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

For Annual and Transition Reports Pursuant
to Sections 13 or 15(d) of the Securities Exchange Act of 1934

Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2004

or

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

For the transition period from _____ to _____

Commission file number 001-07155

R.H. DONNELLEY CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

13-2740040
(IRS Employer Identification No.)

1001 Winstead Drive,
Cary, N.C.

27513
(Zip Code)

(Address of Principal Executive Offices)

Registrant's telephone number, including area code
(919) 297-1600

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

<u>Title of Class</u>	<u>Name of Exchange on Which Registered</u>
Common Stock, par value \$1 per share	New York Stock Exchange

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

None

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) 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 if the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2 of the Act). Yes No

(continued)

The aggregate market value at June 30, 2004, the last day of our most recently completed second quarter, of shares of the Registrant's common stock (based upon the closing price per share of \$43.74 of such stock on The New York Stock Exchange on such date) held by non-affiliates of the Registrant was approximately \$1,368,355,000. At June 30, 2004, there were 31,283,832 outstanding shares of the Registrant's common stock, not including any shares of common stock beneficially owned by The Goldman Sachs Group, Inc. The aggregate market value at March 4, 2005 of shares of the Registrant's common stock (based upon the closing price per share of \$61.45 of such stock on The New York Stock Exchange on such date) held by non-affiliates of the Registrant was approximately \$1,927,492,871. For purposes of both of these calculations, only those shares held by directors and executive officers of the Registrant and shares beneficially owned by The Goldman Sachs Group, Inc. have been excluded as held by affiliates. Such exclusion should not be deemed a determination or an admission by the Registrant that such individuals or entities are, in fact, affiliates of the Registrant. At March 4, 2005, there were 31,572,110 outstanding shares of the Registrant's common stock, including only 3,158 shares of common stock beneficially owned by The Goldman Sachs Group, Inc.

Commission file number 333-59287

R.H. DONNELLEY INC.*

(Exact name of registrant as specified in its charter)

Delaware

(State of Incorporation)

**1001 Winstead Drive,
Cary, N.C.**

(Address of Principal Executive Offices)

36-2467635

(IRS Employer Identification No.)

27513

(Zip Code)

**Registrant's telephone number, including area code
(919) 297-1600**

* R.H. Donnelley Inc. is a wholly owned subsidiary of R.H. Donnelley Corporation. R.H. Donnelley Inc. meets the conditions set forth in General Instructions I 1(a) and (b) of Form 10-K and is therefore filing this report with respect to R.H. Donnelley Inc. with the reduced disclosure format. R.H. Donnelley Inc. became subject to the filing requirements of Section 15(d) on October 1, 1998 in connection with the public offer and sale of its 9.125% Senior Subordinated Notes, which Notes were redeemed in full on February 6, 2004. In addition, R.H. Donnelley Inc. is the obligor of 8.875% Senior Notes due 2010 and 10.875% Senior Subordinated Notes due 2012 and is now subject to the filing requirements of Section 15(d) as a result of such notes. As of March 4, 2005, 100 shares of R.H. Donnelley Inc. common stock, no par value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III

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|---------|--|--|
| Item 10 | Directors and Executive Officers of the Registrant | Information responsive to this Item can be found under the captions "Board of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's Proxy Statement to be filed with the Commission prior to March 31, 2005. |
| Item 11 | Executive Compensation | Information responsive to this Item can be found under the caption "Director and Executive Compensation" in the Company's Proxy Statement to be filed with the Commission prior to March 31, 2005. |
| Item 12 | Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters | Information responsive to this Item can be found under the caption "Security Ownership of Certain Beneficial Owners and Management" in the Company's Proxy Statement to be filed with the Commission prior to March 31, 2005. |
| Item 13 | Certain Relationships and Related Transactions | Information responsive to this Item can be found under the caption "Director and Executive Compensation — Compensation Committee Interlocks and Insider Participation; Certain Relationships and Related Party Transactions" in the Company's Proxy Statement to be filed with the Commission prior to March 31, 2005. |
| Item 14 | Principal Accountant Fees and Services | Information responsive to this Item can be found under the caption "Board of Directors-Committees of the Board of Directors-Audit and Finance Committee" and — "Report of the Audit and Finance Committee-Fees" in the Company's Proxy Statement to be filed with the Commission prior to March 31, 2005. |

PART I

ITEM 1. BUSINESS

Except where otherwise indicated, the terms “Company,” “Donnelley,” “RHD,” “we,” “us” and “our” refer to R.H. Donnelley Corporation and its direct and indirect wholly owned subsidiaries. R.H. Donnelley Inc. is our wholly owned direct subsidiary. Our executive offices are located at 1001 Winstead Drive, Cary, North Carolina 27513 and our telephone number is (919) 297-1600. Our Internet Website address is www.rhd.com. We make available free of charge on our Web site our annual, quarterly and current reports, including amendments to such reports, as soon as practicable after we electronically file such material with, or furnish such material to, the United States Securities and Exchange Commission (“SEC”). Our filings can also be obtained from the SEC Web site at www.sec.gov. However, the information found on our Web site or the SEC Web site is not part of this annual report.

Corporate Overview

We are a leading yellow pages publisher and directional media company. Directional media is where consumers search to find who sells the goods and services they are ready to purchase. We publish Sprint®-branded yellow pages directories in 18 states, with major markets including Las Vegas, Nevada and Orlando and Lee County, Florida, with a total distribution of approximately 18 million serving approximately 160,000 local and national advertisers. We also publish SBC®-branded yellow pages directories in Illinois and Northwest Indiana, with a total distribution of approximately 10 million serving approximately 100,000 local and national advertisers. We also offer online city guides and search Web sites in our major Sprint markets under the Best Red Yellow Pages® brand at www.bestredyp.com and in the Chicagoland area at www.chicagolandyp.com. We also sell local advertising in Illinois and Northwest Indiana onto www.SMARTpages.com, SBC’s Internet yellow pages platform.

On September 1, 2004, we completed the acquisition of the directory publishing business (“SBC Directory Business”) of SBC Communications, Inc. (“SBC”) in Illinois and Northwest Indiana, including SBC’s interests in The DonTech II Partnership (“DonTech”), a 50/50 general partnership between us and SBC (collectively, the “SBC Directory Acquisition”). See “Acquisitions — SBC Directory Acquisition” below for a further description of the acquisition.

On January 3, 2003, we completed the acquisition of the directory publishing business (the “SPA Directory Business”) of Sprint Corporation (“Sprint”) by acquiring all of the outstanding common stock of the various entities comprising Sprint Publishing & Advertising (“SPA”) (collectively, the “SPA Acquisition”). See “Acquisitions — SPA Acquisition” below for a further description of the acquisition.

These acquisitions transformed Donnelley into a leading publisher of yellow pages directories. Prior to the SPA Acquisition, we were one of the largest independent sales agents and pre-press vendors for yellow pages advertising in the United States. At the time, our 2002 revenue reflected sales commissions and pre-press fees from, or other transactions with, our business partners, including Sprint and SBC. Commencing in 2003 following the SPA Acquisition, our operating and financial results reflect our yellow pages publishing business, rather than our former business as a sales agent and pre-press vendor for yellow pages advertising on behalf of other publishers. As a publisher, we report the full value of advertising sales and certain direct costs under the deferral and amortization method. DonTech’s business remained unchanged following the SPA Acquisition, but our investment in DonTech was eliminated in connection with the SBC Directory Acquisition on September 1, 2004. During 2003 and in 2004 until the SBC Directory Acquisition, we continued to earn revenue from pre-press publishing and other ancillary services related to the SBC Directory Business and we continued to report partnership income from our investment in DonTech.

During the third quarter of 2004 following the SBC Directory Acquisition, we revised our historical segment reporting to reflect the change in our business and to reflect the way management now reviews and analyzes the business. Our business of publishing yellow pages directories is now conducted in one reportable operating segment. All pre-press publishing services and other ancillary services previously performed on behalf

of other publishers are now performed entirely on behalf of the directories we publish. As a result of the SBC Directory Acquisition, SBC ceased paying us revenue participation income, we consolidate all net profits from DonTech and our DonTech partnership investment was eliminated. Consequently, partnership income was no longer reported commencing September 1, 2004 and, accordingly, the previously reported DonTech operating segment is no longer applicable. See Note 13 to the Company's audited consolidated financial statements included in Item 8 of this annual report and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this annual report for more information regarding the Company's segments.

Acquisitions

SBC Directory Acquisition

On September 1, 2004, we completed the SBC Directory Acquisition for \$1.41 billion in cash, after working capital adjustments and the settlement of a \$30 million liquidation preference owed to us related to DonTech. This transaction was consummated pursuant to a purchase agreement dated as of July 28, 2004 by and among RHD, Ameritech Corporation ("Ameritech"), a direct wholly owned subsidiary of SBC, and Ameritech Publishing, Inc. ("API"), a direct wholly owned subsidiary of Ameritech. The acquired SBC Directory Business now operates as R.H. Donnelley Publishing & Advertising of Illinois Partnership, one of our indirect wholly owned subsidiaries.

In connection with the SBC Directory Acquisition, we entered into a directory services license agreement, a non-competition agreement, a SMARTpages® reseller agreement and a directory publishing listing agreement (collectively, "SBC Directory Services Agreements") with certain affiliates of SBC. The directory services license agreement designates us as the official and exclusive provider of yellow pages directory services for SBC (and its successors) in Illinois and Northwest Indiana (the "Territory"), grants us the exclusive license (and obligation as specified in the agreement) to produce, publish and distribute white pages directories in the Territory as SBC's agent and grants us the exclusive license (and obligation as specified in the agreement) to use the SBC brand and logo on print directories in the Territory. The non-competition agreement prohibits SBC (and its affiliates and successors), with certain limited exceptions, from (1) producing, publishing and distributing yellow and white pages print directories in the Territory, (2) soliciting or selling local or national yellow or white pages advertising for inclusion in such directories, and (3) soliciting or selling local Internet yellow pages advertising for certain Internet yellow pages directories in the Territory or licensing SBC marks to any third party for that purpose. The SMARTpages reseller agreement gives us the exclusive right to sell local Internet yellow pages advertising and the non-exclusive right to sell Internet yellow pages advertising with respect to geographies outside the Territory to any advertiser (excluding national advertisers) located inside the Territory onto SBC's SMARTpages.com platform (and any successor products as specified in the agreement). The directory publishing listing license agreement gives us the right to purchase and use basic SBC subscriber listing information and updates for the purpose of publishing directories. The SBC Directory Services Agreements are all interrelated and each (other than the SMARTpages reseller agreement) has an initial term of 50 years, subject to automatic renewal and early termination under specified circumstances. The SMARTpages reseller agreement has a term of 5 years.

SPA Acquisition

On January 3, 2003, we completed the acquisition of SPA by purchasing all the stock of two subsidiaries of Sprint, DirectoriesAmerica, Inc. and Centel Directory Company ("Centel"), for \$2.23 billion in cash. This transaction was consummated pursuant to a purchase agreement dated as of September 21, 2002 by and among RHD, Sprint and Centel Directories LLC. The acquired SPA Directory Business now operates as R.H. Donnelley Publishing & Advertising, Inc., one of our indirect wholly owned subsidiaries.

In connection with the SPA Acquisition, we entered into a directory services license agreement, a trademark license agreement and a non-competition agreement (collectively, "SPA Directory Services Agreements") with Sprint. The directory services license agreement grants us the exclusive license (and obligation as specified in the agreement) to produce, publish and distribute yellow and white pages directories

for Sprint (and its successors) in the markets in 18 states where Sprint provided local telephone service at the time of the transaction. The trademark license agreement grants us the exclusive license (and obligation as specified in the agreement) to use certain Sprint trademarks, including the Sprint diamond logo, in those markets. The non-competition agreement prohibits Sprint (and its affiliates and successors) in those markets from selling local directory advertising or producing, publishing and distributing print directories, with certain limited exceptions. The SPA Directory Services Agreements are all interrelated and each has an initial term of 50 years, subject to automatic renewal and early termination under specified circumstances.

Both acquisitions were accounted for as purchase business combinations. The purchase price for each acquisition was allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their respective fair values on each acquisition date. The results of the SBC Directory Business have been included in our consolidated results from and after September 1, 2004 and the results of the SPA Directory Business have been included in our consolidated results from and after January 3, 2003. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this annual report for more information regarding the financing and the accounting for, and financial implications of, these acquisitions.

Historical Overview of Donnelley

Following the SPA Acquisition, we published Sprint-branded yellow pages directories in 18 states and had a total circulation of approximately 18 million, serving approximately 160,000 local and national advertisers. Through DonTech, we sold advertising for SBC-branded directories in Illinois and Northwest Indiana with a circulation of approximately 10 million, serving approximately 100,000 local advertisers. DonTech was our 50/50 partnership with an affiliate of SBC. DonTech provided local advertising sales services for those SBC-branded directories and earned a commission from SBC. Under our former agreements with SBC, we had a 50% interest in the net profits of DonTech and also received revenue participation income directly from SBC. The amount of revenue participation income we earned was based on a percentage of DonTech advertising sales. Revenue participation income comprised approximately 80% to 85% of our total income related to DonTech and was paid directly to us by an affiliate of SBC. We accounted for our investment in DonTech under the equity method and recorded all our income from DonTech and revenue participation income as partnership income. We also provided certain pre-press publishing services, billing and information technology support services with respect to those SBC-branded directories. See our annual report on Form 10-K for the year ended December 31, 2003 for further details regarding our historical relationship with SBC, DonTech's operations prior to the SBC Directory Acquisition and our prior segment reporting.

Prior to the SPA Acquisition, we were one of the largest independent sales agents and pre-press vendors for yellow pages advertising in the United States. In that capacity, we sold advertising for more than 170 yellow pages directories with a total circulation of over 15 million. We sold yellow pages advertising either directly through our own sales force on behalf of SPA, or indirectly through DonTech. We also provided pre-press publishing services for approximately 227 yellow pages directories, including all of the directories for which we and DonTech sold advertising, as well as for an independent publisher for whom we ceased providing services in the first quarter of 2003. See our annual report on Form 10-K for the year ended December 31, 2002 for further details regarding our historical relationship with Sprint, SPA's operations prior to the SPA Acquisition and our prior segment reporting.

Products and Services

We publish directories in two media: print and online. While print and online media themselves are substantially different in form, we view the two as vitally linked in continuing to provide the consumers in our markets a reliable, valuable source of rich, locally relevant directional information, and our advertisers with a highly desirable advertising platform to reach those consumers. Directional information directs consumers to who sells the goods and services they are seeking. We believe that leveraging the value of the locally relevant content that we capture for print directory advertisements is critical to effectively connecting advertisers in our markets with those consumers who are using the Internet to meet some or all of their directional information

needs. We believe that businesses in our markets advertise in our products because of the large volume of qualified leads we deliver.

In 2004, we expanded the distribution of our print directory advertisers' directional information through deployment of our online products in key SPA and Illinois and Northwest Indiana markets. By the end of 2004, we had expanded our bestredyp.com city guide and Internet Yellow pages ("IYP") platform to include over 50 of the largest SPA markets and over 80 SBC Directory Business markets.

We believe that increased usage of online directories will expand overall usage in the United States directory advertising industry. We intend to continue to explore new means to deliver our advertisers' directional information to consumers.

Print Directory Products

We have two principal print directory types: a core directory and a community directory. Core directories generally cover large population areas, whereas community directories typically cover a sub-section of the areas addressed by a core directory. For example, in Lee County, Florida, we publish one core directory and four community directories, Sanibel-Captiva Island, South Fort Myers, Cape Coral/North Fort Myers and Lehigh Acres. These four communities together cover the majority of the core Lee County directory, but not the entire market. Most core directories contain yellow pages, white pages and specialty sections, such as area information, guides and government pages. Community directories also consist of yellow pages, white pages and specialty sections.

The table below details our principal revenue-generating print directory product offerings.

Principal Print Products

Type	Description
Stylized listings for white and yellow pages	Listings appearing in-column consist of name, address and telephone number and are available in a variety of type styles and limited color
Trade items	Advertising space, designed to promote brand name of product or service, placed alphabetically within the column listings of the yellow pages
Space items	Advertising space sold in 1/2 inch increments appearing alphabetically within the column listings of the yellow pages
Display ads	Advertising placed within a heading by size and then by seniority — our ad sizes range from a quarter column to a double full page
Color	Various levels of color sophistication including spot-four color, enhanced color, process photo and hi-impact are available for display products
White pages logos	Listings allowing space for illustrative art work

In addition to these principal products, we offer a broad range of specialty print directory products that advertisers use as high-profile local branding and awareness vehicles. The table below presents an overview of the main revenue-generating specialty products that we offer.

Specialty Print Products

Type	Description
Cover products	Advertising sold on the bottom of the front cover, the inside front cover, the inside back cover, the outside back cover and spine
Tabs	Full page advertising bound into the directory, offering front and back space printed on card stock with a tab protrusion or die-cut indented tab
Ride-alongs	Advertising pieces placed outside the directory, either in the delivery bag during initial distribution of a new directory publication or shrink-wrapped to the directory when sending a book to a new resident
Blow-in cards	Loose postcard-like products inserted into directories
Guides (Golf, Menu, Local Attractions, Maps, etc.)	Sections in the directories on a specific interest area with feature information and banner advertising

Online products

We offer an Internet-based directory, bestredyp.com, to our advertisers in many SPA markets and plan to continue to expand this offering to all SPA markets during 2005. Bestredyp.com provides a city portal with information about the targeted market, along with electronic versions of the white and yellow pages directories. We provide users a dual-purpose interface that allows them to view the directory information in either a typical Internet search engine view or a “look and feel” view that emulates the appearance of our print directories.

In connection with the SBC Directory Acquisition, we recently began offering a similar Internet-based directory in the Chicagoland area, chicagolandyp.com. We also entered into a reseller agreement with SBC which grants us the exclusive right to sell local Internet yellow pages advertising and the non-exclusive right to sell Internet yellow pages advertising with respect to geographies outside Illinois and Northwest Indiana to any advertiser (excluding national advertisers) located in the Territory onto SBC’s SMARTpages.com platform (and any successor products as specified in the agreement) for a period of five years.

We currently view our online products as a complement to our print directory products rather than as a stand-alone business. Our online products focus on a “local experience” by offering rich local content to consumers, which requires little incremental effort by our sales force to obtain. We also utilize a low cost production platform.

Business Cycle Overview

Our directories generally have a 12-month directory cycle, except Las Vegas, which has two six-month directory cycles. A publication cycle generally spans 15 to 20 months from the beginning of the sales cycle to the end of a directory’s life and is comprised of several stages. The marketing stage is generally completed before the end of the first month (other than in-market advertising). The sales stage picks up at the completion of the marketing stage and generally runs through the following five months. Pre-press publishing and printing follows the sales stage, usually lasting an additional two months. Finally, distribution generally occurs over the month prior to and/or during the month of directory publication. Customer service and billing and collections

stages are provided after distribution of a directory and throughout the directory cycle. While the business cycle is similar for all directories, the publishing dates are staggered throughout the year to efficiently utilize our systems and resources, particularly in the sales and publishing areas.

Marketing

Our marketing process includes the functions of market management, product development and management, marketing research, pricing, advertising and public relations. The market management function is decentralized and coordinates with local sales management to develop market plans and products that address the needs of individual local markets. The other marketing functions are centralized and provide support to all markets as warranted. Advertising programs are targeted to advertisers and consumers and are determined by specific market and include television, radio, newspaper and outdoor ad placements.

Sales

Sales are conducted on the local level through premise representatives, telephone representatives and letter renewals, and, on the national level, through national account managers who sell primarily to Certified Marketing Representatives (“CMRs”) serving national advertisers. We distinguish between national advertisers, which advertise in 20 or more directories and span three or more states with at least two different publishers, and local advertisers, which are primarily small-and medium-sized businesses located within our markets. In general, advertising from local advertisers continues to represent the majority of our revenue, accounting for approximately 85% of directory advertising revenue, while approximately 15% is derived from national advertisers.

Local Sales Organization

Our local sales channel is segmented into three sales sub-channels: premise sales, telephone sales and letter renewal. Premise sales representatives conduct sales calls at customers’ business locations and typically handle higher dollar and more complex accounts. Telephone sales representatives handle lower dollar value accounts and conduct their sales over the phone. Letter renewal is used to contact very low dollar value customers that have renewed their account for the same product for several years.

National Sales Organization

Our national sales channel is managed through our national sales department. CMRs have historically been the national media buyers of yellow pages advertising for national advertisers. CMRs are independent third parties that act as agents for national companies and design their advertisements, arrange for the placement of those advertisements in directories and provide billing services. During 2003, we began acting as a CMR ourselves directly placing certain national advertising. Our national account managers are the primary point of contact for all communication and business dealings between RHD and CMRs. National account managers and national sales representatives are accountable for overall national revenue objectives.

Pre-Press Publishing

Pre-press publishing activities include sales canvass preparation, sales order processing, graphics and advertisement creation and white and yellow pages processing. Sales canvass preparation precedes the sales stage. During the sales stage, sales order processing and graphics and ad creation are ongoing. Once an individual sales campaign is complete and final advertisements have been produced, white and yellow pages are paginated, proofed and prepared for printing. We accomplish most of these functions through an Amdocs® publishing system, which we believe to be the industry standard.

Printing and Distribution

All directories are currently printed through our long-standing relationship with printing vendor R.R. Donnelley & Sons Company (“R.R. Donnelley”). We currently have two contracts for the printing of our directories with R.R. Donnelley that expire in December 2005 and December 2007. Although we share a

common heritage, no other common ownership or business relationship exists between R.R. Donnelley and us. Printing is one of our largest cost items accounting for approximately 10% of our total operating and general and administrative expenses.

The delivery of directories is facilitated through several outsourcing relationships. Methods utilized to distribute directories to consumers are selected based on factors such as cost, quality, geography and market need. Predominant delivery methods include United States Postal Service and hand delivery. Occasionally we use United Parcel Service or other types of expedited delivery methods. Frequently a combination of these methods is required to meet the needs of the marketplace.

Billing, Credit and Collection

The majority of our billing, credit and collection functions are handled internally. Local advertisers are generally extended credit and billed monthly over the life of a directory, which is normally 12 months. CMRs (on behalf of each national advertiser) are billed annually in the month of directory publication. Our credit policies are market specific and balance collection risk with sales growth. Generally, new customers are subject to a credit evaluation, as are current customers desiring to expand their advertising program. The billing and collection functions are primarily focused on timely and accurate delivery of invoices and collection and recording of customer payments. A lockbox system is used for customer payments. The collection process is structured to identify delinquent customers in a timely manner and commence collection efforts through various means such as bill messaging, collection letters and calls and/or site visits. Delinquent customers over a specified time period are generally denied advertising rights in subsequent publications.

Customer Service

Our customer service process is designed to resolve customer questions and complaints promptly. Staffing, processes and technology are structured to attempt to personally answer all calls and resolve most questions, complaints and general inquiries on the initial call, which often lowers customer adjustments and increases customer satisfaction. Information received through our customer service process is routinely analyzed to improve the quality and customer focus of our other operating functions, as well as the customer service function itself.

Competition

Print Yellow Pages Advertising Sales

The United States print directory advertising industry is highly competitive. Approximately 80% of total United States directory advertising sales are attributable to Regional Bell Operating Company ("RBOC") and other incumbent directory publishers (collectively, with RBOC publishers, "incumbent publishers") that typically publish directories where they (or their licensors or affiliates) offer local phone service. More than 240 independent yellow pages directory publishers operating in the United States compete with those incumbent publishers and represent the remaining market share.

In nearly all markets, we compete with one or more yellow pages directory publishers, which are predominantly independent publishers, such as the U.S. business of Yell Group Ltd, TransWestern Publishing Company LLC and White Publishing Company. We believe that acting as the exclusive, official incumbent publisher of directories for the incumbent local telephone company (SBC and Sprint) in our markets provides us with a competitive advantage over independent publisher competitors due to better recognition of our brands, higher usage of our directories by consumers and our longer relationships with advertisers in our markets. As an incumbent publisher, we also believe that we can deliver a better value proposition to our advertisers than our independent competitors, largely due to user perception of up-to-date accuracy and completeness that comes with our affiliation with the local telecom service provider. As an incumbent publisher having operated in our markets for many more years than our independent publisher competitors, we believe that we also benefit from established consumer usage patterns and loyal advertiser bases. We also believe that our established operational infrastructure is a competitive advantage over our independent competitors. Our printing, publishing and distribution functions all benefit from longer-term relationships with our key vendors.

We believe that these factors motivate independent publishers to compete with us based on price while they attempt to build their advertiser bases, which results in advertising rates significantly lower than our prices for the same size advertisement. In some markets, we also compete with other incumbent directory publishers in overlapping and adjacent markets. We compete with all these publishers based on value, accessible price point, local relevance, quality, features and distribution.

Competition with Other Traditional Media

We also compete for advertising sales with other traditional media, including newspapers, magazines, radio, direct mail, telemarketing, billboards, and television.

We believe we sustain a competitive advantage over many other media because directory advertising is the preferred form of advertising for many small and medium-sized businesses, often their principal or only form of advertising. We believe that preference for directory advertising is due to its relatively low cost, broad demographic and geographic distribution, enduring presence, directional and permission-based (non-invasive) nature and high consumer usage rates. We believe that directory advertising is attractive to our advertisers because consumers view directories as a free, comprehensive, non-intrusive single source of locally relevant directional information. While overall advertising tends to track a local economy's business cycle, directory advertising tends to be more stable and does not fluctuate as widely with economic cycles due to this preference by small to medium-sized businesses. Print directory advertising also tends to be more stable because failure to advertise in a given print directory cannot be remedied until the replacement print directory is published, which is usually one year later. Moreover, we give priority placement within a directory classification and by size of advertisement to our longest-tenured advertisers. As a result, our print advertisers have a strong incentive to renew their directory advertising with us from year to year, so as not to lose their priority placement within our print directories. We compete with these other media based on value, accessible price point, local relevance, quality, features and distribution.

The Internet

The Internet has emerged as a new medium for advertisers. Advances in technology have brought and will likely continue to bring new participants, new products and new channels to the advertising industry, including increasing use of online and wireless delivery of traditional directory information and electronic search engines/services. Although advertising on the Internet still represents only a small part of the total advertising market, as the Internet grows, it likely will become increasingly important as an advertising medium. From 1997 to 2000, overall references to print yellow pages directories in the United States declined; however, overall references to print yellow pages directories have remained relatively stable from 2000 through 2004. We believe the past decline was primarily a result of demographic shifts among consumers, particularly the increase of households in which English was not the primary language spoken. We also believe that the past decline was attributable to increased usage of Internet-based directory products, particularly in business-to-business and retail categories, as well as the proliferation of very large retail stores for which consumers and businesses may not reference the yellow pages. We believe that over the next several years, references to print yellow pages directories may gradually decline as users may increasingly turn to digital and interactive media delivery devices for local commercial search information. We expect overall directory usage to grow, largely due to steady growth of Internet directory usage.

Directory publishers, including us, have increasingly bundled online advertising with their traditional print offerings in order to enhance total usage and advertiser value. We compete directly through our online city guides, "look and feel" electronic directories and search Web sites at bestredyp.com and chicagolandyp.com with the IYP directories of the independent publishers and the other incumbent publishers. In addition, we are the exclusive reseller of SBC's SMARTpages.com IYP platform to local advertisers in our SBC markets.

Through our online city guides, "look and feel" electronic directories and search Web sites, we also compete with other Internet sites, including those available through wireless applications, that provide classified directory information, such as Switchboard.com, Citysearch.com and Zagat.com, and with search engines and portals, such as Yahoo!®, Google®, MSN® and others, some of which have entered into affiliate agreements

with other major directory publishers. We compete with all of these online competitors based on value, local relevance and features.

The yellow pages directory advertising business is subject to changes arising from developments in technology, including information distribution methods and users' preferences. The use of the Internet and wireless devices by consumers as a means to transact commerce may result in new technologies being developed and services being provided that could compete with our traditional products and services. National search companies such as Google and Yahoo are focusing and placing large priorities on local commercial search initiatives. Our growth and future financial performance may depend on our ability to develop and market new products and services and create new distribution channels, while enhancing existing products, services and distribution channels, to incorporate the latest technological advances and accommodate changing user preferences, including the use of the Internet and wireless devices.

Raw Materials

Our principal raw material is paper. It is one of our largest cost items accounting for approximately 5% to 7% of our total operating and general and administrative expenses. We currently purchase our paper from four vendors under agreements that expire at various times from December 31, 2005 through December 31, 2006. Pursuant to the contract under which we obtain the great majority of our paper and which extends through December 31, 2006, the price of the paper was set at inception of the contract and increases at various dates during the term of the agreement. Should the market price of the paper drop below the set prices under that contract, both parties are obligated to negotiate in good faith a lower paper price. Also, we are subject to delays in receiving this principal raw material. Further, changes in the supply of, or demand for, paper could affect delivery times and market prices.

Intellectual Property

We own and control confidential information as well as a number of trade secrets, trademarks, service marks, trade names, copyrights and other intellectual property rights that, in the aggregate, are of material importance to our business. We believe that the "Donnelley" name and related names, marks and logos are, in the aggregate, material to our business. We are licensed to use certain technology and other intellectual property rights owned and controlled by others, and, similarly, other companies are licensed to use certain technology and other intellectual property rights owned and controlled by us.

We have the exclusive license to produce, publish and distribute directories for Sprint (and its successors) in the markets where Sprint provided local telephone service at the time of the SPA Acquisition as well as the exclusive license to use Sprint's brand, including Sprint's diamond logo, on directories in those markets, and we acquired the "Best Red Yellow Pages®" tagline and the "look and feel" trademarks previously used by SPA. In addition, we have the exclusive license to provide yellow pages directory services for SBC (and its successors) and to produce, publish and distribute white pages directories on behalf of SBC in Illinois and Northwest Indiana, as well as the exclusive right to use the SBC brand and logo on print directories in that territory.

Although we do not consider any individual trademark or other intellectual property to be material to our operations, we believe that, taken as a whole, the licenses and trademarks we acquired in conjunction with the SPA Acquisition and SBC Directory Acquisition are material to our business. We consider our trademarks, service marks, databases, software and other intellectual property to be proprietary, and we rely on a combination of copyright, trademark, trade secret, non-disclosure and contract safeguards for protection. We also benefit from the use of the phrase "yellow pages" and the walking fingers logo, both of which we believe to be in the public domain in the United States.

Employees

As of December 31, 2004, we had approximately 2,000 full-time employees. None of our employees are subject to collective bargaining agreements, and we consider relations with our employees to be good.