contains entertainment, technology and lifestyle segments. We believe this program, which is targeted at younger, underserved viewers, has the potential of delivering meaningful additional revenues in its time period, including political advertising and advertisers' news budgets.

### **Our Stations**

The following table provides general information concerning our continuing stations:

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Station Channel Marketplace	Television Households(1)		November 2002 Audience Share(2)				Beginning of ACME Operation
	Market Ranking	Number	Prime Time(3)		Sign-on to Sign-off(4)		
			Teens 12-17	Adults 18-34	Adults 18-34	Households	
KUWB 30 Salt Lake City, UT	36	769,000	9	10	6	3	April 1998
KWBQ 19 Albuquerque Santa Fe, NM	49	620,000	6	6	5	3	March 1999
KASY 50 Albuquerque Santa Fe, NM	49	620,000	6	4	3	3	November 1999
WBDT 26 Dayton, OH	58	506,000	11	10	7	4	June 1999
WBXX 20 Knoxville, TN	63	490,000	10	9	9	4	October 1997
WIWB 14 Green Bay Appleton, WI	69	419,000	9	8	5	3	June 1999
WTVK 46 Ft. Myers Naples, FL	70	414,000	12	8	5	2	March 1998
WBUI 23 Champaign Springfield Decatur, IL	82	371,000	11	6	3	2	June 1999
WBUE 57 Madison, WI	86	349,000	5	7	4	1	November 2002

(1) All television stations throughout the United States are grouped into 210 markets that are ranked in size according to the number of households with televisions in the market for the 2002/2003 season.

(2) All share information is from Nielsen Media Research.(3) Prime Time represents the hours of programming provided by The WB Network, except for KASY in Albuquerque Santa Fe, NM for which programming is provided by UPN.(4) Sign-on to Sign-off represents the hours from 7:00 a.m. through 1:00 a.m., Monday through Sunday.

*KUWB: Salt Lake City, Utah*



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Designated Market Area: 36  
Total Age 2+ Population: 2,315,000

TV Households: 769,000

*Market Description.* Forty-four percent of the total population of Salt Lake City is under 25 years of age. The estimated average household income in the Salt Lake City market is approximately \$45,700 per year. Major employers in the market include Intermountain Health Care, Brigham Young University, IOMEGA, ICON Health and Fitness and Smith Food & Drug Centers

*Station Overview.* We began operating KUWB in April 1998 under a local marketing agreement and acquired the station in September 1998. KUWB has been affiliated with The WB Network since the network's launch. When we began operating the station, we replaced the primarily religious paid programming and infomercials that were being run on the station in all non-WB Network time periods with syndicated programming. The station's syndicated programming currently includes *That 70's Show*, *Everybody Loves Raymond*, *The Drew Carey Show*, *Spin City* and *Sabrina: The Teenage Witch*. It also carries the NBC-affiliated *Saturday Night Live*. The station has contracted for the future exclusive-market broadcast rights to popular shows such as *King of Queens* and *Malcolm in the Middle*, which begin airing in September 2003 and 2004, respectively. In the November 2002 sweeps period, KUWB delivered an average 1.4 rating amongst adult 18-49 viewers for the 5 p.m. - midnight, Monday through Sunday, time period - a 17% increase over the comparable rating for the November 2001 sweeps period.

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***KWBQ: Albuquerque Santa Fe, New Mexico***

***KASY: Albuquerque Santa Fe, New Mexico***

Designated Market Area: 49  
Total Age 2+ Population: 1,597,000

TV Households: 620,000

*Market Description.* Thirty-six percent of the total population of Albuquerque Santa Fe is under 25 years of age. The estimated average household income in the Albuquerque Santa Fe market is approximately \$40,100 per year. Major employers in the market include Intel, Motorola, General Electric, General Mills, Philips and Levi Strauss.

*KWBQ Station Overview.* We launched KWBQ in March 1999 with The WB Network prime time programming and Kids WB!. In addition, the station's syndicated programming currently includes *That 70's Show*, *King of the Hill*, *Spin City*, *Seinfeld* and *Third Rock from the Sun*. The station has contracted for the future exclusive-market broadcast rights to popular shows such as *King of Queens*, *Malcolm in the Middle*, and *Friends* (second cycle) which begin airing in September 2003, 2004 and 2006, respectively. In the November 2002 sweeps period, KASY delivered a 1.8 rating amongst adult 18-49 viewers for the 5 p.m. - midnight, Monday through Sunday, time period - a 64% increase over the comparable rating for the November 2001 sweeps period.

*KASY Station Overview.* We began operating KASY, the UPN affiliate in the market, under an interim local marketing agreement (LMA) on November 1, 1999 and closed our purchase of the station on December 3, 1999. The station has been a UPN affiliate since that network's launch in January 1995. Prior to November 1999, the station had been operating as an LMA by another station owner in the market. The station's syndicated programming includes *Everybody Loves Raymond*, *Judge Judy*, *Texas Justice* and *Judge Joe Brown*. All of the future program rights negotiated for KWBQ are also available to air on KASY. During the November 2002 ratings period, KASY delivered a 1.2 rating amongst adults 18-49 viewers for the 5 p.m. - midnight, Monday through Sunday, time period - a 71% increase over the comparable rating for the November 2001 sweeps period.

***WBDT: Dayton, Ohio***

Designated Market Area: 58  
Total Age 2+ Population: 1,218,000

TV Households: 506,000

*Market Description.* Thirty-three percent of the total population of Dayton, Ohio is under 25 years of age. The estimated average household income in the Dayton market is approximately \$47,700 per year. Major employers in the market include Chrysler Corp/Acustar Inc., General Motors, Bank One Dayton, American Matsushita and BF Goodrich.

*Station Overview.* We acquired WBDT in June 1999. WBDT signed on the air in October 1980 and has been affiliated with The WB Network since our acquisition of the station. The station's syndicated programming currently includes *That 70's Show*, *Everybody Loves Raymond*, *Will & Grace*, *Just Shoot Me*, *Texas Justice*, and *Sabrina: The Teenage Witch*, and the station has contracted for the future exclusive-market broadcast rights to popular shows such as *King of Queens*, *Malcolm in the Middle*, and *Friends* (second cycle), which begin airing in September 2003, 2004 and 2006, respectively. In October of 2001, Dayton became Nielsen's 52nd metered market. Added comment about meters. May want to expand on it? During the November 2002 sweeps period, WBDT delivered a 2.2 rating amongst adults 18-49 viewers for the 5 p.m. - midnight, Monday through Sunday, time period - a 29% increase over the comparable rating for the November 2001 sweeps period.

***WBXX: Knoxville, Tennessee***

Designated Market Area: 63  
Total Age 2+ Population: 1,157,000

TV Households: 490,000

*Market Description.* Thirty-one percent of the total population of Knoxville is under 25 years of age. The estimated average household income in the Knoxville market is approximately \$40,300 per year. Major employers in the market include the University of Tennessee, TVA, Oakridge National Laboratories, Alcoa and Nippondenso.

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*Station Overview.* We launched WBXX in October 1997. In addition to carrying The WB Network prime time programming and Kids WB! the station also airs games of the Atlanta Braves. In addition, the station's syndicated programming currently includes *That 70's Show*, *Will & Grace*, *Dharma & Gregg*, *King of the Hill*, *Friends*, *The Drew Carey Show*, *Spin City* and *Just Shoot Me*. The station has contracted for the future exclusive-market broadcast rights to popular shows such as *King of Queens* and *Friends* (second cycle), which begin in September 2003 and 2006, respectively. In October 2002, Knoxville became Nielsen's 54th metered market. During the November 2002 sweeps period, WBXX delivered a 2.8 rating amongst adult 18-49 viewers for the 5 p.m. - midnight, Monday through Sunday, time period - a 115% increase over the comparable rating for the November 2001 sweeps period.

**WIWB: Green Bay Appleton, Wisconsin**

Designated Market Area: 69 TV Households: 419,000  
 Total Age 2+ Population: 1,024,000

*Market Description.* Thirty-three percent of the total population of Green Bay Appleton is under 25 years of age. The estimated average household income in the Green Bay Appleton market is approximately \$44,700 per year. Major employers in the market include Fort James Corporation, the Oneida Tribe of Indians of Wisconsin, Schneider National, Humana, Shopko Stores, American Medical Security, Bellin Memorial Hospital and Procter & Gamble Paper Products.

*Station Overview.* We acquired WIWB in June 1999. WIWB signed on the air in August 1998 and has been affiliated with The WB Network since our acquisition of the station. The station's syndicated programming currently includes *That 70's Show*, *Will & Grace*, *Everybody Loves Raymond*, *Frasier*, and *Sabrina: The Teenage Witch* and the station has contracted for the future exclusive-market broadcast rights to popular shows such as *King of Queens* and *Friends* (second cycle), which begin in September 2003 and 2006, respectively. In the November 2002 sweeps period, WIWB delivered a 1.4 rating amongst adult 18-49 viewers for the 5 p.m. - midnight, Monday through Sunday, time period - a 40% increase over the comparable rating for the November 2001 sweeps period.

**WTVK: Ft. Myers Naples, Florida**

Designated Market Area: 70 TV Households: 414,000  
 Total Age 2+ Population: 956,000

*Market Description.* Twenty-five percent of the total population of Ft. Myers Naples is under 25 years of age. The estimated average household income in the Ft. Myers Naples market is approximately \$50,400 per year. Major employers in the market include The Lee County School District, Lee Memorial Health System, Columbia Healthcare and Publix SuperMarkets.

*Station Overview.* We began operating WTVK in March 1998 under a local marketing agreement and acquired the station in June 1998. WTVK signed on the air in October 1990 and has been affiliated with The WB Network since our acquisition of the station. In addition to carrying The WB Network prime time programming and Kids WB!, the station's syndicated programming currently includes *That 70's Show*, *Dharma & Gregg*, *Just Shoot Me*, *Sabrina: The Teenage Witch*, *Spin City*, *The Drew Carey Show* and *Star Trek: Voyager*. The station has contracted for the future exclusive-market broadcast rights to popular shows such as *King of Queens* which begins in September 2003 and *Judge Judy* and *Judge Joe*, which begin in September 2004. In May 2001, the Ft. Myers-Naples market became Nielsen's 51st metered market. In the November 2002 sweeps period, WTVK delivered a 1.7 rating amongst adult 18-49 viewers for the 5 p.m. - midnight, Monday through Sunday, time period - a 42% increase over the comparable rating for the November 2001 sweeps period.

**WBUI: Champaign Springfield Decatur, Illinois**

Designated Market Area: 82 TV Households: 371,000  
 Total Age 2+ Population: 877,000

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*Market Description.* Thirty-three percent of the total population of Champaign Springfield Decatur is under 25 years of age. The estimated average household income in the Champaign Springfield Decatur market is approximately \$45,600 per year. Major employers in the market include ADM, Staley s, Caterpillar, Mueller, Illinois Power, Kraft and the University of Illinois.

*Station Overview.* We acquired WBUI in June 1999. WBUI signed on the air in May 1984 and has been affiliated with The WB Network since our acquisition of the station. The station s syndicated programming currently includes *That 70 s Show*, *Everybody Loves Raymond*, *Spin City Just Shoot Me*, and *Sabrina: The Teenage Witch*. The station has contracted for the future exclusive market broadcast rights to popular shows such as *King of Queens*, *Malcolm in the Middle*, and *Friends* (second cycle), which begin airing in September 2003, 2004 and 2006, respectively. In the November 2002 sweeps period, WBUI delivered a .9 rating amongst adult 18-49 viewers for the 5 p.m. midnight, Monday through Sunday, time period a 25% decrease over the comparable rating for the November 2001 sweeps period.

### **WBUW: Madison, Wisconsin**

Designated Market Area: 86  
Total Age 2+ Population: 835,000

TV Households: 349,000

*Market Description.* Thirty-four percent of the total population of Madison is under 25 years of age. The estimated average household income in the Madison market is approximately \$47,300 per year. Madison is the state capitol of Wisconsin and in addition to the state government, major employers in the market include General Motors, Lands End, Mercy Health System and the University of Wisconsin.

*Station Overview.* We acquired WBUW through a bankruptcy auction in December 2002. Under an interim local management agreement (LMA), we became fully responsible for its operations effective November 1, 2002. WBUW signed on the air in May 1984 as an affiliate of The UPN Network. Pursuant to the terms of our asset purchase agreement, the UPN affiliation was terminated and the station became a primary WB Television Network affiliate in August 2002. The station s syndicated programming currently includes *That 70 s Show*, *Home Improvement*, *Blind Date* and *Change of Heart*. The station has contracted for the future exclusive market broadcast rights to the popular show *King of Queens* and *Friends* (second cycle), which begin airing in September 2003 and 2006, respectively. In the November 2002 sweeps period, WBUW delivered a .7 rating amongst adult 18-49 viewers for the 5 p.m. midnight, Monday through Sunday, time period a 17% increase over the comparable rating for the November 2001 sweeps period.

### **Pending Construction Permit Acquisitions**

We own the rights to acquire construction permits to build four other stations three to be new WB Network affiliates in Lexington, KY, Richmond, VA and Flint Saginaw Bay Cities, MI and the fourth station, in Portland, OR. The acquisition of these construction permits is dependent on the Federal Communications Commission approving the underlying applications. The aggregate purchase price for these four construction permits is approximately \$18.4 million. The construction permit in Portland, Oregon, if granted, is subject to an option granted to Tribune Broadcasting Company in connection with our KWBP-TV sale transaction.

### **Our Affiliation Agreements**

Each of our eight WB Network affiliated stations has entered into a station affiliation agreement with The WB Network that provides each station with the exclusive right to broadcast The WB Network programming in its respective market. These affiliate agreements have three to 10 year terms that expire between April 2004 and April 2009. KASY, our UPN affiliated station in Albuquerque Santa Fe, New Mexico, has entered into an affiliation agreement with UPN that expires in January 2005.

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Under the affiliation agreements, The WB Network and UPN retain the right to program and sell approximately 75% of the advertising time available during their prime time schedule with the remaining 25% available for sale by our stations. Both networks retain approximately 50% of the advertising time available during kids programming aired in other dayparts.

For our eight WB Network affiliated stations, in addition to the advertising time retained for sale by The WB Network, each station is also subject to annual compensation payments to The WB Network. The amount of compensation is determined by taking into account the station's average ratings among adults ages 18-49 during The WB Network prime time programming, as well as the number of prime time programming hours provided per week by The WB Network. For our UPN affiliate, KASY, no compensation is paid by either party. We participate in cooperative marketing efforts with The WB Network and UPN whereby the networks reimburse up to 50% of certain approved advertising expenditures by a station to promote network programming. Our affiliation agreement for WBXX entitles that station to certain most favorable terms agreed to by The WB Network and any affiliate, during the term of the affiliation agreement, and any subsequent modifications.

In addition, as part of our acquisition of WBDT, WIWB and WBUI, we entered into a five-year secondary affiliation agreement (expiring in 2004) with Pax Net at these stations. We are generally obligated to run the Pax Net prime time programming in certain morning dayparts. We retain a portion of the advertising time during this programming for local sales, and Pax Net retains the balance.

## **Advertising/Sales**

Virtually all of our revenues consist of advertising revenues, and no single advertiser accounted for more than 10% of our gross advertising revenues in these periods. Our advertising revenues are generated both by local advertising and national spot advertising.

*Local Advertising.* Local advertising revenues are generated by both local merchants and service providers and by regional and national businesses and advertising agencies located in a particular designated market area. Local advertising revenues represented 57% of our net advertising revenues in 2000, 58% in 2001 and 60% in 2002.

*National Spot Advertising.* National spot advertising represents time sold to national and regional advertisers based outside a station's designated market area. National spot advertising revenues represented 43% of our net advertising revenues in 2000, 42% in 2001 and 40% in 2002. National spot advertising primarily comes from:

new advertisers wishing to test a market;

advertisers who are regional retailers and manufacturers without national distribution;

advertisers who need to enhance network advertising in given markets; and

advertisers wishing to place more advertisements in specified geographic areas.

## **Our Competition**

Broadcast television stations compete for advertising revenues primarily with other broadcast television stations in their respective markets and, to a lesser but increasing extent, with radio stations, cable television system operators, newspapers, billboard companies, direct mail and internet sites. ABC, CBS, NBC and Fox programming generally achieve higher household audience levels than that of The WB Network, UPN and syndicated programming aired by independent stations which is attributable to a number of factors, including:

the traditional networks' efforts to reach a broader audience;

historically, less competition;

generally better channel positions;

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more network programming being broadcast weekly;

the traditional networks' cross-promotions; and

the traditional networks' more established market presence than The WB Network.

However, because The WB Network and UPN provide fewer hours of programming per week than the traditional networks, we have a significantly higher inventory of advertising time for our own use and, therefore, our programs achieve a share of television market advertising revenues greater than their share of the market's audience. We believe that this available advertising time, combined with our efforts to attract (via our programming) the audiences that are key targets of advertisers, and our focus on advertising sales allows us to compete effectively for advertising revenues within our stations' markets.

The broadcasting industry is continuously faced with technical changes and innovations, the popularity of competing entertainment and communications media, changes in labor conditions, and governmental restrictions or actions of federal regulatory bodies, including the FCC, any of which could possibly have an adverse effect on a television station's operations and profits. Sources of video service other than conventional television stations, the most common being cable television, can increase competition for a broadcast television station by bringing distant broadcasting signals not otherwise available to the station's audience, serving as a distribution system for national satellite-delivered programming and other non-broadcast programming originated on a cable system and selling advertising time to local advertisers. Other principal sources of competition include home video exhibition, direct-to-home broadcast satellite television, entertainment services and multi-channel multi-point distribution services. Currently, two FCC permittees, DirecTV and Echostar, provide subscription DBS services via high-power communications satellites and small dish receivers, and other companies provide direct-to-home video service using lower powered satellites and larger receivers. Furthermore, emerging technologies that allow viewers to digitally record and play back television programming may decrease viewership of commercials and, as a result, lower television advertising demand.

Other technology advances and regulatory changes affecting programming delivery through fiber optic telephone lines and video compression could lower entry barriers for new video channels and encourage the development of increasingly specialized niche programming. The Telecommunications Act of 1996 permits telephone companies to provide video distribution services via radio communication, on a common carrier basis, as cable systems or as open video systems, each pursuant to different regulatory schemes. We cannot predict the effect that these and other technological and regulatory changes will have on the broadcast television industry or on the future profitability and value of a particular broadcast television station.

Broadcast television stations compete with other television stations in their designated market areas for the acquisition of programming. Generally, cable systems do not compete with local stations for programming, but various national cable networks do from time to time and on an increasing basis acquire programming that could have been offered to local television stations. Public broadcasting stations generally compete with commercially-rated broadcasters for viewers, but do not compete for advertising revenues. Historically, the cost of programming has increased because of an increase in the number of independent stations and a shortage of quality programming.

## **Federal Regulation of Television Broadcasting**

Television broadcasting is a regulated industry and is subject to the jurisdiction of the FCC under the Communications Act of 1934, as amended from time to time. The Communications Act prohibits the operation of television broadcasting stations except under a license issued by the FCC. The Communications Act empowers the FCC, among other things:

to issue, revoke and modify broadcast licenses;

to decide whether to approve a change of ownership or control of station licenses;

to regulate the equipment used by stations; and

to adopt and implement regulations to carry out the provisions of the Communications Act.

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Failure to observe FCC or other governmental rules and policies can result in the imposition of various sanctions, including monetary forfeitures, the grant of short, or less than maximum, license renewal terms or, for particularly egregious violations, the denial of a license renewal application, the revocation of a license or denial of FCC consent to acquire additional broadcast properties.

*License Grant, Renewal, Transfer and Assignment.* A party must obtain a construction permit from the FCC to build a new television station. Once a station is constructed and commences broadcast operations, the permittee will receive a license which must be renewed by the FCC at the end of each license term (which may be as long as eight years under current law). The FCC grants renewal of a broadcast license if it finds that the station has served the public interest, convenience, and necessity, there have been no serious violations by the licensee of the Communications Act or FCC rules and policies, and there have been no other violations of the Communications Act and FCC rules and policies which, taken together, would constitute a pattern of abuse. If the FCC finds that a licensee has failed to meet these standards, the FCC may deny renewal, condition renewal, or impose some other sanction (such as forfeiture). Any other party with standing may petition the FCC to deny a broadcaster's application for renewal. However, only if the FCC issues an order denying renewal will the FCC accept and consider applications from other parties for a construction permit for a new station to operate on that channel. The FCC may not consider any new applicant for the channel in making determinations concerning the grant or denial of the licensee's renewal application. Although renewal of licenses is granted in the majority of cases even when petitions to deny have been filed, we cannot be sure our station licenses will be renewed for a full term or without modification.

Our current licenses expire as follows:

Station (by market ranking)	Expiration Date
KUWB / Salt Lake City	October 1, 2006
KWBQ / Albuquerque Santa Fe	October 1, 2006
KASY / Albuquerque Santa Fe	October 1, 2006
WBDT / Dayton	October 1, 2005
WBXX / Knoxville	August 1, 2005
WIWB / Green Bay Appleton	December 1, 2005
WTVK / Ft. Myers Naples	February 1, 2005
WBUI / Champaign Decatur Springfield	December 1, 2005
WBUW / Madison	December 1, 2005

The Communications Act prohibits the assignment of a broadcast license or the transfer of control of a broadcast licensee without the prior approval of the FCC. In determining whether to permit the assignment or transfer of control of, or the grant or renewal of, a broadcast license, the FCC considers a number of factors pertaining to the licensee, including:

- compliance with various rules limiting common ownership of media properties;
- the character of the licensee and those persons holding attributable interests therein; and
- compliance with the Communications Act's limitations on alien ownership.

Character generally refers to the likelihood that the licensee or applicant will comply with applicable law and regulation. Attributable interests generally refer to the level of ownership or other involvement in station operations which would result in the FCC attributing ownership of that station or other media outlet to the person or entity in determining compliance with FCC ownership limitations.

To obtain the FCC's prior consent to assign a broadcast license or transfer control of a broadcast licensee, an application must be filed with the FCC. If the application involves a substantial change in ownership or control, the application must be placed on public notice for a period of no less than 30 days during which petitions to deny the application may be filed by interested parties, including certain members of the public. If the FCC grants the

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application, interested parties have no less than 30 days from the date of public notice of the grant to seek reconsideration or review of that grant by the commission or, as the case may be, a court of competent jurisdiction. The full FCC commission has an additional 10 days to set aside on its own motion any action taken by the FCC's staff. When passing on an assignment or transfer application, the FCC is prohibited from considering whether the public interest might be better served by an assignment or transfer to any party other than the assignee or transferee specified in the application.

*Ownership Restrictions.* The officers, directors and equity owners of 5% or more of our outstanding voting stock or the voting stock of a company holding one or more broadcast licenses are deemed to have an attributable interest in the broadcast company. However, specified institutional investors, including mutual funds, insurance companies and banks acting in a fiduciary capacity, may own up to (but not as much as) 20% of the outstanding voting stock without being subject to attribution if they exercise no control over the management or policies of the broadcast company. Finally, even if it owns non-voting stock, a third party could be deemed to have an attributable interest if it owns more than 33 percent of a station's (or the Company's) asset value (which is generally defined by the FCC to mean the aggregate of equity plus debt) and either has another attributable interest in the same market as the station(s) or provides more than 15 percent of the weekly programming for the station(s).

The FCC rules generally prohibit the issuance of a license to any party, or parties under common control, for a television station if that station's Grade B contour overlaps with the Grade B contour of another television station in the same DMA in which that party or those parties already have an attributable interest. FCC rules provide an exception to that general prohibition and allow ownership of two television stations with overlapping Grade B contours under any one of the following circumstances:

there will be eight independent full-power television stations in the DMA after the acquisition or merger and one of the two television stations owned by the same party is not among the top four-ranked stations in the DMA based on audience share;

the station to be acquired is a failing station under FCC rules and policies;

the station to be acquired is a failed station under FCC rules and policies; or

the acquisition will result in the construction of a previously unbuilt station.

A court of appeals determined in a recent decision that the FCC's restrictions on television ownership were not justified by evidence in the public record and failed to satisfy the standards set forth in the Communications Act. In reaching that conclusion, the court focused on the inconsistency in the FCC's assessment of competition in formulating its media ownership rules. In shaping the television ownership rules, the FCC considered only the existence of other television stations on the theory that television does not compete with other media; conversely, in shaping rules concerning common ownership of television and radio stations in the same market, the FCC acknowledged and accounted for competition among television stations, radio stations, daily newspapers and cable television systems. In response to the court decision and other developments, the FCC inaugurated a comprehensive rulemaking proceeding to review its broadcast ownership rules to ensure that they are adequately supported by the factual record and are consistent with each other.

FCC regulations also prohibit one owner from having attributable interests in television broadcast stations that reach in the aggregate more than 35% of the nation's television households. For purposes of this calculation, stations in the UHF band, which covers channels 14-69, are attributed with only 50% of the households in their respective markets (while 100% of the market households are attributed to stations in the VHF band, which covers channels 2-13). A recent court decision concluded that the FCC's 35% limitation is not adequately supported by sufficient evidence in the public record and directed the FCC to conduct further proceedings to determine whether a limitation on national television attribution can be justified and, if so, what that limitation should be. As a result, that issue is also being considered in the FCC's comprehensive rulemaking on broadcast ownership rules.

The FCC's comprehensive rulemaking is also considering the radio-television cross-ownership rule. One of those issues concerns rules which generally allow the holder of an attributable interest in a television station to have an attributable interest in:



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up to six radio stations in a market with 20 independent media voices;

up to four radio stations in a market with 10 independent media voices; and

at least one radio station in any market.

Another major issue being considered in the FCC's comprehensive rulemaking is the newspaper cross-ownership rule. FCC rules generally prohibit a party with an attributable interest in a television station from owning a daily newspaper serving a community located within the relevant coverage area of that television station. The FCC is now seeking evidence and argument to decide whether those rules should be retained, modified, or repealed in their entirety.

The FCC's comprehensive rulemaking is not revisiting issues related to common ownership of television stations and cable television systems in the same market. The rule which prohibited that common ownership was vacated by the court which addressed the national cap on television ownership. The FCC did not challenge that judicial decision.

*Restrictions on Foreign Ownership.* The Communications Act prohibits the issuance of broadcast licenses to, or the holding of a broadcast license by, foreign citizens or any corporation of which more than 20% of the capital stock is owned of record or voted by non-U.S. citizens or their representatives or by a foreign government or a representative thereof, or by any corporation organized under the laws of a foreign country. The Communications Act also authorizes the FCC to prohibit the issuance of a broadcast license to, or the holding of a broadcast license by, any corporation controlled by any other corporation of which more than 25% of the capital stock is owned of record or voted by aliens. The FCC has interpreted these restrictions to apply to other forms of business organizations, including partnerships. As a result of these provisions, the licenses granted to our subsidiaries that hold FCC licenses could be revoked if more than 25% of our stock were directly or indirectly owned or voted by aliens. Our certificate of incorporation contains limitations on alien ownership and control substantially similar to those contained in the Communications Act. Pursuant to our certificate of incorporation, we have the right to refuse to sell shares to aliens or to repurchase alien-owned shares at their fair market value to the extent necessary, in the judgment of our board of directors, to comply with the alien ownership restrictions.

*Programming and Operation.* The Communications Act requires broadcasters to serve the public interest, convenience and necessity. The FCC has gradually restricted or eliminated many of the more formalized procedures it had developed to promote the broadcast of programming responsive to the needs of the station's community of license. Licensees continue to be required, however, to present programming that is responsive to community problems, needs and interests and to maintain certain records demonstrating such responsiveness. Complaints from viewers concerning a station's programming will be considered by the FCC when it evaluates the licensee's renewal application, but these complaints may be filed and considered at any time.

Stations must also pay regulatory and application fees and follow various FCC rules that regulate, among other things:

political advertising;

children's programming;

the broadcast of obscene or indecent programming;

sponsorship identification; and

technical operations.

Failure to observe these or other rules and policies can result in the imposition of various sanctions, including monetary forfeitures, the grant of short, less than the maximum, renewal terms, or for particularly egregious violations, the denial of a license renewal application or the revocation of a license.

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*Review of Must Carry Rules.* FCC regulations implementing the Cable Television Consumer Protection and Competition Act of 1992 require each television broadcaster to elect, at three-year intervals beginning October 1, 1993, to either:

require carriage of its signal by cable systems in the station's market which is referred to as must carry rules; or

negotiate the terms on which such broadcast station would permit transmission of its signal by the cable systems within its market, which is referred to as retransmission consent.

The United States Supreme Court upheld the must-carry rules in a 1997 decision. These must carry rights are not absolute, and their exercise is dependent on a variety of factors such as:

the number of active channels on the cable system;

the location and size of the cable system; and

the amount of programming on a broadcast station that duplicates the programming of another broadcast station carried by the cable system.

Therefore, under certain circumstances, a cable system may decline to carry a given station. We have elected must carry for each of our stations on all of the cable systems where such carriage can be elected. See also *Digital Television Services* below.

*Local Marketing Agreements.* Under FCC rules, the licensee of a television station providing more than 15% of another television station's programming under a local marketing agreement is considered to have an attributable interest in the other station for purposes of the FCC's national and local multiple ownership rules if both stations are located in the same market. The FCC also adopted a grandfathering policy providing that local marketing agreements that are in compliance with the previous FCC rules and policies and were entered into before November 5, 1996, would be permitted to continue in force until the FCC conducts its biennial review of regulations in 2004. Local marketing agreements entered into after November 5, 1996 but prior to the adoption of the new FCC rules in 1999 were grandfathered until August 2001.

Prior to the adoption of the FCC's new rules, we did, from time to time, enter into local marketing agreements, generally in connection with pending station acquisitions. By using local marketing agreements, we can provide programming and other services to a station that we have agreed to acquire before we receive all applicable FCC and other governmental approvals.

Subject to ownership restrictions in the new FCC rules and policies, FCC rules and policies generally permit local marketing agreements if the station licensee retains ultimate responsibility for and control of the applicable station, including finances, personnel, programming and compliance with the FCC's rules and policies. We cannot be sure that we will be able to air all of our scheduled programming on a station with which we may have a local marketing agreement or that we would receive the revenue from the sale of advertising for such programming.

*Digital Television Services.* The FCC has adopted rules for implementing digital television service in the United States. Implementation of digital television will improve the technical quality of television signals and provide broadcasters the flexibility to offer new services, including high-definition television and data broadcasting.

The FCC has established service rules and adopted a table of allotments for digital television. Under the table, all eligible broadcasters with a full-power television station are allocated a separate channel for digital television operation. Stations will be permitted to phase in their digital television operations over a period of years, after which they will be required to surrender their license to broadcast the analog, or non-digital, television signal. FCC rules required all commercial television stations to be on the air with a digital signal by May 1, 2002. However, the FCC invited television owners in medium and smaller markets to request an extension of that deadline for their respective stations if they needed it, and certain of our stations have received such extensions.

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In announcing its receptivity to extensions of digital television construction deadlines, the FCC recognized the practical and technical difficulties of requiring television broadcasters to implement digital television. For those same reasons, the FCC suspended most of the construction and service deadlines that had previously been imposed. The FCC recently inaugurated a new rulemaking proceeding to reinstate those deadlines. In the meantime, the Communications Act still requires television broadcasters to return their analog license to the government by 2006 unless specified conditions exist that, in effect, limit the public's access to digital television transmissions in a particular market. Legislative proposals have been introduced in Congress that could affect that deadline, but to date none have been enacted.

The Communications Act and the FCC's rules impose certain conditions on the FCC's implementation of digital television service. Among other requirements, the FCC must:

limit the initial eligibility for licenses to existing television broadcast licensees or permittees (who held those licenses or permits by April 3, 1997);

allow digital television licensees to offer ancillary and supplementary services; and

charge appropriate fees to broadcasters that supply ancillary and supplementary services for which such broadcasters derive certain non-advertising revenues.

Equipment and other costs associated with the digital television transition, including the necessity of temporary dual-mode operations, will impose some near-term financial costs on television stations providing the services. The potential also exists for new sources of revenue to be derived from digital television. We cannot predict the overall effect the transition to digital television might have on our business.

Another major issue surrounding the implementation of digital television is the scope of a local cable television system's obligation to carry the signals of local broadcast television stations. The FCC has issued an order stating that, for the present, a cable television system is only obligated to carry a television's digital signal if the station does not have an analog signal. The FCC has not yet determined the scope of a cable television system's must-carry obligations when a broadcast television station has both an analog signal and a digital signal that each has a substantial audience.

*Children's Television Act.* FCC rules limit the amount of commercial matter that a television station may broadcast during programming directed primarily at children 12 years old and younger. FCC rules further require television stations to serve the educational and informational needs of children 16 years old and younger through the stations' own programming as well as through other means. Television broadcasters must file periodic reports with the FCC to document their compliance with foregoing obligations.

*Other FCC and Legislative Matters.* The FCC repealed the rule that prohibited one of the major television networks (ABC, CBS, NBC or Fox) from owning another television network. Viacom utilized that change in FCC rules to acquire an interest in UPN. The FCC's comprehensive rulemaking proceeding is now examining the rule that prohibits dual ownership of two or more of the major networks. We cannot predict how the FCC will resolve that issue or how or when the relaxation of the prior dual network rule may affect our business.

The Satellite Home Viewer Act and related FCC regulations allow satellite carriers to deliver broadcast programming to subscribers who are unable to obtain television network programming over the air from local television stations. Congress later amended the act to facilitate the ability of satellite carriers to provide subscribers with programming from both local and non-local television stations (regardless of the subscribers' ability to receive the television signals over the air). The FCC has adopted rules to implement certain of those legislative changes and is conducting rulemaking proceedings to implement others. A principal component of the new regulation requires satellite carriers to carry the analog signals of all local television stations in a market if they carry one. We have taken advantage of that regulation to require carriage of our stations on satellite systems in the Salt Lake City, Albuquerque-Santa Fe, Knoxville and Ft. Myers-Naples markets. The FCC has refused to require satellite carriers to carry a television station's digital signal, even if the station does not have an analog signal. We cannot predict whether that policy will remain in place and, if so, whether it could adversely affect our business in the future.

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On November 7, 2002, the FCC adopted new rules that require broadcast licensees to provide equal employment opportunities. The new rules require broadcast licensees to widely disseminate information on employment vacancies and to promote diversification in their employment. The new rules are intended to supplement a broadcaster's obligation to refrain from racial or other prohibited discrimination in its employment practices under other applicable federal as well as state and local laws and regulations. The new EEO rules impose substantial record-keeping obligations on broadcasters, require that certain television stations (those with five or more full-time employees) submit reports concerning their EEO efforts mid-way through their license term, and require all television stations to submit information on their EEO compliance with their renewal applications.

Federal regulatory agencies and Congress from time to time consider proposals for additional or revised rules. We cannot predict how those proposals or other issues discussed above will be resolved, although their outcome could have an adverse or favorable impact on the broadcasting industry generally or us specifically.

The foregoing summary of FCC and other governmental regulations is not intended to be comprehensive. For further information concerning the nature and extent of federal regulation of broadcast stations, you should refer to the Communications Act, other Congressional acts, FCC rules, and the public notices and rulings of the FCC.

## **Employees**

At December 31, 2002, our continuing operations had 253 employees, none of whom are subject to collective bargaining agreements. We believe that our relationships with our employees are good.

## **Available Information**

The Company maintains an Internet website at [www.acmecomcommunications.com](http://www.acmecomcommunications.com) where the Company's Annual Report on Form 10-K, Quarterly Reports on 10-Q, Current Reports on Form 8-K and all amendments to those reports are available without charge, as soon as reasonably practicable following the time that they are filed with or furnished to the Securities and Exchange Commission.

## **Item 2. *Properties***

All of our leased studio, office and tower facilities are leased pursuant to long-term leases. We believe that all facilities and equipment are adequate, with minor changes and additions, for conducting operations as presently contemplated. Set forth below is information with respect to our studios and other facilities for our current stations and our discontinued operations. Information as to tower size reflects the height above average terrain of the antenna radiation center.

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Market	Approximate Size	Ownership
St. Louis, Missouri(4)		
Studio and office facilities	36,000 sq. ft.	Leased
Tower (analog)	1,011 ft.	Leased
Tower (digital)	945 ft.	Leased
Portland, Oregon(4)		
Studio and office facilities	15,255 sq. ft.	Owned
Tower (analog)	1,785 ft.	Leased
Tower (digital)(2)	1,716 ft.	Owned
Salt Lake City, Utah		
Studio and office facilities	9,500 sq. ft.	Leased
Tower (analog & digital)(2)	4,125 ft.	Owned
Albuquerque Santa Fe, New Mexico		
Studio and office facilities	9,000 sq. ft.	Leased
Tower (analog & digital)	4,183 ft.	Leased
Tower (analog & digital back-up)	4,222 ft.	Leased
Dayton, Ohio		
Studio and office facilities	10,000 sq. ft.	Leased
Tower (analog & digital)	954 ft.	Leased
Knoxville, Tennessee		
Studio and office facilities	8,000 sq. ft.	Leased
Tower (analog & digital)(1)	2,399 ft.	Owned
Green Bay Appleton, Wisconsin		
Studio and office facilities	2,640 sq. ft.	Leased
Tower (analog)(1)	660 ft.	Owned
Tower (digital)(3)	1,089 ft.	Leased
Ft. Meyers Naples, Florida		
Studio and office facilities	5,000 sq. ft.	Leased
Tower (analog & digital)	1,496 ft.	Leased
Champaign Springfield Decatur, Illinois		
Studio and office facilities	9,600 sq. ft.	Owned
Tower (analog & digital)(1)	2,001 ft.	Owned
Madison, Wisconsin		
Studio and office facilities	4,000 sq. ft.	Leased
Tower (analog)	1,053 ft.	Leased

(1) Tower owned on leased property.

(2) Represents partnership interests in digital television towers in the Salt Lake and Portland markets.(3) Tower to be operational in 2003(4) Station sold in March 2003

**Item 3. Legal Proceedings**

We currently, and from time to time, are involved in litigation incidental to the conduct of our business. We maintain comprehensive general liability and other insurance that we believe to be adequate for the purpose. We are not currently a party to any lawsuit or proceeding that we

believe could have a material adverse effect on our financial condition or results of operations.

**Item 4. *Submission of Matters to a Vote of Security Holders***

No matter was submitted to a vote of the security holders during the fourth quarter of 2002.

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**Executive Officers of the Registrant**

The following table sets forth information about our executive officers at December 31, 2002.

Name	Age	Position
Jamie Kellner	55	Chairman of the Board and Chief Executive Officer
Douglas Gealy	42	President, Chief Operating Officer and Director
Thomas Allen	50	Executive Vice President, Chief Financial Officer and Director
Edward Danduran	50	Vice President, Controller

*Jamie Kellner* is a founder of ACME and has served as our Chief Executive Officer and Chairman of the Board since 1997. Mr. Kellner is also a founder and the Chairman and Chief Executive Officer of The WB Network since 1993. Mr. Kellner was President of Fox Broadcasting Company from its inception in 1986 to 1993.

*Douglas Gealy* is a founder of ACME and has served as our President and Chief Operating Officer and as a member of our Board since 1997. Since December of 1996, Mr. Gealy has been involved in development activities for ACME. Before founding ACME, Mr. Gealy served for one year as Executive Vice President of Benedek Broadcasting Corporation. From 1991 to 1996, Mr. Gealy was a Vice President and General Manager of WCMH and its local marketing agreement, WWHO, both in Columbus, Ohio, and following the acquisition of these stations by NBC, served as President and General Manager of these stations.

*Thomas Allen* is a founder of ACME and has served as our Executive Vice President and Chief Financial Officer and as a member of our Board since 1997. Since June 1996, Mr. Allen has been involved in development activities for ACME. From August 1993 to May 1996, Mr. Allen was the Chief Operating Officer and Chief Financial Officer for Virgin Interactive Entertainment. Before that Mr. Allen served as Senior Vice President and Chief Financial Officer of the Fox Broadcasting Company from 1986 to 1993.

*Edward Danduran* has been our Vice President and Controller since July 1997. From November 1995 until April 1997, Mr. Danduran was a Financial Consultant for Virgin Interactive Entertainment, Inc. From 1989 to 1995, Mr. Danduran was the Chief Financial Officer of Phoneby, a business communications company.

**PART II**

**Item 5. Market for Registrant's Common Equity and Related Stockholder Matters**

The Company's common stock is traded on the NASDAQ National Market under the symbol ACME. As of March 26, 2003, there were 31 stockholders of record.

We have not declared or paid any cash dividends or distributions on our common stock since our inception. We anticipate that, for the foreseeable future, all earnings will be retained for use in our business and no cash dividends will be paid on our common stock. Any payment of future cash dividends on our common stock will be dependent upon the ability of our subsidiaries to pay dividends or make cash payments or advances to us. Our credit agreement and our subsidiaries' indentures impose restrictions on our subsidiaries' ability to make these payments. Our ability to pay future dividends will also be subject to restrictions under any future debt obligations and other factors that our board of directors deems relevant.

Below are the Nasdaq high, low and closing prices of ACME Communications, Inc. for each quarter of 2002 and 2001.

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	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
<b>2002</b>				
High	\$ 10.45	\$ 11.25	\$ 9.66	\$ 8.45
Low	6.00	7.23	6.68	5.35
Close	10.34	7.35	7.80	7.97
<b>2001</b>				
High	\$ 12.75	\$ 11.13	\$ 9.40	\$ 7.35
Low	8.50	7.00	5.52	4.00
Close	10.56	8.01	7.00	6.41

**Item 6. Selected Financial Data**

Following is ACME Communications' selected consolidated financial data for the past five years. In accordance with generally accepted accounting principles, operating results relating to our St. Louis and Portland stations, which are being sold, are included and accounted for as discontinued operations. This data is derived from the audited Consolidated Financial Statements of the Company and should be read in conjunction with the Consolidated Financial Statements and Notes thereto (located at Item 8 of this filing) and with Management's Discussion and Analysis of Financial Condition and Results of Operations (located at Item 7 of this filing).

	For the Years Ended December 31,				
	1998	1999	2000	2001	2002
	(In thousands, except per share data)				
<b>Statement of Operations Data:</b>					
Net revenues	\$ 5,737	\$ 16,288	\$ 26,153	\$ 27,793	\$ 36,006
Operating expenses:					
Station operating expenses	8,064	18,867	28,393	30,846	36,936
Depreciation and amortization	2,472	5,776	9,003	9,730	3,981
Corporate	2,627	6,398	3,522	3,769	3,984
Equity-based compensation(1)		39,639	335	335	267
LMA fees	228	28			45
Operating loss	(7,654)	(54,420)	(15,100)	(16,887)	(9,207)
Other income (expenses):					
Interest income	231	499	1,380	921	125
Interest expense	(23,777)	(28,475)	(27,141)	(28,625)	(30,859)
Gain (loss) on sale of assets	1,112		(67)		
Other expense			(91)	(73)	(153)
Loss from continuing operations before income taxes and minority interest	(30,088)	(82,396)	(41,019)	(44,664)	(40,094)
Income tax benefit (expense)	4,021	6,465	12,467	14,308	(24,276)
Loss from continuing operations before minority interest	(26,067)	(75,931)	(28,552)	(30,356)	(64,370)
Minority interest	1,684	2,085			
Loss from continuing operations	(24,383)	(73,846)	(28,552)	(30,356)	(64,370)
Income from discontinued operations, net of tax	2,443	\$ 3,067	\$ 6,514	\$ 2,507	\$ 8,394



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Net Loss	<u>\$(21,940)</u>	<u>\$(70,779)</u>	<u>\$(22,038)</u>	<u>\$(27,849)</u>	<u>\$(55,976)</u>
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**Table of Contents****Statement of Operations Data (Continued):**

For the Years Ended December 31,

	1998	1999	2000	2001	2002
(In thousands, except per share data)					
Loss from continuing operations before income taxes and minority interest, as reported	\$ (30,088)	\$ (82,396)	\$ (41,019)	\$ (44,664)	\$ (40,094)
Tax benefit (expense)(4)	10,026	14,304	12,467	14,308	(24,276)
Loss before minority interest	(20,062)	(68,092)	(28,552)	(30,356)	(64,370)
Pro forma minority interest allocation(4)	1,385	1,629			
Loss from continuing operations	(18,677)	(66,463)	(28,552)	(30,356)	(64,370)
Income from discontinued operations	2,443	3,067	6,513	2,507	8,394
Pro forma net loss	(16,234)	(63,396)	(22,038)	(27,849)	(55,976)
Income (loss) per share:(4)					
Continuing operations	\$ (3.70)	\$ (8.35)	\$ (1.70)	\$ (1.81)	\$ (3.84)
Discontinued operations	0.48	0.39	0.38	0.15	0.50
Net loss per share, basic and diluted	\$ (3.22)	\$ (7.96)	\$ (1.32)	\$ (1.66)	\$ (3.34)
Basic and diluted weighted average common shares outstanding	5,045,256	7,961,379	16,750,000	16,750,000	16,750,000
Pro forma net loss	\$ (16,234)	\$ (63,396)	\$ (22,038)	\$ (27,849)	\$ (55,976)
Add back:					
Goodwill amortization	3,093	4,652	6,387	6,388	
Broadcast licenses amortization	6,318	8,750	10,024	10,028	
Income tax expense	(2,415)	(3,344)	(3,831)	(3,836)	
Adjusted net loss	\$ (9,238)	\$ (53,338)	\$ (9,458)	\$ (15,269)	\$ (55,976)
Basic and Diluted loss per share:					
Add back:					
Reported net loss	\$ (3.22)	\$ (7.96)	\$ (1.32)	\$ (1.66)	\$ (3.34)
Add back:					
Goodwill amortization	0.62	0.58	0.38	0.38	
Broadcast licenses amortization	1.25	1.10	0.60	0.60	
Income tax expense	(0.48)	(0.42)	(0.23)	(0.23)	
Adjusted net loss	\$ (1.83)	\$ (6.70)	\$ (0.57)	\$ (0.91)	\$ (3.34)
<b>Balance Sheet Data:</b>					
Total assets	\$ 286,827	\$ 409,892	\$ 411,192	\$ 407,385	\$ 393,276
Total debt(2)	225,728	217,078	239,251	250,150	275,001
Total stockholders equity	1,413	126,835	105,326	78,006	22,491

**Supplemental Financial Data:**

<b>Broadcast cash flow and EBITDA(3):</b>					
Operating loss	\$ (7,654)	\$ (54,420)	\$ (15,100)	\$ (16,887)	\$ (9,207)
Add back:					
Equity-based compensation(1)		39,639	335	335	267
Depreciation and amortization	2,472	5,776	9,003	9,730	3,981
LMA Fees	228	28			45
Amortization of program rights	1,045	2,900	6,784	7,529	9,109
Corporate expenses	2,627	6,398	3,522	3,769	3,984
Adjusted program payments(3)	(1,208)	(3,288)	(6,689)	(7,882)	(9,459)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Broadcast cash flow	(2,490)	(2,967)	(2,145)	(3,406)	(1,280)
Less:					
Corporate expenses	2,627	6,398	3,522	3,769	3,984
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
EBITDA	\$ (5,117)	\$ (9,365)	\$ (5,667)	\$ (7,175)	\$ (5,264)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Broadcast cash flow margin(3)	(43.4)%	(18.2)%	(8.2)%	(12.3)%	(3.6)%
EBITDA margin(3)	(89.2)%	(57.5)%	(21.7)%	(25.8)%	(14.6)%

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(1) Equity-based compensation is allocable as follows:

	<b>Year ended December 31,</b>			
	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001 2002</b>
	<b>(in thousands)</b>			
Station operating expense				
\$ \$66 \$197 \$197 \$173				
Corporate				
39,573 138 138 93				
Total				
\$ \$39,639 \$335 \$335 \$267				

(2) Includes the Company's 12% senior secured discount notes, the 10 7/8% senior discount notes, convertible debt, revolving credit facility and capital lease obligations.

(3) We define:

broadcast cash flow as operating income, plus equity-based compensation, depreciation and amortization, LMA fees, amortization of program rights, and corporate expenses, less program payments – the latter as adjusted to reflect reductions for liabilities relating to expired rights or rights which have been written-off in connection with acquisitions;

EBITDA as broadcast cash flow less corporate expenses;

broadcast cash flow margin is broadcast cash flow as a percentage of net revenues; and

EBITDA margin is EBITDA as a percentage of net revenues.

We have included broadcast cash flow, broadcast cash flow margin, EBITDA and EBITDA margin data because management believes that these measures are useful to an investor to evaluate our ability to service debt and to assess the earning ability of our stations operations. However, you should not consider these items in isolation or as substitutes for net income, cash flows from operating activities or other statement of operations or cash flows data prepared in accordance with generally accepted accounting principles. These measures

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are not necessarily comparable to similarly titled measures employed by other companies. The Company believes that operating loss is the closest GAAP measure to EBITDA and broadcast cash flow.

- (4) Pro forma net loss in 1998 and 1999 is calculated as actual net loss adjusted to reflect (i) a provision for income taxes on earnings before taxes, which gives effect to the Company being C corporation for all periods and (ii) the impact on the net loss allocated to the minority interest. Actual net loss and pro forma net loss are the same for 2000, 2001 and 2002.

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### *Overview*

On December 27, 2002, we announced that we had entered into agreements to sell two of our stations, KPLR-TV serving the St. Louis marketplace and KWBP-TV, serving the Portland, Oregon marketplace, to subsidiaries of Tribune Company for an aggregate, all-cash, consideration of \$275 million plus a payment for the closing-date working capital (subject to adjustment) of the St. Louis Station. We completed these transactions on March 21, 2003. The results relating to these two stations have been accounted for as discontinued operations in accordance with generally accepted accounting principles ( GAAP ).

The nine television stations that comprise our continuing operations are regionally diverse and range in market size (based on television households) from 36 through 86 in the nation. All but one of our stations are affiliates of The WB Television Network. Our second station in the Albuquerque-Santa Fe marketplace is a UPN affiliate. Our nine stations have only been on the air, or achieving measurable ratings, for 3-6 years.

We derive revenues primarily from the sale of advertising time to local, regional and national advertisers. Our revenues depend on popular programming that attracts audiences in the demographic groups targeted by advertisers, allowing us to sell advertising time at satisfactory rates. Our revenues also depend significantly on factors such as the national and local economy and the level of local competition.

Our revenues are generally highest during the fourth quarter of each year, primarily due to increased expenditures by advertisers in anticipation of holiday season consumer spending and an increase in viewership during this period. We generally pay commissions to advertising agencies on local, regional and national advertising and to national sales representatives on national advertising. Our revenues reflect deductions from gross revenues for commissions payable to advertising agencies and national sales representatives.

Our primary ongoing operating expenses are programming costs, employee compensation, advertising and promotion expenditures and depreciation and amortization. Programming expense consists primarily of amortization of broadcast rights relating to syndicated programs as well as costs associated with our morning news show, *The Daily Buzz*, music rights fees and sports rights fees. Changes in employee compensation expense result primarily from increases in total staffing levels, from adjustments to fixed salaries based on individual performance and inflation and from changes in sales commissions paid to our sales staff based on levels of advertising revenues. Advertising and

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promotion expenses consist primarily of media and related production costs resulting from the promotion of our stations and programs. This amount is net of any reimbursement received or due to us for such advertisement and promotion from The WB Network, UPN or from other program suppliers.

In the fall of 2000, we began to experience a noticeable slowdown in non-political advertiser demand. By December 2000, it was clear that there was a dramatic weakness in demand affecting all media-related companies and there were broader indications that the U.S. economy was in a slowdown. This slack demand continued through all of 2001, and the resultant effect of the events of September 11, 2001 only made a tough year worse. By industry accounts, 2001 television revenues declined approximately 13-15% over 2000, the steepest decline in the last 50 years. Nearly every publicly traded television broadcaster, including the Company, posted year-over-year declines in advertising revenues. Advertising demand began to rebound early in 2002 and by the end of the year, aided by robust political advertising demand in most markets, year-over-year gains in most of our markets averaged approximately 10%.

Although television advertising revenues grew in 2002 over 2001, and early 2003 market audits seem to indicate that this growth trend has continued, the current Iraqi conflict and an uncertain national economic environment provides little visibility as to the health of the advertising marketplace in general, and the eight marketplaces that we serve in particular.

### *Results of Operations*

#### *Year Ended December 31, 2002 compared to Year Ended December 31, 2001*

Net revenues for the year ended December 31, 2002 increased \$8.2 million (30%) to \$36.0 million compared to \$27.8 million for the year ended December 31, 2001. These revenue gains reflect primarily our ratings gains over the past year along with modest market revenue gains during 2002. On a same-station basis, excluding the results of our Madison acquisition in 2002, our revenues increased 29%.

Station operating expenses increased to \$36.9 million compared to the prior year's operating expenses of \$30.8 million. This increase of 20% was attributable primarily to our continued investment in programming, including our September 2002 launch of a new three-hour morning news show, *The Daily Buzz*, increases in our sales related costs and new expenses related to our roll-out of digital transmission services at most of our stations.

Depreciation and amortization expense for 2002 was \$4.0 million compared to \$9.7 million for 2001. This \$5.7 million decrease reflects the cessation of the amortization of intangible assets effective January 1, 2002 in connection with our implementation of SFAS No. 142 Accounting for Goodwill and Other Intangible Assets.

Corporate expenses for 2002 increased to \$4.0 million from \$3.8 million in 2001. This 6% increase in corporate expenses was due primarily to increased incentive compensation expense, professional fees and increased directors and officers insurance costs.

Equity-based compensation was \$267,000 in 2002 compared to \$335,000 in 2001. This non-cash expense, which relates to options granted below market value in 1999 to certain management in exchange for the termination of their participation in the Company's previously established long-term incentive plan, decreased in 2002 due to the termination of some of those participants.

Interest expense for the current year was \$30.9 million compared to \$28.6 million for 2001. This \$2.2 million increase in interest expense is the result of increasing principal balances arising from continued amortization of original issuance discounts on our ACME Television subsidiary's 10-7/8% Senior Discount Notes due 2004 (the Television Notes), which began accruing cash interest on October 1, 2001, and our ACME Intermediate subsidiary's 12% Senior Secured Discount Notes due 2005 (the Intermediate Notes), which began accruing cash interest on October 1, 2002. In addition, during 2002 we incurred higher interest charges on our senior credit facility, which was undrawn during 2001, but which was drawn upon in 2002 to fund interest payments on the Television Notes and capital expenditures in excess of operating cash flow.

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We incurred a tax expense of \$24.3 million in 2002 compared to a tax benefit of \$14.3 million in 2001. The tax expense in 2002 relates primarily to an increase in the valuation allowance required as a result of the implementation of SFAS No. 142 in the first quarter of 2002. The difference in the statutory federal rate of 34% and the Company's effective tax benefit of 32% relates to the impact of non-deductible expenses.

Our negative broadcast cash flow for 2002 was \$1.3 million, compared to a \$3.4 million negative broadcast cash flow in 2001. This 62% decrease in negative broadcast cash flow reflects the revenue gains achieved by our stations exceeding our increase in station operating expenses compared to 2001.

Our income from discontinued operations for the twelve months ended December 31, 2002 was \$8.4 million compared to \$2.5 million for calendar 2001. This increased income relates primarily to a reduction in amortization of intangibles (as a result of the adoption of SFAS No. 142), partially offset by an increase in our tax expense of discontinued operations.

Our net loss for 2002 was \$56.0 million as compared with the \$27.8 million loss incurred in 2001, an increase of \$28.1 million. This increase in our net loss is primarily the result of the one-time deferred tax expense recorded in 2002 resulting from the impact of SFAS No. 142 and increased interest expense, partially offset by improved operating results and reduced amortization of intangible assets.

*Year Ended December 31, 2001 compared to Year Ended December 31, 2000*

Net revenues for the year ended December 31, 2001 increased 6% to \$27.8 million as compared to \$26.2 million for the year ended December 31, 2000. This increase reflects modest revenue gains at our stations driven by increased ratings and market shares despite double digit declines in advertising market revenues in most of our markets.

Station operating expenses increased to \$30.8 million compared to the prior year's operating expenses of \$28.4 million. This 9% increase was due primarily to increased programming expenses and increased sales expenses relating primarily to Nielsen ratings services, net of reduced promotion expenses and incentive compensation expenses.

Depreciation and amortization expense was \$9.7 million in 2001 compared to \$9.0 million in 2000. This increase relates to increased depreciation on the significant capital expenditures placed into service during 2001 and 2000.

Corporate expenses for 2001 increased to \$3.8 million from \$3.5 million in 2000. This 7% increase relates primarily to increased professional fees incurred in connection with potential strategic transactions and increased directors and officers insurance expense, net of a reduction in incentive compensation expense.

Equity-based compensation was \$335,000 for both 2001 and 2000 and relates to options granted below market value in 1999 to senior management in exchange for the termination of their participation in the Company's previously established long-term incentive plan.

Interest expense for 2001 was \$28.6 million compared to \$27.1 million for 2000. This \$1.5 million increase in interest expense is primarily the result of the increased accretion of the Intermediate and Television Notes.

The tax benefit for 2001 was \$14.3 million compared to a \$12.5 million tax benefit for 2000, representing an effective tax benefit of 32% and 30% for 2001 and 2000, respectively. The difference in the statutory federal rate of 34% and the Company's effective tax benefit of 32% for 2001 and 30% for 2000 relates to the impact of non-deductible expenses.

Our negative broadcast cash flow for 2001 was \$3.4 million, compared to a \$2.1 million negative broadcast cash flow in 2000. This 59% increase in negative broadcast cash flow is primarily attributable to the increased station operating expenses in excess of only modest revenue gains, and therefore lower margins at most of our stations.

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Our income from discontinued operations for the twelve months ended December 31, 2001 was \$2.5 million compared to \$6.5 million for calendar 2000. This decreased income relates primarily to a decline in revenues at our discontinued stations which in turn relates to the downturn in advertising demand in these markets.

Our net loss for 2001 was \$27.8 million as compared with the \$22.0 million loss incurred in 2000, an increase of \$5.8 million. This increase in our net loss is primarily the result of the decrease in our net income from discontinued operations and increased interest expense.

## **Liquidity and Capital Resources**

Net cash used in operating activities was \$26.9 million for the year ended December 31, 2002 compared to net cash used in operating activities of \$25.1 million for 2001, an increase in use of cash of \$1.8 million. The increased use was primarily due to an increase in working capital needs as receivables built at the end of 2002 on strengthening ad sales.

Net cash used in investing activities was \$13.7 million for the year ended December 31, 2002, compared to \$7.1 million for 2001. The \$6.6 million increase relates primarily to our purchase of our Madison Station, net of reduced capital expectation.

Net cash provided by financing activities for the year ended December 31, 2002 was \$15.2 million, compared to \$1.8 million in 2001. The increase relates primarily to our borrowings to fund our Madison acquisition and increased capital expenditures relating to our digital build-out.

The Company has carried a high debt level since the issuance of its Television Notes and its Intermediate Notes in September 1997. These notes were issued at an original discount. The Television Notes began accruing cash interest on October 1, 2000 and the first semi-annual interest payment of \$9.5 million was made on March 31, 2001. The Intermediate Notes began accruing cash interest on October 1, 2002 and the initial semi-annual interest payment of \$4.2 million will be made on March 31, 2003. As of December 31, 2002, the balance under the Company's senior revolving credit facility was approximately \$18.8 million. The Company was in compliance with the covenants of all of our credit agreements as of December 31, 2002. At December 31, 2002, the Company had \$4.8 million of cash, \$2.9 million of which is restricted to collateralize capital lease obligations, and working capital of \$159.3 million.

Although we generated positive annual operating cash flow from our combined continuing and discontinued broadcast operations, before considering interest payments, since our inception in 1997, the weak advertising environment in 2001 resulted in our first-ever decline in such cash flow. On December 27, 2002, we announced that we had entered into agreements to sell our stations KPLR-TV, serving the St. Louis marketplace, and KWBP-TV, serving the Portland, Oregon marketplace, to subsidiaries of Tribune Company (the Tribune Transaction) for \$275 million in an all-cash transaction. The proceeds from these transactions, which closed on March 21, 2003, will be substantially used to repay much of the Company's debt. On March 21, 2003, we repaid all balances owing under our senior credit facility, issued redemption notices for all of our \$175 million Television Notes at the call price of 102.72 and issued a partial redemption notice for \$41.634 million of our \$71.634 million Intermediate Notes at the call price of 103.00. The redemption date for both issues is set for April 21, 2003. Following the redemption, we will have \$30 million outstanding of the Intermediate Notes. Our semi-annual interest payment on the Intermediate Notes will be reduced to \$1.8 million with the next payment due September 30, 2003.

At December 31, 2002, amounts due under all capital lease facilities was \$12.2 million bearing an implicit average interest rate of 8.41% per annum. We expect to incur approximately \$6 million in additional capital expenditures in 2003, primarily related to our upgrade of our transmission facilities at WBUW in Madison and, to a lesser extent, the routine capital expenditures at our other eight television stations.

Until such time as we amend, restructure or replace our current senior credit agreement, we have no borrowings available under that facility. The Company's remaining nine television stations will generate significantly reduced broadcast cash flow without the discontinued operations, but the Company's debt level and related interest expense will have been substantially reduced. The Company believes that the remaining proceeds from the Tribune Transaction, after repayment of the senior credit facility and redemption of the Television Notes and \$41.634 million of Intermediate Notes, will be sufficient to satisfy the Company's cash requirements for its existing operations for at least the next twelve months.

We expect to either amend, restructure or replace our senior credit facility during the second quarter of 2003. We are also in discussions to secure a capital lease line to finance our ongoing and future capital equipment expenditures. The Company expects that any future acquisitions and (related capital expenditures) of television stations, including any of the four construction permits, would be financed through these same sources and, if necessary, through additional debt and equity financings. Although we believe it would be a secondary alternative, we



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also have the ability to sell select stations in the event of unforeseen credit difficulties, such as might be experienced if there were further declines in the U.S. economy or in advertising demand. There is no guarantee that such other means of raising capital will be at terms acceptable to the Company, and accordingly current stockholders could be adversely affected by such financings.

**Certain Factors That May Effect Future Results and Financial Condition**

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The following factors could have a material and adverse impact on the Company's business:

The developmental nature of our continuing stations poses risks to stockholders, including the following:

we have not generated positive operating cash flow from our continuing operations and the future performance of the Company will depend upon our ability to continue increasing our ratings and revenues in a relatively healthy advertising environment;

our ability to obtain financing in the future for working capital, capital expenditures and general corporate purposes, including acquisitions might be impeded; and

we are more vulnerable to economic downturns and our ability to withstand competitive pressures is limited.

We derive substantially all of our revenues from advertisers in diverse industries. If a number of our advertisers continue to reduce their expenditures because of the current or a future general economic downturn, or an economic downturn in one or more industries or regions, or for any other reason, our results of operations would be materially and adversely affected.

If we do not meet our interest obligations under either our Intermediate Note indenture or an amended, restructured or new senior revolving credit facility, or if we otherwise default under these instruments, our debt may be accelerated under these instruments as well as other debt instruments we have. In addition, because of our leverage, we may be less able to respond to market conditions or meet extraordinary capital needs. If we are unable to generate sufficient cash flow from operations or borrow under an amended, restructured or new revolving credit agreement to meet our obligations and commitments, we will be required to raise additional debt or equity capital. Additionally, we may be required to sell material assets or operations or delay or forego acquisitions. These alternative strategies would likely not be effected on satisfactory terms, if at all.

Our Intermediate Note indenture contains restrictive covenants that limit our ability to:

incur additional debt;

pay dividends;

merge, consolidate or sell assets;

make acquisitions or investments; or

change the nature of our business.

We expect that an amended, restructured or new senior credit facility will be completed during the second quarter of 2003 and that it will require us to maintain certain financial covenants. If we fail to meet some or all of the covenants contained in this facility, we may not be able to borrow under the facility which might adversely affect our ability to make acquisitions as planned or meet general or extraordinary capital needs.

We have incurred net losses in each of our fiscal years since inception and expect to continue to experience net losses in the foreseeable future. These net losses have principally been the result of interest expense on our outstanding debt and non-cash charges for depreciation expense related to fixed assets.

Our plans to acquire additional television stations during the past several years have been adversely affected by our increased leverage resulting from a decline in our broadcast cash flow and the related constraints in borrowing under our revolving credit facility. Although we will have significantly reduced our debt through the sale of our discontinued operations, we will still likely need to borrow under a senior credit facility to successfully execute and implement additional station acquisitions. Our inability to secure such a credit facility could limit our future growth.

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Furthermore, our ability to acquire additional television stations is affected by the following:

many competing acquirers have greater resources available to make such acquisitions than we have;

desired stations might not be available for purchase;

we might be unable to obtain The WB Network affiliation for all of the stations we acquire;

we might not have the financial resources necessary to acquire additional stations;

we might be unable to obtain FCC approval of the assignments or transfers of control of FCC licenses; and

current FCC rules limit the number of television broadcasting properties that any one person or entity, including its affiliates, may own in any given market which could limit our ability to pursue desired stations.

Generally when we sign acquisition agreements, we enter into interim local marketing agreements with the seller under which we receive some or all of station revenues and pay proportionate station expenses. Because the seller retains ultimate programming control, we bear the economic risks of paying station expenses until closing the acquisition.

Mr. Kellner's consulting agreement provides that he may perform services for other businesses unaffiliated with ours that, in certain limited circumstances, may be competitive. Because of Mr. Kellner's experience in the television broadcast industry, if Mr. Kellner provides services to a competing business, it could materially affect our operations.

Mr. Kellner's position at The WB Network could create conflicts with his position with us if our interests differ from those of The WB Network. Because Mr. Kellner is both our Chief Executive Officer and The WB Network's Chief Executive Officer, The WB Network requires that he recuse himself from any material transaction between The WB Network and us. Additionally, due to his responsibilities with The WB Network, Mr. Kellner continues to have limited time available to devote to us.

All of our continuing television stations are relatively new in their markets and are still developing. Many of them have never generated positive broadcast cash flow and the group, as a whole, has never generated positive broadcast cash flow. Our ability to service our debt and stay in compliance with any credit agreements or indentures is ultimately dependent on our generating positive broadcast cash flow.

Emerging technologies that allow viewers to digitally record and play back television programming may decrease viewership of commercials and, as a result, lower our advertising revenues.

The required conversion of the broadcast industry to provide digitally transmitted television signals has required us to make significant capital expenditures which, in the short-term, will not be balanced by consumer demand for digital television. While the FCC required all broadcasters to provide a digitally transmitted signal by May 2002, several of our stations received extensions from the FCC. We expect all of our stations to be transmitting digitally by the end of 2003. Furthermore, the FCC requires that all stations stop using analog signals on the stations by 2006. As of year-end 2002, digital television sets are present in less than 5% of U.S. television households, and accordingly, we are unable to predict the extent of consumer demand for digital television will be or when that demand will arise.

*Contractual Cash Obligations*

Our contractual cash obligations, including the repayment of our revolving credit facility, the redemption of our Television Notes and the partial redemption of our Intermediate Notes, by year of payment, are as follows:

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<u>Year</u>	<u>Long Term Debt(1)</u>	<u>Interest on Long Term Debt(2)</u>	<u>Programming Rights Obligations(3)</u>	<u>Capital Lease Obligations(3)</u>	<u>Operating Lease Obligations(3)</u>	<u>Total Contractual Cash Obligations</u>
	(in thousands)					
2003	\$ 241,430	\$ 17,305	\$ 10,231	\$ 4,743	\$ 2,083	275,792
2004		3,600	10,934	2,843	1,991	19,368
2005	30,000	3,600	11,621	2,654	1,627	49,502
2006			9,911	1,013	1,563	12,487
2007			8,125	42	1,371	9,538
Thereafter			9,068	855	7,257	17,180
<b>Total</b>	<b>\$ 271,430</b>	<b>\$ 24,505</b>	<b>\$ 59,890</b>	<b>\$ 12,151</b>	<b>\$ 15,892</b>	<b>\$ 383,868</b>

- (1) includes revolving credit facility, Television Notes and Intermediate Notes and the redemption premiums on the Television Notes and \$41.634 million of the Intermediate Notes.
- (2) Includes interest on the Television Notes and \$41.634 million of the Intermediate Notes through April 21, 2003 (redemption date).
- (3) excludes obligations of discontinued operations.

In addition to the above contractual obligations, the Company expects that its capital expenditures for 2003, which are primarily related to our upgrade of transmission facilities for our Madison station and conversion to digital broadcasting as required by the FCC, will be approximately \$6 million for our continuing stations.

In August 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which supersedes both SFAS No. 121, and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30 (Opinion 30), Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, for the disposal of a segment of a business (as previously defined in Opinion 30). SFAS No. 144 retains the fundamental provisions in SFAS No. 121 for recognizing and measuring impairment losses on long-lived assets held for use and long-lived assets to be disposed of by sale. The Company adopted SFAS No. 144 on January 1, 2002. The adoption of SFAS No. 144 for long-lived assets held for use did not have an impact on the Company's financial statements. The Company did not record any impairment charges in 2002. The provisions of SFAS No. 144 for assets held for sale or other disposal generally are required to be applied prospectively after the adoption date to newly initiated disposal activities.

*Critical Accounting Policies and Estimates*

The Company'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 us 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 on-going basis, we evaluate our estimates, including those related to broadcast rights, bad debts, intangible assets, income taxes, and contingencies and litigation. The Company bases its estimates on historical experience and on various other assumptions that we believe 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. The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

*Programming Rights*

The Company's programming rights are stated, on a gross basis, at the lower of amortized cost or estimated realizable value. The Company evaluates estimated realizable value of programming rights based on current usage and revenue performance and projected future revenue and usage of such programs. Changes in the Company's programming schedule could impact the estimated realizable value of programming. In addition, estimates of future revenue performance relate to the number of advertising spots which will be sold by the Company and the amount generated from such sales. A decrease in the number of spots sold or the amount for such sales could also impact the Company's estimated realizable value. During 2000, 2001 and 2002, the Company recorded write downs of program rights due to impairments of \$84,000, \$66,000, and \$100,000, respectively.

*Impairment of Long-Lived Asset Values*

The carrying values of our long-lived assets are reviewed for impairment based upon estimated future undiscounted cash flows of the stations. As of December 31, 2002, the Company has not recorded any impairment related to long-lived assets. Future adverse changes in market conditions, changes in technology and other factors could reduce the expected future cash flows and result in an impairment charge.

In April 2002, the FASB issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections* ( SFAS 145 ). SFAS 145 rescinds SFAS 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. Upon adoption of SFAS 145, we will be required to apply the criteria in APB Opinion No. 30, *Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* (Opinion No. 30), in determining the classification of gains and losses resulting from the extinguishment of debt. Additionally, SFAS 145 amends SFAS 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. SFAS 145 will be effective for fiscal years beginning after May 15, 2002 with early adoption of the provisions related to the rescission of SFAS 4 encouraged. Upon adoption, companies must reclassify prior period items that do not meet the extraordinary item classification criteria in Opinion No. 30. The adoption of SFAS 145 for long-lived assets held for use did not have a material impact on our consolidated financial statements because the impairment assessment under SFAS 144 is largely unchanged from SFAS 121. However we are in compliance with the disclosure requirements as of December 31, 2002.

*Revenue Recognition*

The Company records revenue from the sale of airtime related to advertising and contracted time at the time of broadcast. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of

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its customers to make required payments. The Company utilizes information available to it, including the timing of payments and the financial condition of our customers, to estimate the allowance for doubtful accounts. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. The Company does not have a significant concentration of accounts receivable from any single customer or industry segment.

*Accounting for Goodwill and Other Intangible Assets*

In June 2001, the Financial Accounting Standards Board (the FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations completed or initiated after June 30, 2001 SFAS No. 141 also specifies criteria that must be met before intangible assets acquired in a purchase method business combination can be recognized and reported apart from goodwill, noting that any purchase price allocable to an assembled workforce may not be accounted for separately. SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead, tested for impairment (at least annually) in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 121, Accounting for the Impairment of Long Lived Assets and for Long Lived Assets to Be Disposed Of .

The Company adopted the provisions of SFAS No. 141 in June 2001 and adopted SFAS No. 142 effective January 1, 2002. In accordance with SFAS No. 142, Goodwill and other intangible assets acquired in business combinations that were completed before July 1, 2001 were amortized until the adoption of SFAS No. 142.

As the Company represents one reporting unit, as defined by SFAS No. 142, goodwill has been evaluated on a consolidated basis. The Company determined that its fair value exceeded its carrying value as of January 1, 2002 and December 31, 2002 (its annual impairment testing date) and, accordingly, no impairment was recorded during 2002. In addition, as prescribed by SFAS No. 142, the Company is no longer amortizing goodwill effective January 1, 2002.

In the connection with the adoption with Statement 142, the Company determined that its intangible assets have an indefinite life. Accordingly, the Company tested these intangible assets in accordance with the provisions of Statement 142 and no longer amortizes these intangibles effective January 1, 2002. The Company also determined that the fair value of its intangible assets exceeded their carrying values as of January 1, 2002 and December 31, 2002 and, accordingly, there was no impairment.

As of the date of adoption, January 1, 2002, the Company had unamortized goodwill in the amount of \$106.4 million and unamortized identifiable intangible assets in the amount of \$165.0 million, all of which was subject to the transition provisions of Statements 141 and 142. No amortization expense related to goodwill and intangible assets was recorded for the year ended December 31, 2002.

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*Impact of Recent Accounting Pronouncements*

In June 2001, the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligations*. SFAS No. 143 requires the Company to record the fair value of an asset retirement obligation, as a liability, in the period in which it incurs a legal obligation associated with the retirement of a tangible long-lived asset. The Company is also required to record a corresponding asset that is depreciated over the useful life of the asset. Under SFAS No. 143, the asset retirement liability is to be adjusted each accounting period to reflect the passage of time and any changes in the estimated future cash flows underlying the obligation. The Company is required to adopt SFAS No. 143 on January 1, 2003. The Company does not currently have a significant amount of asset retirement obligations and therefore believes the adoption of SFAS No. 143 will not have a material impact on the Company's financial statements.

On December 31, 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure* ( SFAS 148 ), which amends SFAS No. 123, *Accounting for Stock-Based Compensation* ( SFAS 123 ). SFAS 148 amends the disclosure requirements in SFAS 123 for stock-based compensation for annual periods ending after December 15, 2002 and for interim periods beginning after December 15, 2002. The disclosure requirements apply to all companies, including those that continue to recognize stock-based compensation under APB Opinion No. 25, *Accounting for Stock Issued to Employees*. Effective for financial statements for fiscal years ending after December 15, 2002, SFAS 148 also provides three alternative transition methods for companies that choose to adopt the fair value measurement provisions of SFAS 123. We do not choose to adopt the fair value measurement provisions of SFAS 123. However, we are in compliance with the disclosure requirements as of December 31, 2002.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* ( FIN 45 ), which addresses the disclosure to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. The disclosure requirements are effective for interim and annual financial statements ending after December 15, 2002. We do not have any guarantees that require disclosure under FIN 45.

FIN 45 also requires the recognition of a liability by a guarantor at the inception of certain guarantees. FIN 45 requires the guarantor to recognize a liability for the non-contingent component of a guarantee, which is the obligation to stand ready to perform in the event that specified triggering events or conditions occur. The initial measurement of this liability is the fair value of the guarantee at inception. The recognition of the liability is required even if it is not probable that payments will be required under the guarantee or if the guarantee was issued with a premium payment or as part of a transaction with multiple elements. The initial recognition and measurement provisions are effective for all guarantees within the scope of FIN 45 issued or modified after December 31, 2002.

As noted above we have adopted the disclosure requirements of FIN 45 and will apply the recognition and measurement provisions for all guarantees entered into or modified after December 31, 2002. To date we have not entered into any guarantees.

In February 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities* ( FIN 46 ), which addresses the consolidation by business enterprises of variable interest entities, which have one or both of the following characteristics: (1) the equity investment at risk is not sufficient to permit the entity to finance its activities without additional financial support from other parties, or (2) the equity investors lack one or more of the following essential characteristics of a controlling financial interest: (a) the direct or indirect ability to make decisions about the entity's activities through voting or similar rights, (b) the obligation to absorb the expected losses of the entity if they occur, or (c) the right to receive the expected residual returns of the entity if they occur. FIN 46 will have a significant effect on existing practice because it requires existing variable interest entities to be consolidated if those entities do not effectively disburse risks among parties involved. In addition, FIN 46 contains detailed disclosure requirements. FIN 46 applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. This Interpretation may be applied prospectively with a cumulative-effect adjustment as of the date on which it is first applied or by restating previously issued financial statements for one or more years with a cumulative-effect adjustment as of the beginning of the first year restated.

In June 2002, the Financial Accounting Standards Board issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 supersedes previous accounting guidance, principally Emerging Issues Task Force Issue ( EITF ) No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Credit Costs Incurred in a Restructuring)*. SFAS No. 146 requires that the liability for costs associated with an exit or disposal activity be initially measured at fair value and recognized when the liability is incurred. The provisions of SFAS No. 146 are required to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The adoption of SFAS No. 146 is not expected to have a material impact on the Company's financial statements.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

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The Company's revolving credit facility has a variable interest rate. Accordingly, the Company's interest expense could be materially affected by future fluctuations in the applicable interest rate. At December 31, 2002, the Company had outstanding borrowings of \$18.8 million under the revolving credit facility, all of which was repaid on March 21, 2003.

We are also exposed to risk from a change in interest rates to the extent we are required to refinance existing fixed rate indebtedness at rates higher than those prevailing at the time the existing indebtedness was incurred. As of December 31, 2002, our \$175.0 million Television Notes and \$71.6 million Intermediate Notes mature in the years 2004 and 2005, respectively. Effective October 1, 2000, the senior discount notes began accruing cash interest. The interest payment on these notes amounts to approximately \$9.5 million every six months. Cash interest on the senior secured discount notes is payable semi-annually, in arrears, commencing on March 31, 2003. Based upon the quoted market price, the fair value of the senior discount notes and senior secured discount notes was \$177.6 and \$68.1 million, respectively, as of December 31, 2002.

On March 21, 2003, we closed the sale of our discontinued operations to subsidiaries of the Tribune Company. In connection with that closing, we repaid all outstanding borrowings under our senior credit facility and issued a redemption notice on all of our \$175 million Television Notes and \$41,634 million of our \$71,634 million Intermediate Notes. Following the redemption of the notes, set for April 21, 2003, we will have \$30 million of the Intermediate Notes outstanding requiring a semi-annual interest payment of \$1.8 million.



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**Item 8. *Financial Statements and Supplemental Data***

**ACME COMMUNICATIONS, Inc. and SUBSIDIARIES**

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**Independent Auditors Report**

The Board of Directors and Stockholders of  
ACME Communications, Inc.:

We have audited the accompanying consolidated balance sheets of ACME Communications, Inc. and subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2002. In connection with our audit of the consolidated financial statements, we have also audited the financial statement schedules listed in the index of Item 15. These consolidated financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ACME Communications, Inc. and subsidiaries as of December 31, 2002 and 2001 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedules, when considered in relation to the consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2002, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets.

/s/ KPMG LLP

Los Angeles, California  
February 13, 2003, except for note 15,  
which was as of March 21, 2003

**Table of Contents****ACME Communications, Inc. and Subsidiaries  
Consolidated Balance Sheets**

	<b>As of December 31,</b>	
	<b>2001</b>	<b>2002</b>
	<b>(In thousands)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 17,275	\$ 1,860
Restricted cash	1,741	2,910
Accounts receivable, net	7,698	10,458
Current portion of programming rights	7,835	9,894
Prepaid expenses and other current assets	1,266	1,084
Assets held for sale	204,049	211,964
Deferred income taxes	576	
	<u>240,440</u>	<u>238,170</u>
Total current assets	240,440	238,170
Property and equipment, net	29,133	30,165
Programming rights, net of current portion	12,912	15,102
Intangible assets, net	97,738	102,870
Deferred income taxes	20,468	
Other assets	6,694	6,969
	<u>397,385</u>	<u>393,276</u>
Total assets	\$ 407,385	\$ 393,276
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 7,742	\$ 8,163
Accrued liabilities	11,398	11,583
Current portion of programming rights payable	7,913	9,627
Current portion of obligations under lease	3,290	3,710
Liabilities held for sale	39,194	45,810
	<u>69,537</u>	<u>78,893</u>
Total current liabilities	69,537	78,893
Programming rights payable, net of current portion	12,619	14,814
Obligations under lease, net of current portion	9,436	8,441
Other liabilities	363	89
Deferred income taxes		5,698
Notes payable under revolving credit facility		18,789
10 7/8% senior discount notes	175,000	175,000
12% senior secured notes	62,424	69,061
	<u>329,379</u>	<u>370,785</u>
Total liabilities	329,379	370,785
Stockholders' equity:		
Preferred stock, \$.01 par value; 10,000,000 shares authorized, no shares issued and outstanding		
Common stock, \$.01 par value; 50,000,000 shares authorized, 16,750,000 shares issued and outstanding	168	168
Additional paid-in capital	131,337	131,798
Accumulated deficit	(53,499)	(109,475)

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Total stockholders' equity	<u>78,006</u>	<u>22,491</u>
Total liabilities and stockholders' equity	<u>\$407,385</u>	<u>\$ 393,276</u>