CROWN MEDIA HOLDINGS INC
Form 10-Q
November 15, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2004

or

o 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: 000-30700

Crown Media Holdings, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**84-1524410** (I.R.S. Employer Identification No.)

6430 S. Fiddlers Green Circle,
Suite 225,
Greenwood Village, Colorado 80111
(Address of Principal Executive Offices and Zip Code)

(303) 220-7990
(Registrant s Telephone Number, Including Area Code)

(Former Name, Former Address, and Former Fiscal Year,
if Changed Since Last Report.)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or 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 ý No o

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

As of November 12, 2004, the number of shares of Class A Common Stock, $.01 par value outstanding was 73,863,037, and the number of shares of Class B Common Stock, $.01 par value, outstanding was 30,670,422.

TABLE OF CONTENTS

In this Form 10-Q the terms Crown Media Holdings or the Company, refer to Crown Media Holdings, Inc. and, unless the context requires otherwise, subsidiaries of Crown Media Holdings that operate or have operated our businesses, Crown Media International, LLC (Crown Media International), Crown Media United States, LLC (Crown Media United States), Crown Media Distribution, LLC (Crown Media Distribution), Crown Entertainment Limited (Crown Entertainment), and Crown Media Trust (Crown Media Trust). The term common stock refers to our Class A common stock and Class B common stock, unless the context requires otherwise.

The names Hallmark, Hallmark Entertainment and other product or service names are trademarks or registered trademarks of their owners.

PART I. FINANCIAL INFORMATION

Item 1. *Financial Statements (Unaudited)*

CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share amounts)

		As of December 31, 2003		As of September 30, 2004 (Unaudited)
ASSETS				
Cash and cash equivalents	$	4,306	$	7,569
Accounts receivable, less allowance for doubtful accounts of $6,703 and $5,845, respectively		57,905		57,045
Program license fees affiliates, net		27,127		31,961
Program license fees non-affiliates, net		65,571		70,617
Subtitling and dubbing, net		2,827		2,611
Receivable from affiliate		12,083		14,087
Prepaid and other assets		15,143		15,528
Total current assets		184,962		199,418
Accounts receivable, net of current portion		5,891		8,653
Program license fees affiliates, net of current portion		47,748		42,645
Program license fees non-affiliates, net of current portion		106,047		94,522
Subtitling and dubbing, net of current portion		2,020		1,461
Film assets, net		750,737		672,073
Subscriber acquisition fees, net		113,196		108,972
Property and equipment, net		29,235		22,574
Goodwill		314,033		314,033
Debt issuance costs, net		6,478		5,268
Prepaid and other assets, net of current portion		1,363		1,172
Total assets	$	1,561,710	$	1,470,791

4

CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	As of December 31, 2003	As of September 30, 2004 (Unaudited)
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES:		
Accounts payable and accrued liabilities	$ 34,417	$ 34,402
Subscriber acquisition fees payable	9,119	17,987
License fees payable to affiliates	30,671	106,872
License fees payable to non-affiliates	87,720	76,486
Payables to affiliates	7,827	12,465
Payable to Hallmark Entertainment Holdings, Inc.		52,052
Payable to Hallmark Entertainment, Inc.		47,948
Interest payable to HC Crown	2,655	5,105
Credit facility and interest payable	510	310,548
Capital lease obligation	1,559	1,661
Deferred revenue	2,163	2,488
Total current liabilities	176,641	668,014
Accrued liabilities, net of current portion	18,906	20,796
Subscriber acquisition fees payable, net of current portion	1,500	915
License fees payable to affiliates, net of current portion	60,229	2,764
License fees payable to non-affiliates, net of current portion	82,090	71,029
Line of credit payable to HC Crown	75,000	75,000
Payable to Hallmark Entertainment Holdings, Inc.	52,052	
Payable to Hallmark Entertainment, Inc.	47,948	
Senior unsecured note to HC Crown, including accrued interest.	417,083	449,603
Credit facility, net of current portion	300,000	
Capital lease obligation, net of current portion	7,731	6,472
Company obligated mandatorily redeemable preferred interest, including accretion	9,079	10,802
Total liabilities	1,248,259	1,305,395
Commitments and contingencies		
STOCKHOLDERS EQUITY:		
Class A common stock, $.01 par value; 200,000,000 shares authorized; issued and outstanding shares of 73,863,037 as of December 31, 2003 and September 30, 2004	739	739
Class B common stock, $.01 par value; 120,000,000 shares authorized; issued and outstanding shares of 30,670,422 as of December 31, 2003 and September 30, 2004	307	307
Paid-in capital	1,308,880	1,348,345
Accumulated other comprehensive income	2,013	2,319
Accumulated deficit	(998,488)	(1,186,314)
Total stockholders equity	313,451	165,396
Total liabilities and stockholders equity	$ 1,561,710	$ 1,470,791

See accompanying notes to unaudited consolidated financial statements.

CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(In thousands, except per share amounts)

	Three Months Ended September 30, 2003	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2003	Nine Months Ended September 30, 2004
		(Unaudited)		
Revenue:				
Subscriber fees, net	$ 17,543	$ 20,038	$ 51,433	$ 60,190
Advertising	20,468	29,775	65,798	90,483
Advertising by Hallmark Cards	347	256	1,047	1,050
Film asset license fees	12,606	5,534	20,010	17,968
Other revenue	22	171	79	256
Total revenue, net	50,986	55,774	138,367	169,947
Cost of services:				
Programming costs:				
Affiliates	10,010	12,125	28,734	33,958
Non-affiliates	19,717	20,621	48,510	59,651
Amortization of film assets	11,371	8,941	24,957	24,407
Impairment of film assets		57,931		57,931
Subscriber acquisition fee amortization	6,468	7,010	19,074	19,042
Depreciation and amortization of technical facilities	1,185	1,182	3,556	3,548
Operating costs	11,736	11,277	33,819	31,140
Total cost of services	60,487	119,087	158,650	229,677
Selling, general and administrative expense	17,743	19,679	44,193	54,288
Marketing expense	3,474	2,899	17,645	16,859
Reorganization credit				(279)
Depreciation and amortization expense	2,548	2,167	7,619	6,897
Loss from operations	(33,266)	(88,058)	(89,740)	(137,495)
Loss on early extinguishment of debt	(39,812)		(39,812)	
Guaranteed preferred beneficial accretion			(23,218)	
Interest expense, net	(15,374)	(16,801)	(30,230)	(48,483)
Loss before income tax provision	(88,452)	(104,859)	(183,000)	(185,978)
Income tax provision	(593)	(904)	(2,132)	(1,848)
Loss before cumulative effect of a change in accounting principle	(89,045)	(105,763)	(185,132)	(187,826)
Cumulative effect of change in accounting principle	16,328		16,328	
Net loss	$ (72,717)	$ (105,763)	$ (168,804)	$ (187,826)
Other comprehensive income (loss):				
Foreign currency translation adjustment	(315)	(175)	95	306
Comprehensive loss	$ (73,032)	$ (105,938)	$ (168,709)	$ (187,520)
Weighted average number of Class A and Class B shares outstanding, basic and diluted	104,473	104,533	104,468	104,533
Loss from before cumulative effect of change in accounting principle	$ (0.85)	$ (1.01)	$ (1.77)	$ (1.80)
Cumulative effect of change in accounting principle	0.15	0.00	0.15	0.00
Net loss per share, basic and diluted	$ (0.70)	$ (1.01)	$ (1.62)	$ (1.80)

See accompanying notes to unaudited consolidated financial statements.

CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Nine Months Ended September 30, 2003	2004
	(Unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (168,804)	$ (187,826)
Adjustments to reconcile net loss to net cash used in operating activities:		
Cumulative effect of change in accounting principle	(16,328)	
Loss on early extinguishment of debt	39,812	
Impairment of film assets		57,931
Depreciation and amortization	137,864	159,673
Accretion on guaranteed preferred beneficial interest	22,018	
Loss on change in fair value of derivative liability	1,200	
Accretion on convertible debt	9,468	
Accretion on company obligated mandatorily redeemable preferred interest	537	1,723
Provision for allowance for doubtful accounts	2,546	71
Gain on sale of property and equipment	(31)	(124)
Stock-based compensation	3,367	8,319
Changes in operating assets and liabilities:		
Increase in accounts receivable	(9,536)	(1,949)
Additions to program license fees	(177,829)	(90,147)
Additions to subtitling and dubbing	(2,409)	(2,227)
Additions to subscriber acquisition fees	(2,031)	(23,100)
Increase in prepaid and other assets	(4,302)	(2,633)
Increase (decrease) in accounts payable and accrued liabilities.	69,356	(26,648)
Increase in interest payable	4,265	35,010
Increase (decrease) in subscriber acquisition fees payable	(32,255)	8,911
Increase in license fees payable to affiliates	23,183	18,736
Decrease in payables to affiliates	(6,779)	(141)
Increase in deferred revenue	2,059	325
Net cash used in operating activities	(104,629)	(44,096)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(3,135)	(1,225)
Proceeds from disposition of property and equipment	62	191
Net cash used in investing activities	(3,073)	(1,034)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from tax sharing agreement with Hallmark Cards	31,950	39,465
Borrowings under the HC Crown note payable	70,000	
Borrowings under the HC Crown senior unsecured note	400,000	
Borrowings under the credit facility	11,000	15,000
Payments on the credit facility	(67,250)	(5,000)
Repurchase of trust preferred securities	(326,674)	
Distribution to holders of guaranteed preferred beneficial interest	(7,406)	
Principal payments under capital lease obligation	(1,064)	(1,157)
Net cash provided by financing activities	110,556	48,308
Effect of exchange rate changes on cash	(66)	85
Net increase in cash and cash equivalents	2,788	3,263
Cash and cash equivalents, beginning of period	335	4,306
Cash and cash equivalents, end of period	$ 3,123	$ 7,569
Supplemental disclosure of cash and non-cash activities:		

Interest paid	$	11,050	$	10,453
Interest paid on preferred securities	$	8,944	$	
Income taxes paid	$	2,132	$	1,848
Payment on HC Crown note payable commitment fee in stock	$	281	$	

See accompanying notes to unaudited consolidated financial statements.

CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

For the Three and Nine Months Ended September 30, 2003 and 2004

1. Business and Organization

Organization

Crown Media Holdings, Inc. (Crown Media Holdings or the Company), through its subsidiaries, owns and operates pay television channels (collectively the Hallmark Channel or the channel) dedicated to high quality, entertainment programming for adults and families, in the United States and in various countries throughout the world. The international operations of the Hallmark Channel are operated by Crown Media International LLC (Crown Media International) and, in the United Kingdom, by Crown Entertainment Limited (Crown Entertainment). Crown Media International commenced its operations outside the United States in 1995. Domestically, the Hallmark Channel is operated and distributed by Crown Media United States LLC (Crown Media United States). Crown Media International acquired an interest in Crown Media United States in 1998 and as a result of subsequent transactions Crown Media Holdings owned 100% of the common interests of Crown Media United States by March 2001. Significant investors in Crown Media Holdings include Hallmark Entertainment Investments Co. (Hallmark Entertainment Investments), a subsidiary of Hallmark Cards, Incorporated (Hallmark Cards), the National Interfaith Cable Coalition, Inc. (NICC), and, indirectly through their investments in Hallmark Entertainment Investments, Liberty Media Corporation (Liberty Media) and J.P. Morgan Partners (BHCA), L. P. (J.P. Morgan).

Potential Sale of the International Business

In April 2004, the Company announced that it is exploring strategic alternatives for its international operations and the international rights to its film library, including, but not necessarily limited to, a sale or other corporate transaction in an effort to maximize shareholder value.

The Company is in current negotiations for the sale of its international operations and the international rights to its film library. However, the Company has not reached a final agreement regarding the terms of any such sale. The Company cannot provide assurance that an agreement for any such sale will be executed or that such a sale will be executed or consummated. In addition, any sale would require the consent of existing lenders under the bank credit facility. The Company is required under its amended debt agreements to use substantially all of the net proceeds from such a sale to pay down its credit facility and certain of its obligations to affiliates. Under the amendment to the credit facility executed on October 28, 2004, the Company agreed, in the event of a sale of the international businesses, to a reduction in the maximum borrowings under the facility from the current allowable borrowings of $320.0 million to $180.0 million.

Liquidity

Cash Flows

As of September 30, 2004, the Company had $7.6 million in cash and cash equivalents on hand and $10.0 million available under its bank credit facility. The Company s principal sources of funds are currently cash inflows from operations, cash on hand, periodic cash inflows expected under the tax sharing agreement with Hallmark Cards and amounts available for borrowing under its bank credit facility. On October 28, 2004, the Company received an additional tax sharing payment of $9.3 million.

The Company s principal uses of funds during 2004 and 2005 have been, and are expected to be, the payment of operating expenses, payments for licensing of programming and subscriber acquisition fees, and interest payments under its bank credit facility. As part of the Company s growth strategy, the Company expects to continue making investments in programming and distribution during 2004 and 2005.

As of September 30, 2004, the Company believes that cash inflows from its operations, cash on hand, remaining availability under its credit facility and payments anticipated under the tax sharing agreement with Hallmark Cards, all of which are currently its principal sources of funds, will be sufficient to meet its liquidity needs through the amended maturity date of its credit facility. As disclosed in note 8, subsequent to the end of the third quarter, the Company amended its credit facility which included an acceleration of the maturity and termination date of the facility from August 2006 to September 1, 2005. This revision, along with agreements with certain affiliates of Hallmark Cards, has resulted in approximately $470.0 million of obligations becoming due and payable on September 1, 2005. Of this amount, $130.0 million of outstanding obligations will become due and payable, if earlier, upon the sale of the Company s international operations and international film rights.

The Company is currently negotiating for the sale of the international operations which would provide cash resources to retire a portion of these obligations due and payable on September 1, 2005. The Company intends to either extend or refinance the credit facility prior to its maturity date. In addition, other financing alternatives could include the issuance of additional equity or debt securities. There can be no assurance, however, that the credit facility can or will be extended or refinanced or that additional funding will be available, if at all, on terms acceptable to the Company.

If the Company is unable to successfully complete the sale of the international business and restructure its obligations that become due in September 2005, the Company will not have sufficient available funds to repay such obligations.

2. Summary of Significant Accounting Policies

Interim Financial Statements

In the opinion of management, the accompanying consolidated balance sheets and related interim consolidated statements of operations and cash flows, include all adjustments, consisting of normal recurring items necessary for their fair presentation in conformity with accounting principles generally accepted in the United States. Interim results are not necessarily indicative of results for a full year. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes to those statements for the year ended December 31, 2003 including the Company s Annual Report on Form 10-K for the year ended December 31, 2003.

Principles of Consolidation

The consolidated financial statements include the consolidated accounts of Crown Media Holdings, including those of its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

Crown Media Holdings considers all highly liquid financial instruments purchased with an initial maturity of three months or less to be cash equivalents. The fair value of Crown Media Holdings cash equivalents approximates cost at each balance sheet date.

Subscriber Acquisition Fees

Crown Media United States has distribution agreements with every major pay television distributor (based on number of subscribers) in the United States. These distributors carry the Hallmark Channel on certain of their cable, satellite, terrestrial television, or satellite master antenna television systems. Under certain of these agreements, Crown Media United States is obligated to pay subscriber acquisition fees, if defined subscriber levels are met, in order to obtain additional carriage of the Hallmark Channel by those distributors. Such costs are accrued when Crown Media United States receives notice from the distributors that they have met the penetration percentage or subscriber count defined in the underlying agreements.

Subscriber acquisition fees are amortized over the contractual life of the distribution agreements (ranging from 4 to 9 years) as a reduction of subscriber fee revenue. If the amortization expense exceeds the revenue recognized on a per distributor basis, the excess amortization is included as a component of cost of services. Crown Media Holdings assesses the recoverability of these costs periodically. It also assesses the recoverability when events such as changes in distributor relationships occur or other indicators, which would suggest impairment.

Subscriber acquisition fees are comprised of the following:

	As of December 31, 2003	As of September 30, 2004 (unaudited)
	(In thousands)	
Subscriber acquisition fees, at cost	$ 191,377	$ 214,477
Accumulated amortization	(78,181)	(105,505)
Subscriber acquisition fees, net	$ 113,196	$ 108,972

As of December 31, 2003, and September 30, 2004, the consolidated balance sheets also reflect subscriber acquisition fees payable of $10.6 million and $18.9 million, respectively. For the three months ended September 30, 2003 and 2004, Crown Media United States made cash payments of $10.1 million and $10.7 million, respectively. For the nine months ended September 30, 2003 and 2004, Crown Media United States made cash payments of $34.3 million and $14.2 million, respectively.

Under certain of the agreements with distributors mentioned above, additional subscriber acquisition fees will become payable by the Company if defined incremental subscriber levels are reached. Under certain of the agreements, the Company may also be required to pay substantial marketing support payments, if subscribers exceed proscribed benchmarks, as defined in the respective agreements. These marketing support payments are expensed when it becomes probable that subscribers will meet such benchmarks.

Program License Fees

Program license fees are payable in connection with the acquisition of the rights to air programs acquired from others. In accordance with Statement of Financial Accounting Standards (SFAS) No. 63, *Financial Reporting by Broadcasters,* program rights are generally deferred and then amortized on a straight-line basis over their license periods or anticipated usage. At the inception of these contracts and periodically thereafter, Crown Media Holdings evaluates the recoverability of these costs compared to the estimated future revenues directly associated with the programming and related expenses. Where an evaluation indicates that a programming contract will ultimately result in a loss, additional amortization is provided to currently recognize that loss. The Company broadcasts certain of its film assets on the Hallmark Channel, primarily in its international markets. The Company accounts for such usage by first calculating the cost of the broadcast rights under the individual-film-forecast-computation method and then amortizes the computed cost over the respective license period using the straight-line method.

Subtitling and Dubbing

Subtitling and dubbing represent costs incurred to prepare programming for airing in international markets. These costs are capitalized as incurred and are amortized over the shorter of the program s airing window for programming licensed from unaffiliated third-parties or the program s estimated life for programming licensed from Hallmark Entertainment Distribution and the Company s film assets. Subtitling and dubbing costs related to programming licensed from Hallmark Entertainment Distribution are amortized over a maximum period of 3 years. Amortization expense for subtitling and dubbing costs was $980,000 and $1.0 million for the three months ended September 30, 2003 and 2004, respectively. Amortization expense for subtitling and dubbing costs was $3.3 million and $3.0 million for the nine months ended September 30, 2003 and 2004, respectively.

	As of December 31, 2003	As of September 30, 2004 (unaudited)
	(In thousands)	
Subtitling and dubbing assets, at cost	$ 7,863	$ 7,410
Accumulated amortization	(3,016)	(3,338)
Subtitling and dubbing assets, net	$ 4,847	$ 4,072

Property and Equipment

Property and equipment are recorded at cost. Depreciation of property and equipment is provided using the straight-line method over the estimated useful lives of the respective assets, ranging from three to eight years. Leasehold improvements are amortized over the life of the underlying lease. When a property is sold or otherwise disposed of, the cost and related accumulated depreciation and amortization are removed from the accounts and any resulting gain or loss is included in income. The costs of normal maintenance and repairs are charged to expense when incurred.

Accounting for Trust Preferred Securities

In December 2001, Crown Media Holdings formed a special-purpose entity, Crown Media Trust. Crown Media Trust issued trust preferred securities in Crown Media Trust s name to investors in a private placement and loaned the proceeds to Crown Media Holdings. This loan was designed so that interest and principal payments matched the dividend and any redemption requirements on the trust preferred securities issued by Crown Media Trust. Interest received by Crown Media Trust from Crown Media Holdings funded distributions to the holders of the preferred securities.

Crown Media Holdings owned 100% of the common equity in Crown Media Trust. The trust preferred securities included terms that allowed the holder to earn a return above the stated dividend rate on the securities under certain conditions. Based on fair value calculations using discounted cash flows and Black-Scholes models, a portion of the proceeds from the preferred securities was allocated and classified in Crown Media Holdings balance sheet as guaranteed preferred beneficial interest in Crown Media Trust s debentures and a portion was classified as convertible debt. Issuance costs related to the guaranteed preferred beneficial interest portion were netted against the guaranteed preferred beneficial interest and accreted as additional expense in earnings. Issuance costs related to the convertible debt portion were recorded as a deferred debt issuance costs asset and were amortized as additional interest expense, using the effective interest method.

On December 17, 2001, Crown Media Holdings completed the $265.0 million private placement of the trust preferred securities to a group of institutional investors. Under the terms of the private placement, Crown Media Holdings issued units to the investors, each unit consisted of one preferred security of Crown Media Trust, and one contingent appreciation certificate, issued by Crown Media Holdings.

Crown Media Holdings calculated the initial value of the contingent appreciation certificate portion of the trust preferred securities by using Black-Scholes models and by using a combination of put and call options that would provide the same future payout as the convertible debt portion. Crown Media Holdings calculated the initial fair value of the guaranteed preferred beneficial interest portion of the trust preferred securities using a discounted cash flow model. The proceeds from the private placement of the trust preferred securities of $265.0 million were bifurcated between the convertible debt and guaranteed preferred beneficial interest portions based upon their relative fair values.

On August 5, 2003, Crown Media Holdings repurchased all of the preferred securities of Crown Media Trust and related contingent appreciation certificates issued by the Company. The securities were repurchased for approximately $329.1 million, including approximately $2.4 million of scheduled cash distributions on the trust preferred securities during the quarter.

Revenue Recognition

Subscriber fees from pay television distributors are recognized each month as revenue when an agreement is executed, programming is provided, the price is determinable, and collectibility is reasonably assured. Subscriber fees from pay television distributors are recorded net of amortization of subscriber acquisition costs in accordance with Emerging Issues Task Force (EITF) No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products)*. Subscriber acquisition fee expense is recorded to the extent that the amortization of subscriber acquisition costs exceeds the related revenue earned from the pay television distributor.

Advertising revenues are recognized as earned in the period in which the advertising is telecast and are generally billed monthly in arrears. If the collectibility of this revenue is not reasonably assured with any individual customer, the revenue is not recognized until cash is received. Advertising revenues are recorded net of agency commissions. Agency commissions are calculated based on a stated percentage applied to gross billing revenue for the Company s broadcasting operations. Customers remit the gross billing amount to the agency and the agency remits gross billings less their commission to the Company. Payments received in advance of being earned are recorded as deferred revenue.

Advertising revenue and expenses in barter transactions are recorded at the fair value of the advertising to be provided. The fair value is determined based upon amounts paid in cash for similar advertisements from buyers unrelated to the other party in the barter transaction. When the revenue does not meet the requirements of EITF No. 99-17, *Accounting for Advertising Barter Transactions,* no revenue is recognized. No barter revenue or related expenses were recorded for the three months ended September 30, 2003. For the nine months ended September 30, 2003, revenue from advertising barter transactions of $94,000, and the corresponding barter expenses were included as a component of both advertising revenue and marketing expenses in the accompanying consolidated statements of operations. For both the three and nine months ended September 30, 2004, revenue from advertising barter transactions of $401,000, and the corresponding barter expenses were included as a component of both advertising revenue and marketing expenses in the accompanying consolidated statements of operations.

Revenue from film asset licensing agreements is recognized in accordance with Statement of Position (SOP) 00-02, *Accounting by Distributors or Producers of Films*. Revenues are recognized when all of the following have occurred: an agreement is executed, the film is available for exhibition by the licensee, the license fee is fixed or reasonably determinable, collectibility is reasonably assured and the cost of each film is known or reasonably determinable. Revenue from film asset licensing agreements containing multiple film titles is allocated among the various film titles based on their relative fair values. Payments received from licensees prior to the availability of a film are recorded as deferred revenue.

Revenues from foreign sources for the three months ended September 30, 2003 and 2004, represented 40% and 41%, respectively, of total revenue. Revenues from foreign sources for the nine months ended September 30, 2003 and 2004, represented 44% and 41%, respectively, of total revenue. Such revenues, generally denominated in United States dollars, were primarily from sales to customers in Australia, Denmark, Israel, Mexico, Poland, Romania, Russia, South Africa, Spain, and the United Kingdom, during all periods presented. The Company records revenue from certain foreign countries only when the cash is received due to the uncertainty regarding collection. For the three months ended September 30, 2003 and 2004, $315,000 and $235,000, respectively, was invoiced, but not recorded as revenue. For the nine months ended September 30, 2003 and 2004, $3.2 million and $832,000, respectively, was invoiced, but not recorded as revenue.

Cost of Services

Cost of services includes signal distribution expenses, depreciation of the Company s Network Operations Center and amortization of the capital lease for uplink and transponder space, amortization of program license fees, subtitling and dubbing amortization and costs, subscriber acquisition amortization in excess of subscriber revenue and costs, and amortization of film assets.

Long-Lived Assets

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* long-lived assets, such as property, plant and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed would be separately presented in the balance sheet and reported at the lower of the carrying amount of fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet. The Company reviews its goodwill for impairment under SFAS No. 142 and its film assets for impairment under SOP 00-2, as discussed below.

As a result of the Company exploring the sale of its international channel operations and the international rights to its film library, the Company analyzed its international channel operations for impairment during the three months ending September 30, 2004. The Company s projections of future cash flows to be generated by the international channel operations exceeded the carrying value of the net assets within the international channel operations asset group and therefore, the asset group was deemed to be recoverable. For purposes of this assessment, the Company allocated the probability-weighted cash flows, taking in to account the probability of selling the business or continuing to operate the business, to the international channel operations and the international rights to the film assets based upon the relative fair values of the asset groups.

Film Assets

In September 2001, the Company acquired certain film assets from Hallmark Entertainment Distribution. The Company amortizes its film assets using the individual-film-forecast-computation method over a maximum period of 10 years from the date of acquisition. The individual-film-forecast-computation method amortizes such assets in the same ratio that current period actual revenue bears to estimated unrecognized ultimate revenues. The Company s projections of ultimate revenue regarding sales of certain rights related to its film assets to third parties and anticipated internal use of its film assets are based on the history of each film and similar films, sales and marketing plans, and other factors, all of which require significant judgment by management. In accordance with SOP 00-02, the Company assesses the ultimate revenue projections on a quarterly basis.

The Company reviews the recoverability of each film in accordance with SOP 00-02 and on a quarterly basis assesses whether events or circumstance have changed which indicate that the fair value of a film is lower than its unamortized cost or carrying value. If the carrying value of any individual film assets exceeds its fair value, the film asset is written-down to its fair value. A discounted cash flow model is used to estimate the fair value of the individual films. Future cash flows are based on the terms of any existing contractual arrangements plus the projected cash inflows from future license sales. The Company considers the following factors, among others, in estimating future cash inflows for each film: (a) if previously released, the film s performance in historical markets, (*b*) the public s perception of the film s story, cast, director, or producer, (*c*) historical results of similar films, (*d*) historical results of the cast, director, or producer on prior films, and (*e*) running time of the film. In estimating a film s fair value, the Company considers those cash outflows necessary to generate the film s cash inflows. Therefore, future exploitation and participation costs are factored into the estimation of fair value. On an annual basis, the Company is required by the covenants in its credit agreement to have an outside expert perform a valuation of the film library as a whole.

In the third quarter of 2004, the Company reviewed each of its film assets for impairment as a result of the Company exploring the sale of its international operations and the international rights to its film library. The Company computed fair value of each film using the discounted cash flow model outlined above and also considered the indications of fair value for the international rights to its film library as a group. A non-cash impairment charge was recorded in the third quarter 2004 for each film where the calculated fair value was less than its carrying value at

September 30, 2004. The resulting impairment charge was $57.9 million.

Amortization expense for the film assets was $11.4 million and $8.9 million for the three months ended September 30, 2003 and 2004, respectively. Amortization expense for the film assets was $25.0 million and $24.4 million for the nine months ended September 30, 2003 and 2004, respectively. At September 30, 2004, the Company expects to amortize $55.0 million to $65.0 million of film assets during the year ending December 31, 2004.

	As of December 31, 2003	As of September 30, 2004 (unaudited)
	(In thousands)	
Film assets	$ 810,928	$ 810,928
Residual assets	9,129	12,656
Accumulated amortization and impairment	(69,320)	(151,511)
Film assets, net	$ 750,737	$ 672,073

Goodwill

The Company has allocated all of its goodwill to its domestic reporting unit, Crown Media United States, since the goodwill was recorded as a result of a series of transactions whereby the Company became the owner of 100% of the membership units of Crown Media United States. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, Crown Media Holdings ceased amortizing goodwill on January 1, 2002, and performs an impairment analysis of its goodwill on an annual basis and if events and circumstances indicate that the carrying amount may not be recoverable. Annually, the Company employs a valuation expert to evaluate the carrying value of the Company s goodwill for impairment, as required by SFAS No. 142. The Company has selected November 30 as its annual goodwill impairment review date. The valuation utilized a discounted cash flow methodology to estimate the fair value of the domestic reporting unit. The estimated cash flow available for distribution over a ten-year period was added to the estimated terminal value and discounted to the present using the domestic reporting unit s estimated weighted average cost of capital. The assumptions utilized in the discounted cash flow model required significant judgment by management and its valuation expert. As this valuation exceeded the carrying value of the domestic reporting unit as of November 30, 2003, the step one test described by SFAS No. 142 was deemed to have been passed and the step two test was not performed.

Taxes on Income

Pursuant to the Tax Sharing Agreement entered into with Hallmark Cards on March 11, 2003, the Company s results of operations for tax purposes became a part of the Hallmark Cards consolidated federal tax return as of and subsequent to March 11, 2003. However, the Company continues to account for income taxes on a separate return basis. The Company accounts for income taxes using an asset and liability method that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and net operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Company reduces deferred tax assets by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized. Any payments received from Hallmark Cards under the Tax Sharing Agreement are recorded as an increase in paid-in capital and any future reversal of the valuation allowance will be recorded as a reduction in paid-in capital, to the extent payments were received for such benefits under the Tax Sharing Agreement.

Translation of Foreign Currency

The balance sheets and statements of operations of certain Crown Media Holdings foreign subsidiaries are measured using local currency as the functional currency. Revenues, expenses and cash flows of such subsidiaries are translated into United States dollars at the average exchange rates prevailing during the period. Assets and liabilities are translated at the rates of exchange at the balance sheet date. Translation gains and losses are deferred as a component of accumulated other comprehensive income (loss). Foreign currency transaction gains and losses recorded upon the remeasurement of financial assets and liabilities denominated in currencies other than the functional currency of the subsidiary are included in determining net loss for the period.

Net Loss Per Share

Basic net loss per share is computed by dividing the net loss for the period by the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed based on the weighted average number of common shares and potentially dilutive common shares outstanding. The calculation of diluted net loss per share excludes potential common shares if the effect would be antidilutive. Potential common shares consist of incremental common shares issuable upon the exercise of stock options and restricted stock units. Approximately 1.7 million and 1.4 million stock options for the three and nine months ended September 30, 2003 and 2004, respectively, have been excluded from the calculations of diluted earnings per share because their effect would have been antidilutive. Approximately 2.0 million restricted stock units for the three and nine months ended September 30, 2003, respectively, have been excluded from the calculations of diluted earnings per share because their effect would have been antidilutive. Approximately 2.8 million restricted stock units for the three and nine months ended September 30, 2004, respectively, have been excluded from the calculations of diluted earnings per share because their effect would have been antidilutive.

Stock-Based Compensation, Employee Incentives and Retention

The Company accounts for its stock-based employee compensation plan using the intrinsic value method under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* and related Interpretations. Accordingly, compensation cost for stock options issued to employees is measured as the excess, if any, of the quoted market price of the Company s stock at the date of the grant over the exercise price of the underlying stock options. In December 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure an amendment of SFAS No. 123.* SFAS No. 148 requires certain additional disclosures of the estimated fair value of stock-based compensation. Such estimated fair value is determined through the use of the Black-Scholes option pricing model. SFAS No. 123, *Accounting for Stock-Based Compensation,* encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value.

In April 2003, the Company s Board of Directors approved actions to provide additional incentives to encourage retention of its employees. Crown Media Holdings then outstanding stock options held by employees had exercise prices significantly above the current market value of its Class A common stock. The Company made an offer in May 2003 to senior management and vice presidents, totaling approximately 55 persons, to exchange their options for restricted stock units (RSUs). The exchange ratio was one RSU for every 2.5 options for shares of the Company s Class A common stock, resulting in a total of 5,126,732 options exchanged for 2,050,693 RSUs. Each RSU, upon vesting, represents the right to receive one share of Class A common stock or the value of the share in cash at the time of vesting. The RSUs vest over three years in one-third increments on the anniversary of the grant date each year. The Company s Board may determine, at its discretion, whether the payment is made in common stock or cash for each of the one-third increments. As a result of the Board s decision to settle the first one-third increment in cash, Crown Media Holdings is recording compensation expense based on the fair value of the common stock required to settle the RSUs at each reporting period end during the vesting period of the RSUs. Such compensation expense is calculated using variable plan accounting. Options for 279,254 shares of common stock that were not exchanged are also subject to variable plan accounting in which compensation is remeasured at each reporting date until the options are exercised, expire unexercised or are forfeited.

In May 2004, the Company s Board of Directors approved an additional grant to employees of 1,065,000 RSUs. The Employment RSUs, which constitute 70% of the award granted in 2004, vest in equal one-third installments over the next three years on the anniversary of the grant date each year. The Company is accruing expense related to the Employment RSUs ratably over each installment s vesting period. The Performance RSUs, constituting 30% of the award granted in 2004, vest on the 3rd anniversary of the grant date, provided that the price of the Crown common stock is $14 or higher on that date. The Company will begin to accrue compensation expense for the Performance RSUs when it becomes probable that the price of the Company s stock will be $14 or more on the 3rd anniversary of the grant date. The Company s Board may determine whether the RSUs are settled in cash or common stock. Crown Media Holdings is adjusting compensation expense at the end of each reporting period based on the fair value of the common stock required to settle the RSUs. Such compensation expense is calculated using variable plan accounting.

In May 2004, the Company granted 115,000 RSUs to a Company executive and changed the original vesting terms of this employee s 2003 grant such that one-half of the grant will vest in January 2005 and the other half will vest in January 2006. Compensation expense already recorded for this employee s 2003 grant will not be adjusted, rather, compensation expense for the remaining unvested portion of the grant will be accrued in one-half increments ratably over the new vesting periods. Crown Media Holdings is adjusting compensation expense at the end of each reporting period based on the fair value of the common stock required to settle the RSUs at each reporting period end during the vesting period of the RSUs. Such compensation expense is calculated using variable plan accounting.

The Company recorded $3.1 million and $3.4 million, respectively, of compensation expense associated with the RSUs during the three and nine months ended September 30, 2003, which has been recorded as an accrued liability in the accompanying consolidated balance sheet and is included in selling, general and administrative expense in the accompanying consolidated statement of operations. The Company recorded $2.5 million and $8.3 million of compensation expense associated with the RSUs during the three and nine months ended September 30, 2004, respectively, which has been recorded as an accrued liability in the accompanying consolidated balance sheet and is included in selling, general and administrative expense in the accompanying consolidated statement of operations. The Company settled the first one-third increment of the 2003 RSUs in June 2004 for approximately $3.5 million in cash.

In addition, in May 2003, the Company s Board immediately vested the stock options of all employees below the vice-president level who held options at that time and granted them a right to receive a future cash payment of $1.00 for each outstanding option held by the employee. The immediate vesting of the employees stock options created a new measurement date which required the Company to record stock compensation expense, if any, for the excess of the Company s stock price on the measurement date over the underlying stock options exercise price. Since the price of the Company s Class A common stock on the measurement date was less than the exercise price of all of the stock options owned by the employees, no compensation expense was recorded under APB 25. However, the June 2004 cash payments totaling $344,386 was contingent upon each respective employees continuous employment through that date. As a result, the Company was recording compensation expense from June 2003 through May 2004 as the compensation was earned. For the three and nine months ended September 30, 2003, $80,000 and $109,000, respectively, of compensation expense was recorded related to this obligation, which has been included in accrued liabilities in the accompanying consolidated balance sheet. For the nine months ended September 30, 2004, $140,000 of compensation expense was recorded related to this obligation, which has been included in accrued liabilities in the accompanying consolidated balance sheet. In June 2004, eligible employees received the $1.00 per option payment.

Had compensation expense for these plans been determined consistent with SFAS No. 123, Crown Media Holdings net loss and loss per share would have been increased to the following pro forma amounts for the three and nine months ended September 30, 2003 and 2004:

Pro Forma Effects

(unaudited)

(In thousands, except per share amounts)

	Three Months ended September 30, 2003	Three Months ended September 30, 2004	Nine Months ended September 30, 2003	Nine Months ended September 30, 2004
Net loss	$ (72,717)	$ (105,763)	$ (168,804)	$ (187,826)
Pro forma stock options expense at estimated fair value	(1,644)	(660)	(4,952)	(1,983)
Stock plan expense included in net loss			6	
Pro forma net loss	$ (74,361)	$ (106,423)	$ (173,750)	$ (189,809)
Weighted average shares	104,473	104,533	104,468	104,533
Pro forma net loss per share, basic and diluted	$ (0.71)	$ (1.02)	$ (1.66)	$ (1.82)

There were no stock options granted during 2003 or during the three and nine months ended September 30, 2003 and 2004.

Retention Program

The Company has established a retention program for approximately 175 employees who could be affected if Crown Media Holdings international business is sold. Under the program, employees that remain with the Company through the earlier of the date on which a sale of the international business becomes effective or December 31, 2004, are entitled to retention of approximately $7.4 million. If the Company announces prior to December 31, 2004, that it has decided not to sell the international business, reduced retention payments of approximately $3.7 million will be payable within 30 days of that announcement. The Company recorded $2.2 million of expense for both the three and nine months ended September 30, 2004, respectively, in regard to this retention program.

Derivative Financial Instruments

The Company follows the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended. The standard requires the recognition of all derivative instruments on the balance sheet as either assets or liabilities measured at fair value. Changes in fair value are recognized immediately in earnings unless the derivatives qualify as hedges of future cash flows. The Company discontinues hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting the cash flows of the hedged item, the derivative expires or is sold, terminated or exercised, or the derivative is no longer designated as a hedging instrument. Changes in the fair value of the contingent appreciation certificates included in the trust preferred securities were recognized immediately in earnings. The trust preferred securities were repurchased in August 2003 and the cost associated with the settlement of the contingent appreciation certificates has been included in the loss on early extinguishment of debt in the accompanying consolidated statements of operations.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires Crown Media Holdings to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates employed by the Company are as follows.

The Company estimates and records the level of subscriber fees one month in advance based upon the actual prior month s subscriber levels. The Company s advertising revenue is heavily reliant upon third party ratings estimates to determine the quantity of advertising delivered to viewers.

When multiple films are sold under a single arrangement, in order to properly recognize revenue when each license fee commences, the Company must estimate the relative fair value of each film and allocate the total contracted price to the different films in the arrangement.

The Company has established an allowance for doubtful accounts based upon historical charge-off experience. Periodically, management analyzes the attributes of the accounts which management has written-off during the period and adjusts the allowance percentages management applies to its aged receivable balances.

The initial recoverability of subscriber acquisition fees is evaluated by projecting the incremental subscriber fee and advertising revenue attributable to the incremental subscribers obtained through the distribution agreement. This analysis includes significant judgment and estimation by management in terms of the estimated incremental advertising per subscriber.

The Company amortizes its film assets using the individual-film-forecast-computation method over a maximum period of 10 years from the date of acquisition, which amortizes such assets in the same ratio that current period actual revenue bears to estimated unrecognized ultimate revenues. Estimated unrecognized ultimate revenues are based on the history of each film and similar films, sales and marketing plans, and other factors, all of which require significant judgment by management.

When events or circumstances indicate that the carrying amount of a long-lived asset or asset group may not be recoverable from its undiscounted cash flows, the Company estimates such future cash flows and measures the impairment loss, if necessary, as the difference between the carrying amount and fair value of the asset. Estimates of future cash flow and the assumptions used in the discounted cash flow model used by management to estimate fair value require significant judgment by management.

Concentration of Credit Risk

Financial instruments, which potentially subject Crown Media Holdings to a concentration of credit risk, consist primarily of cash, restricted cash, cash equivalents and accounts receivable. Generally, Crown Media Holdings does not require collateral to secure receivables. Crown Media Holdings has no significant off-balance sheet financial instruments with risk of accounting losses.

Fair Value

Accounts payable and receivable, are reasonable estimates of their fair values because of their short-term nature. The interest rates on the bank credit facility and the line of credit with HC Crown are variable and/or reset periodically, therefore, the fair value of this debt is not significantly affected by fluctuations in interest rates. The carrying amount of the senior unsecured note to HC Crown at September 30, 2004, was $449.6 million, its fair value was $422.4 million and its unrealized gain was $27.2 million, assuming an interest rate of 11%. The company obligated mandatorily redeemable preferred interest was revalued to its fair value as of July 1, 2003, upon adoption of SFAS No. 150 *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. The Company estimates the fair value of the company obligated mandatorily redeemable preferred interest on an annual basis in November as it is not practicable to perform the valuation more frequently. The Company employs a discounted cash flows approach to value the company obligated mandatorily redeemable preferred interest that involves a significant amount of time to perform. The valuation is dependent upon the future pre-tax income of Crown Media United States since the Company is only obligated to make payments on the instrument to the extent pre-tax income is generated by Crown Media United States.

Recently Issued Accounting Pronouncements

At a recent meeting, the FASB unanimously voted for proposed accounting standards relating to equity-based compensation to be effective for fiscal periods beginning after December 15, 2004 (January 1, 2005 for the Company). An exposure draft was released in the first quarter of 2004 and the final standard is expected to be issued in 2004. The accounting standard is expected to require all companies to utilize the fair value method of accounting for equity-based compensation in accordance with SFAS No. 123, Accounting for Stock-Based Compensation. Companies can voluntarily adopt SFAS No. 123, using a variety of adoption methods. The Company is currently evaluating the impact of the proposed accounting standards and the adoption alternatives provided under both the current standards and the proposed standards. Crown Media Holdings discloses the pro forma impact of stock based compensation on its earnings in its notes to financial statements.

In March 2004, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 03-01, *The Meaning of Other-Than-Temporary Impairment and Its Applications to Certain Investments*. EITF Issue No. 03-01 includes new guidance on evaluating and recording impairment losses on debt and equity investments, as well as new disclosure requirements for investments that are considered to be temporarily impaired. The accounting guidance of EITF Issue No. 03-01 is effective for reporting periods beginning after June 15, 2004, while the disclosure requirements for debt and equity securities accounted for under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, are effective for annual periods ending after December 15, 2003. The Company believes that the adoption of EITF Issue No. 03-01 will not have a material impact on its financial position or results of operations.

In December 2003, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition* , which supercedes SAB No. 101, *Revenue Recognition in Financial Statements.* SAB No. 104 s primary purpose is to rescind accounting guidance contained in SAB No. 101 related to multiple element revenue arrangements, superceded as a result of the issuance of EITF Issue No. 00-21. Additionally, SAB No. 104 rescinds the SEC s Revenue Recognition in Financial Statements Frequently Asked Questions and Answers (FAQ) issued with SAB No. 101 that had been codified in SEC Topic 13, *Revenue Recognition*. Selected portions of the FAQ have been incorporated into SAB No. 104. While the wording of SAB No. 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB No. 101 remain largely unchanged by the issuance of SAB No. 104. EITF 00-21 was effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. There was no impact to the Company s consolidated financial statements related to SAB No. 104 for the three and nine months ended September 30, 2004.

3. Reorganization

In October 2002, the Company began reorganizing its operations in order to concentrate its efforts on the Hallmark Channel in the U.S. and in its more successful international markets. The Company completed decentralizing many oversight and non-technical support functions formerly located in the Company s U.S.-based offices and transferred those responsibilities to regional staff. In Latin America, the Company entered into an agreement with a local distribution partner, Pramer S.C.A., who is now responsible for the day-to-day operations of the Hallmark Channel in this region. At the completion of the reorganization in April 2003, the Company s workforce was reduced by approximately 30% or 130 positions. Accordingly, the Company recorded a reorganization charge of $28.8 million during the fourth quarter of 2002. This charge was comprised of a charge of $5.5 million for severance costs and charges of $23.3 million related to exit costs for permanently abandoned satellite, transponder and facility leases.

The following table displays the activity and balances of the reorganization accrual account from December 31, 2003, to September 30, 2004, which have been included in accounts payable and accrued liabilities in the accompanying consolidated balance sheets.

	Severance	Facilities	Satellite and Transponder	Total
		(In thousands)		
Balance at December 31, 2003	$ 4	$ 1,523	$ 13,511	$ 15,038
Additions due to accretion			48	48
Deductions due to adjustments to estimates	(4)	(126)	(149)	(279)
Deductions due to payments		(278)	(2,740)	(3,018)
Balance at September 30, 2004	$	$ 1,119	$ 10,670	$ 11,789

19

4. Program license fees

Program license fees are comprised of the following:

	As of December 31, 2003	As of September 30, 2004 (unaudited)
	(In thousands)	
Hallmark Entertainment Distribution	$ 112,069	$ 118,752
NICC	1,885	9,247
Other affiliates	5,906	5,906
Non-affiliates	242,329	268,521
Program license fees, at cost	362,189	402,426
Accumulated amortization	(115,696)	(162,681)
Program license fees, net	$ 246,493	$ 239,745

Programming costs for the three months ended September 30, 2003 and 2004, were $29.7 million and $32.7 million, respectively. Programming costs for the nine months ended September 30, 2003 and 2004, were $77.2 million and $93.6 million, respectively. Amortization of program license fees, included as a component of programming cost in the accompanying consolidated statements of operations, was $29.3 million and $32.7 million for the three months ended September 30, 2003 and 2004. Amortization of program license fees, included as a component of programming cost in the accompanying consolidated statements of operations, was $75.6 million and $93.6 million for the nine months ended September 30, 2003 and 2004.

At December 31, 2003, and September 30, 2004, $4.8 million and $4.6 million, respectively, of program license fees were included in prepaid and other assets on the accompanying consolidated balance sheets since the airing windows had not begun but payment had been made.

License fees payable are comprised of the following:

	As of December 31, 2003	As of September 30, 2004 (unaudited)
	(In thousands)	
Hallmark Entertainment Distribution	$ 90,609	$ 108,233
NICC	291	1,403
Non-affiliates	169,810	147,515
Total license fees payable	260,710	257,151
Less current maturities	(118,391)	(183,358)
Long-term license fees payable	$ 142,319	$ 73,793

5. Credit Facility

In connection with the completion of the purchase of the film assets in 2001, Crown Media Holdings entered into a credit agreement with a syndicate of banks, led by JP Morgan Chase Bank, under which the banks have extended to Crown Media Holdings a five-year $320.0 million secured credit facility. The credit facility includes a term loan of $100.0 million and a revolving line of credit of $220.0 million, up to $20.0 million of which can be letters of credit issued at the request of Crown Media Holdings. At September 30, 2004, Crown Media Holdings had outstanding borrowings of $310.0 million under the credit facility and there were no letters of credit outstanding. As a result of an amendment to the credit facility executed on October 28, 2004, the entire balance is due in 2005 and, therefore, is classified as a current liability in the accompanying consolidated balance sheets. (Of the outstanding amount, $130.0 million is due on the sale of the international operations and international film rights if such an event occurs earlier than the maturity date.) This loan is guaranteed by Crown Media Holdings subsidiaries and is secured by all tangible and intangible property of Crown Media Holdings and its subsidiaries. The Company is obligated to maintain certain financial debt covenants in conjunction with the credit facility. As a result of the film asset impairment charge recorded in the third quarter 2004, the Company was not in compliance with the trailing 12-month EBITDA (as defined) financial covenant at September 30, 2004. The amendment to the credit facility executed on October 28, 2004, excluded the film asset impairment charge from the calculation of trailing 12-month EBITDA.

Interest expense on borrowings under the credit facility for the three months ended September 30, 2003 and 2004, was $2.9 million and $3.5 million, respectively. Interest expense on borrowings under the credit facility for each of the nine months ended September 30, 2003 and 2004, was $9.9 million.

6. Related Party Transactions

Senior Unsecured Note

In August 2003, the Company issued a senior unsecured note to HC Crown for $400.0 million. A portion of the proceeds was used to repurchase the Company s outstanding trust preferred securities, and the balance of the proceeds, after expenses, was used to reduce amounts outstanding under its bank credit facility.

The senior unsecured note payable to HC Crown does not require interest or principal payments until August 2007. Instead, the principal amount of the senior unsecured note accretes at 10.25% per annum, compounding semi-annually, to $596.6 million at August 5, 2007. From that date, interest at 10.25% per annum will be payable semi-annually on the accreted value of the senior unsecured note to HC Crown. The note matures on August 5, 2011, and is pre-payable by Crown Media Holdings at any time after August 5, 2004, without penalty. At December 31, 2003, $400.0 million of principal and $17.1 million of accreted interest were included in the senior unsecured note payable in the accompanying consolidated balance sheet. At September 30, 2004, $400.0 million of principal and $49.6 million of accrued interest were included in the senior unsecured note payable in the accompanying consolidated balance sheet. The note purchase agreement for the senior unsecured note contains certain covenants which restrict on the part of the Company, among other matters, from the incurrence of any additional indebtedness, the repurchase or other acquisitions of the Company s stock, investments in other parties and the incurrence of liens on the Company s assets. As a fee for the issuance of the notes, the Company paid $3.0 million to HC Crown, which is being amortized as additional interest expense over the term of the note payable.

Line of Credit Payable to HC Crown

On December 14, 2001, the Company executed a $75.0 million promissory note with HC Crown maturing on the earlier of six months from the termination of the credit facility or December 21, 2007. As discussed in note 8, the credit facility termination date has been amended to September 1, 2005, and as such, the line of credit becomes due and payable on February 2006. This note replaced the promissory note previously issued to HC Crown dated September 28, 2001. This line of credit is subordinate to the credit facility. The rate of interest under this line of credit is equal to LIBOR plus three percent, payable quarterly. At both December 31, 2003, and September 30, 2004, borrowings under the note were $75.0 million. Accrued interest on the note of $2.7 million and $5.1 million as of December 31, 2003, and September 30, 2004, respectively, is included in interest payable to HC Crown on the accompanying consolidated balance sheets.

Tax Sharing Agreement

On March 11, 2003, Crown Media Holdings became a member of Hallmark Cards consolidated federal tax group and entered into a federal tax sharing agreement with Hallmark Cards (the Tax Sharing Agreement). Hallmark Cards includes Crown Media Holdings in its consolidated federal income tax return. Accordingly, Hallmark Cards has benefited from past tax losses and will benefit from future federal tax losses, which may be generated by Crown Media Holdings. Based on the Tax Sharing Agreement, Hallmark Cards has agreed to pay Crown Media Holdings all of the benefits realized or realizable by Hallmark Cards as a result of including Crown Media Holdings in its consolidated income tax return, 75% in cash on a quarterly basis and the balance when Crown Media Holdings becomes a federal taxpayer. Under the Tax Sharing Agreement, at Hallmark Cards option, the balance of the 25% in federal tax benefits may also be applied as an offset against any amounts owed by Crown Media Holdings to any member of the Hallmark Cards consolidation group under any loan, line of credit or other payable, subject to limitations under any loan indentures or contracts restricting such offsets. As of September 30, 2004, Hallmark Cards has not exercised this option.

The Company received $49.4 million under the Tax Sharing Agreement during 2003. The Company received $32.0 million and $39.5 million under the Tax Sharing Agreement during the nine months ended September 30, 2003 and 2004, respectively. In October 2004, the Company received an additional $9.3 million under the Tax Sharing Agreement. These receipts have been recorded as an addition to paid-in capital in the accompanying consolidated balance sheet.

Hallmark Entertainment Investments

On March 11, 2003, Hallmark Entertainment Holdings, Inc. (Hallmark Entertainment Holdings , a wholly-owned subsidiary of Hallmark Cards) contributed 100% of the Crown Media Holdings shares owned by it to Hallmark Entertainment Investments. Two of Crown Media Holdings investors, Liberty Crown, Inc., a subsidiary of Liberty Media, and JP Morgan, also contributed 100% of their Crown Media Holdings shares to Hallmark Entertainment Investments, and VISN contributed 10% of its Crown Media Holdings shares to Hallmark Entertainment Investments, all in return for shares in Hallmark Entertainment Investments. Hallmark Entertainment Holdings, now an owner of more than 80% of Hallmark Entertainment Investments, has voting power over all of the Crown Media Holdings shares owned by Hallmark Entertainment Investments.

Costs Incurred on Crown Media Holdings Behalf

Since inception, Hallmark Entertainment has at times paid certain costs on behalf of Crown Media Holdings. For the three and nine months ended September 30, 2003, the Company paid $186,000 and $1.0 million to Hallmark Entertainment as a reimbursement of such costs. No amounts were reimbursed to Hallmark Entertainment during the three and nine months ended September 30, 2004. Hallmark Entertainment incurred $600,000 and $3.0 million, respectively, on Crown Media Holdings behalf for the three and nine months ended September 30, 2004. Unreimbursed costs of $670,000 and $3.7 million are included in payable to affiliates in the accompanying consolidated balance sheets as of December 31, 2003, and September 30, 2004, respectively.

Services Agreement with Hallmark Cards

Crown Media Holdings entered into an Intercompany Services Agreement with Hallmark Cards, which was effective January 1, 2003, under which Hallmark Cards agreed for a term of three years to provide Crown Media Holdings with tax, risk management, health safety, environmental, insurance, legal, treasury and cash management services and real estate consulting services. Under the agreement, the Company agreed to pay Hallmark Cards $515,000 per year for these services, plus out-of-pocket expenses and third party fees, payable in arrears on the last business day of each quarter. At December 31, 2003 and September 30, 2004, unpaid accrued service fees and unreimbursed expenses of $6.8 million and $8.4 million, respectively, have been included in payable to affiliates in the accompanying consolidated balance sheets.

Film Asset Services Agreement with Hallmark Entertainment

The Company entered into a film asset services agreement with Hallmark Entertainment, under which Hallmark Entertainment provides Crown Media Holdings with services related to the administration, distribution and other exploitation of the Company s film assets. The services agreement expires on December 31, 2006, subject to cancellation by either party after the first or second year. In consideration for the services provided by Hallmark Entertainment, Crown Media Holdings is obligated to pay a service fee of $1.5 million per year, payable in quarterly installments of $375,000. Crown Media Holdings paid $375,000 to Hallmark Entertainment during both of the three months ended September

30, 2003 and 2004. Crown Media Holdings paid $1.1 million to Hallmark Entertainment during both of the nine months ended September 30, 2003 and 2004. At both December 31, 2003, and September 30, 2004, unpaid accrued service fees of $375,000 were included in payable to affiliates in the accompanying consolidated balance sheet.

Trademark Agreement with Hallmark Cards

Crown Media United States, Crown Media International and Crown Entertainment have trademark license agreements with Hallmark Cards and Hallmark Licensing, Inc. for use of the Hallmark mark for the versions of the Hallmark Channel distributed both in the United States and internationally and for the Hallmark Movie Channel. These trademark license agreements expire on September 1, 2005.

Program License Agreements with Hallmark Entertainment Distribution

Crown Media International has a program license agreement with Hallmark Entertainment Distribution dated January 1, 2001. The agreement expires on December 31, 2005, subject to a renewal through December 31, 2010. Under the terms of the agreement, Crown Media International has the exclusive right to exhibit Hallmark Entertainment Distribution produced programming in the territories in which Crown Media International operates during three 18-month windows. Crown Media International also has the exclusive right to exhibit programming in markets where it does not currently operate, if it elects to distribute the channel in those markets, subject to any agreement between Hallmark Entertainment Distribution and a third party existing at the time Crown Media International launches the channel in those markets. In addition, under the agreement, Hallmark Entertainment Distribution is generally obligated to sell to Crown Media International all of the programming it produces and Crown Media International is obligated to purchase up to 50 programs produced per year during the term of the agreement.

Crown Media United States also licenses programming for distribution in the United States from Hallmark Entertainment Distribution under a separate program license agreement, dated January 1, 2001. Under this program agreement, Crown Media United States licenses programs owned or controlled by Hallmark Entertainment Distribution, as well as all programming produced by or on behalf of Hallmark Entertainment Distribution for Crown Media United States. The program agreement has a term of five years and is automatically renewable for additional three-year periods, subject to rate adjustments, so long as Hallmark Entertainment Distribution or its affiliates, owns an interest of 35% or more of Crown Media Holdings. If, at any time, Hallmark Entertainment Distribution ceases to own a 35% interest in Crown Media Holdings, and if, at that time, the remaining term of the program agreement is less than two years, then the remaining term of the program agreement will be extended to the date two years after the date on which Hallmark Entertainment Distribution ceased to own a 35% interest in Crown Media Holdings.

If either Crown Media United States or Crown Media International sub-licenses any licensed program to a third party, they must equally share with Hallmark Entertainment Distribution the excess, if any, of the sublicensing fee over the initial program license fee paid by the Company. The Company did not sub-license any licensed programs to third parties during the three and nine months ended September 30, 2003 and 2004. Amounts due to Hallmark Entertainment Distribution as a result of sub-licensing agreements entered into in other periods have been included in license fees payable to affiliates in the accompanying balance sheets as noted below.

Programming costs related to the Hallmark program agreements were $7.1 million and $9.2 million, respectively, for the three months ended September 30, 2003 and 2004. Programming costs related to the Hallmark program agreements were $19.2 million and $25.1 million, respectively, for the nine months ended September 30, 2003 and 2004. As of December 31, 2003, and September 30, 2004, $90.6 million and $108.2 million, respectively, are included in license fees payable to affiliates in the accompanying consolidated balance sheets.

Company Obligated Mandatorily Redeemable Preferred Interest and NICC License Agreements

VISN owns a $25.0 million company obligated mandatorily redeemable preferred interest in Crown Media United States (the preferred interest) issued in connection with an investment by Crown Media International in Crown Media United States. On November 13, 1998, HEN Domestic Holdings, Inc., a wholly-owned subsidiary of Crown Media International, Vision Group, VISN and Henson Cable Networks, Inc. signed an amended and restated company agreement governing the operation of Crown Media United States, which agreement was further amended on February 22, 2001 and January 1, 2002 (the company agreement).

Under the company agreement, the members agreed that if during any year ending after January 1, 2005 and prior to December 31, 2009, Crown Media United States has net profits in excess of $10.0 million, and the preferred interest has not been redeemed, Crown Media United States will redeem the preferred interest in an amount equal to the lesser of: (i) such excess net profits; (ii) $5.0 million; or (iii) the amount equal to the preferred liquidation preference on the date of redemption. Crown Media United States may voluntarily redeem the preferred interest at any time, however, it is obligated to do so on the date of redemption (December 31, 2010). Due to the mandatory redemption provision of the preferred interest, on July 1, 2003, the preferred interest was remeasured at fair value and reclassified to non-current liabilities in accordance with the provisions of SFAS No. 150.

Under the company agreement, Crown Media United States may be required to make certain payments in regards to programming provisions to the National Interfaith Cable Coalition (NICC). Specifically, Crown Media United States may be required to pay license fees to NICC or fund production costs consisting of: (i) a total of $5.3 million per year, with CPI escalations, for two recurring programming blocks produced by NICC; (ii) up to $10 million per year for an additional recurring signature series program block co-produced by NICC and Crown Media United States; (iii) up to $600,000 per non-dramatic holiday special produced by NICC; and (iv) up to $1.0 million per dramatic holiday special co-produced by NICC and Hallmark Entertainment. In addition, six months prior to the expiration of the agreement, Crown Media United States must negotiate in good faith with NICC regarding a continuation of this programming and funding commitment. If agreement is not reached and Crown Media United States does not continue the NICC programming and funding commitments at the same levels, NICC is entitled to compel Crown Media Holdings to buy all of NICC s Crown Media Holdings shares at their then-current market value no later than 60 days following the expiration of the amendment. Crown Media United States, however, can nullify this put by electing to continue the NICC programming and funding commitments at the same levels.

Pursuant to additional amendments effective January 1, 2002, and January 1, 2004, Crown Media United States agreed to advance NICC $3,000,000 in each of 2002, 2003 and 2004 to help fund NICC s cost of expanding its production operations to produce the aforementioned programming. This advance will be recovered from the license fees payable for this programming when such programming is produced and accepted by Crown Media United States for distribution on the channel. These expenses are included as components of affiliate programming costs in the accompanying consolidated statements of operations.

During the three months ended September 30, 2003 and 2004, Crown Media United States paid NICC in the aggregate of $2.7 million and $653,000, respectively, related to the company agreement. During the nine months ended September 30, 2003 and 2004, Crown Media United States paid NICC in the aggregate of $7.7 million and $7.9 million, respectively, related to the company agreement. As of December 31, 2003, and September 30, 2004, $291,000 and $1.4 million, respectively, related to this arrangement are included in license fees payable to affiliates in the accompanying consolidated balance sheets.

7. Operations in Different Geographic Areas

Information relating to Crown Media Holdings operations in different geographic regions is set forth in the following table.

	Revenue from Unrelated Entities	Revenue from Related Entities	Operating Loss	Identifiable Assets
		(In millions)		
Three months ended September 30, 2003:				
Domestic	$ 17.6	$ 0.3	$ (25.6)	$ 674.1
International	20.5		(7.9)	91.7
Film distribution	12.6		0.2	792.4
Consolidated total	$ 50.7	$ 0.3	$ (33.3)	$ 1,558.2
Loss on extinguishment of debt			(39.8)	
Interest expense			(15.4)	
Loss before income taxes			$ (88.5)	
Three months ended September 30, 2004:				
Domestic	$ 26.9	$ 0.3	$ (21.9)	$ 667.9
International	23.1		(4.3)	84.7
Film distribution	5.5		(61.9)	718.2
Consolidated total	$ 55.5	$ 0.3	$ (88.1)	$ 1,470.8
Interest expense			(16.8)	
Loss before income taxes			$ (104.9)	
Nine months ended September 30, 2003:				
Domestic	$ 56.9	$ 1.0	$ (63.6)	$ 674.1
International	60.5		(17.6)	91.7
Film distribution	20.0		(8.6)	792.4
Consolidated total	$ 137.4	$ 1.0	$ (89.8)	$ 1,558.2
Loss on extinguishment of debt			(39.8)	
Guaranteed preferred beneficial accretion			(23.2)	
Interest expense			(30.2)	
Loss before income taxes			$ (183.0)	
Nine months ended September 30, 2004:				
Domestic	$ 81.6	$ 1.0	$ (59.1)	$ 667.9
International	69.3		(12.0)	84.7
Film distribution	18.0		(66.4)	718.2
Consolidated total	$ 168.9	$ 1.0	$ (137.5)	$ 1,470.8
Interest expense			(48.5)	
Loss before income taxes			$ (186.0)	

British Sky Broadcasting, which is domiciled in the United Kingdom and revenues from which are included in the Company s international segment, accounted for 8% and 15% of the Company s consolidated revenues for the three months ended September 30, 2003 and 2004, respectively. British Sky Broadcasting, accounted for 8% and 14% of the Company s consolidated revenues for the nine months ended September 30, 2003 and 2004, respectively. No other individual country, other than the United States and the United Kingdom, accounted for more than 10% of the Company s consolidated revenues. No individual pay television distributor accounted for more than 10% of the Company s consolidated subscribers for the three and nine months ended September 30, 2003 and 2004.

8. Subsequent Events

On October 28, 2004, the Company entered into an amendment of its bank credit facility. The amendment modified certain covenants with regard to current EBITDA and Net Worth thresholds and eliminated the debt to capitalization and leverage ratios. As amended, the term loan of $100.0 million is payable on the earlier of a Foreign Asset Sale Effective Date or September 1, 2005. A Foreign Asset Sale Effective Date is generally the date on which the Company sells its international business and international rights to its film library. On a Foreign Asset Sale Effective Date, the revolving line of credit under the bank credit facility will be reduced from $220.0 million to $180.0 million and the line of credit will mature on September 1, 2005. The Agent bank has the ability to approve on behalf of the lending banks the final terms of any sale of the international business as described above, including the documentation for the transaction. In addition, certain of the financial covenants, as revised, will be effective only on a Foreign Asset Sale Effective Date, and proceeds of the sale are required to be used to pay down the credit facility so that the outstanding amount does not exceed $180.0 million and certain obligations due to Hallmark affiliates.

ITEM 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Overview

Current Challenges

The Company faces many challenges in the current domestic and international marketplaces. The domestic cable industry is saturated with channels striving to position themselves on lower analog tiers and on digital platforms of cable TV distributors. The Company has less leverage in the marketplace in regard to channel line-up positioning and advertising sales than many of our competitors since they operate multiple channels while we operate only one channel. Among other things, owners of multiple channels are able to leverage demand for their more popular channels to convince distributors and advertisers to distribute and advertise on their less successful channels. Our ratings and subscribers must continue to grow in future years in order to increase subscriber demand for our channel and our advertising revenues. The Company strives to obtain additional subscribers by renegotiating distribution agreements, and, as a result, may face increased subscriber acquisition fee payments. The Company also attempts, and has succeeded, in improving its ratings by acquiring new programming and revising its programming schedules to meet the demands of its viewers. A larger audience share results in higher advertising rates, which, in turn, increases revenue. Domestically, we foresee in 2004 an increase in our domestic advertising revenues due to an enhanced programming schedule and growing subscriber counts.

In the United Kingdom and our Europe Middle East and Africa (EMEA) market, we have acquired programming, much of which has not been previously aired on cable television in the aforementioned markets. We expect this programming to attract additional viewers, resulting in increased ratings. In our Latin American and Asian markets, our primary focus is to manage our investment, minimize our programming expenditures through the use of our film assets, expand our subscriber base and thereby command increased subscriber fees and advertising revenue. We face challenges to overcoming the political and economic problems in certain of our international markets. Management continuously evaluates our position in these countries. The Company completed the restructuring of its international segment during 2003 by decentralizing many oversight and non-technical support functions formerly located in the Company s U.S.-based offices and transferring those responsibilities to regional staff. Certain operating expenses decreased because of this action, primarily the ongoing expense related to salaries and leasing transponder space.

Our film assets provide us with a significant, additional source for revenue and cash flow. External demand for our film library assets improved during 2003, with the improvement of the economy and an increase in incentives for our sales force. Our film assets have experienced decreased sales in 2004 as explained below.

The primary financial and non-financial measures analyzed by management are Adjusted EBITDA (as defined below) and the metrics driving each of our revenue lines such as: subscriber counts, advertising rates, domestic ratings and ratings for certain international markets, and demographics of our viewing audiences.

International Business

In April 2004, the Company announced that it is exploring strategic alternatives for its international operations and the international rights to its film library, including, but not necessarily limited to, a sale or other corporate transaction in an effort to maximize shareholder value. The Company at the date of this Report is negotiating a sale to a third party of its international operations and the international rights to its film library. For information regarding a possible sale of the international business, see Potential Sale of the International Business in Note 1 of the Notes to the Unaudited Consolidated Financial Statements in this Report.

The Company has established a retention program for approximately 175 employees who could be affected if Crown Media Holdings international business is sold. Under the program, employees that remain with the Company through the earlier of the date on which a sale of the international business becomes effective or

December 31, 2004, are entitled to retention of approximately $7.4 million. If the Company announces prior to December 31, 2004, that it has decided not to sell the international business, reduced retention payments of approximately $3.7 million will be payable within 30 days of that announcement.

Cash Flow

Our management is striving to generate positive cash flows in 2004 and future years through the sale of advertising and ongoing cost management. We will continue to monitor expenses, and, potentially, reduce certain expenses in 2004 to meet our cash flow goals. Our cash flow goals will be significantly affected by a sale of our international operations and international film rights.

Significant uses of cash during the nine months ended September 30, 2004, were for program acquisitions in primarily our domestic and United Kingdom markets. The Company also paid subscriber acquisition fees resulting from distribution agreements renegotiated in 2003 and prior years. Attainment of certain subscriber levels will also cause an increase in subscriber acquisition fee payments in future years, but, as many of our more significant distribution agreements expire in 2007, we do not foresee significant subscriber acquisition fee payments until after 2007.

Writedown of Film Assets

For the third quarter of 2004, the Company reviewed each of its film assets for impairment as a result of the Company exploring the sale of its international operations and the international rights to its film library. The Company computed fair value of each film using the discounted cash flow model outlined above and also considered the indications of fair value for the international rights to its film library as a group. A non-cash impairment charge was recorded in the third quarter 2004 for each film where the calculated fair value was less than its carrying value at September 30, 2004. The resulting impairment charge was $57.9 million. The Company concluded on November 11, 2004, that this non-cash impairment charge was required under generally accepted accounting principles to be recorded in the Company s financial results for the third quarter of 2004. Please see Note 2 of Notes to the Unaudited Consolidated Financial Statements in this Report for additional information on this impairment charge.

Revenue

Our revenue consists of primarily subscriber fees, advertising and film asset license fees.

Subscriber Fees

Subscriber fees are generally payable to us on a per subscriber basis by pay television distributors for the right to carry our channels. In the United States, we pay certain television distributors up-front subscriber acquisition fees to carry our channel. However, such payments are not common in the international cable television markets. Subscriber acquisition fees that we pay are capitalized and amortized over the contractual term of the applicable distribution agreement as a reduction in subscriber fee revenue. If the amortization expense exceeds the revenue recognized on a per distributor basis, the excess amortization is included as a component of cost of services. At the time we sign a distribution agreement, we evaluate the recoverability of the costs we incur against the incremental revenue directly and indirectly associated with each agreement.

Rates we receive per subscriber vary according to:

- the level of sophistication and degree of competition in the market;
- the relative position in the market of the distributor and the popularity of the channel;
- the packaging arrangements for the channel; and

other commercial terms such as granting the distributor exclusivity to carry our channel (only in territories outside the U.S.) and length of the contract term.

In some circumstances, international distributors provide minimum revenue guarantees.

We are in continuous negotiations with both our existing distributors and new distributors to increase our subscriber base in order to enhance our advertising results. In the United States, we are often subject to requests by distributors to pay subscriber acquisition fees for additional subscribers or to waive or accept lower subscriber fees if certain numbers of additional subscribers are provided. In both domestic and international markets we also may help fund the distributors efforts to market our channels or we may permit distributors to offer limited promotional periods without payment of subscriber fees. As we continue our efforts to add subscribers, our domestic subscriber revenue will continue to be negatively affected by subscriber acquisition fee amortization, waiver of subscriber fees and bulk discounts resulting from the attainment of certain subscriber levels; however, we believe that as a result of these measures, our subscriber counts will increase which in turn will allow us to attract additional advertisers and command higher advertising rates.

We also expect international subscriber rates to decrease as we renew distribution agreements. These international rates are affected by the increasing competitive nature of the industry, the growth of digital cable, the shift in the industry in more developed countries from subscriber fee revenue to advertising revenue, potential foreign currency fluctuations associated with global economies and the potential economic turbulence in certain of our markets. Although we anticipate international subscriber rates to decrease, we expect subscriber counts to increase and, thereby, offset the negative effect the decreased subscriber rates will have on revenue.

Our distribution agreement with a primary pay television distributor in Spain was amended on October 1, 2003. Under the amendment, the distribution of our channel to that party will end on December 31, 2004. If a new agreement is not reached with this distributor, the Company may discontinue distribution of the channel in this territory in 2005.

Our channel is usually offered as one of a number of channels on either a basic tier or part of other program packages and is not generally offered on a stand-alone basis. Thus, while a cable or satellite customer may subscribe and unsubscribe to the tiers and program packages in which our channel is placed, these customers do not subscribe and unsubscribe to our channel alone. We are not provided with information from the distributors on their overall subscriber churn and in what manner their churn rates affect our subscriber counts; we instead are provided information on the total number of subscribers who receive the Hallmark Channel.

Our subscriber count depends on the number of distributors carrying the Hallmark Channel and the size of such distributors as well as the program tiers on which our channel is carried by these distributors. From time to time, we experience decreases in the number of subscribers domestically and internationally as promotional periods end or a distributor arrangement is amended or is terminated by us or the distributor. Changes to distribution arrangements in 2004 have not been significant. Management analyzes the estimated effect each new or amended distribution agreement will have on revenues and costs. Based upon these analyses, management endeavors to achieve a fair combination of subscriber commitments and subscriber acquisition fees with each of our domestic distributors.

Advertising

Advertising sales generally are made on the basis of a price per advertising spot or per unit of audience measurement (for example, a ratings point). Thus, our advertising revenues are heavily dependent on third parties ratings of the persons viewing our channel. Prices vary on a market-by-market basis. Rates differ among markets depending on audience demographics.

In markets where regular audience measurements are available, our advertising rates are generally calculated on the basis of an agreed upon price per unit of audience measurement in return for a guaranteed commitment by the advertiser. In these countries, we commit to provide advertisers certain rating levels in connection with their advertising. Revenue is recorded net of estimated delivery shortfalls, which are usually settled by providing the advertiser additional advertising time. In other less sophisticated markets, our advertising rates are calculated on the basis of cost per advertising spot or package of advertising spots, and the price varies by audience level expected (but not measured) during a particular time slot. This is the predominant arrangement in the countries outside the United States in which we sell advertising time. Advertising rates also vary by time of year due to seasonal changes in television viewership.

Film Licensing

Crown Media Distribution generates revenue from the film assets by granting licenses to exhibit the films to third parties. We are also using the films as programming for our channel. Customers for our film assets consist of other television channels, home video distributors and brokers who resell rights to our film assets in various international markets. License fees for our film assets are generally negotiated based upon the size of the potential audience who will be viewing the programming.

Cost of Services

Our cost of services consists primarily of program license fees, amortization of our film assets; subscriber acquisition fee expense; the cost of signal distribution; dubbing and subtitling programming for foreign audiences; administration, distribution and other exploitation of our film assets; and the cost of promotional segments that are aired between programs. We expect cost of services to continue to increase in the future as we expand our existing markets and third party programming to support our advertising strategy. We expect the cost of services to increase in 2004 as compared to 2003 because of the following: we intend to acquire or use a greater amount and variety of quality programming as a part of our efforts to continue the increases in our ratings; and we anticipate higher levels of subscriber acquisition fee amortization as result of incremental increases in the distribution of our channel.

Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires Crown Media Holdings to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

For information regarding use of estimates, accounting treatment and accounting policies concerning revenue, subscriber acquisition fees, program license fees, subtitling and dubbing, film assets, long-lived assets impairment, goodwill and intangible assets, taxes on income, stock-based compensation, and the 2002 reorganization, please see the Notes to Unaudited Consolidated Financial Statements.

The following discussion concerns certain accounting estimates and assumptions that are considered to be material due to the levels of subjectivity and judgment necessary to account for uncertain matters and the susceptibility of such matters to changes.

Revenue Recognition

Subscriber fees from pay television distributors are recognized as revenue when an agreement is executed, programming is provided, the price is determinable, and collectibility is reasonably assured. We estimate and record the level of subscriber fees one month in advance based upon the actual prior month s subscriber levels. Historical results support our method of estimating subscriber fee revenue as subscriber levels generally increase each month.

Advertising revenues are recognized as earned in the period in which the advertising is telecast and are generally billed monthly. If uncertainty as to the collectibility of this revenue exists, the revenue is recognized on a cash basis.

Advertising revenue and expenses in barter transactions are recorded at the fair value of the advertising to be provided. In certain markets, delivery of advertising is determined based upon data received from third parties who measure the ratings of our channels. The ratings information drives our calculations of impressions delivered which in turn drives the amount of revenue we recognize from each advertising spot. Our advertising revenue is therefore heavily reliant upon these third party ratings estimates to determine the quantity of advertising delivered to viewers.

Revenue from film asset licensing agreements is recognized when an agreement is executed, the film is available for exhibition by the licensee, the license fee is fixed or reasonably determinable, collectibility is reasonably assured and the cost of each film is known or reasonably determinable. When multiple films are sold under a single arrangement, in order to properly recognize revenue when each license period commences, we must estimate the relative fair value of each film and allocate the total contracted price to the different films in the arrangement. Our estimation of relative fair value uses similar information as is used in our annual third party valuation of our film assets.

The Company records revenue from customers in certain foreign countries only when the cash is received due to the uncertainty regarding collection.

Allowance for Doubtful Accounts

The Company has established an allowance for doubtful accounts based upon historical charge-off experience. Periodically, we analyze the attributes of the accounts which we have written-off during the period and adjust the allowance percentages we apply to our aged receivable balances. As noted previously, for revenue generated in certain countries in which economic factors lead us to believe that collectibility of these revenues is not reasonably assured, we recognize such revenue as it is received in cash.

Subscriber Acquisition Fees

Crown Media United States has distribution agreements with every major cable distributor in the United States, some of which require the payment of subscriber acquisition fees. The initial recoverability of these subscriber acquisition fees is evaluated by projecting the incremental subscriber fee and advertising revenue attributable to the incremental subscribers obtained through the distribution agreement. This analysis includes significant judgment and estimation by management in terms of the estimated incremental advertising per subscriber.

Film Assets

In September 2001, the Company acquired certain film assets from Hallmark Entertainment Distribution. The Company amortizes its film assets using the individual-film-forecast-computation method over a maximum period of 10 years from the date of acquisition. The individual-film-forecast-computation method amortizes such assets in the same ratio that current period actual revenue bears to estimated unrecognized ultimate revenues. The Company s projections of ultimate revenue regarding sales of certain rights related to its film assets to third parties and anticipated internal use of its film assets are based on the history of each film and similar films, sales and marketing plans, and other factors, all of which require significant judgment by management. In accordance with SOP 00-02, the Company assesses the ultimate revenue projections on a quarterly basis.

The Company reviews the recoverability of each film in accordance with SOP 00-02 and on a quarterly basis assesses whether events or circumstance have changed which indicate that the fair value of a film is lower than its unamortized cost or carrying value. If the carrying value of any individual film assets exceeds its fair value, the film asset is written-down to its fair value. A discounted cash flow model is used to estimate the fair value of the individual films. Future cash flows are based on the terms of any existing contractual arrangements plus the projected cash inflows from future license sales. The Company considers the following factors, among others, in estimating future cash inflows for each film: (a) if previously released, the film s performance in historical markets, (*b*) the public s perception of the film s story, cast, director, or producer, (*c*) historical results of similar films, (*d*) historical results of the cast, director, or producer on prior films, and (*e*) running time of the film. In estimating a film s fair value, the Company considers those cash outflows necessary to generate the film s cash inflows. Therefore, future exploitation and participation costs are factored into the estimation of fair value. On an annual basis, the Company is required by the covenants in its credit agreement to have an outside expert perform a valuation of the film library as a whole.

Effects of Transactions with Related and Certain Other Parties

Hallmark Transactions

In 2004 and in prior years, we entered into a number of significant transactions with Hallmark Cards and its subsidiaries. These transactions concern, among other things, programming, trademark licenses, administrative services, a line of credit, a Tax Sharing Agreement and the issuance of a $400.0 million senior unsecured note.

Tax Sharing Agreement

In March 2003, the Company became a member of Hallmark Cards consolidated federal tax group and entered into a Tax Sharing Agreement with Hallmark Cards, which was amended at the time the Company issued the senior unsecured note to HC Crown. We account for income taxes as if Crown Media Holdings were a separate taxpayer. Accordingly, Hallmark Cards ability to use our tax losses does not impact our assessment of the need for a valuation allowance on deferred tax assets, including future tax losses. Any payments received from Hallmark Cards under the Tax Sharing Agreement are recorded as an increase in paid-in capital. During 2003, the Company received $49.4 million under the Tax Sharing Agreement. During the nine months ended September 30, 2004, the Company received $39.5 million under the Tax Sharing Agreement. In October 2004, the Company received an additional $9.3 million under the Agreement. For information regarding the Tax Sharing Agreement, please see Notes 2 and 6 to the Notes to Unaudited Consolidated Financial Statements.

Senior Unsecured Note

On August 5, 2003, Crown Media Holdings repurchased all of the outstanding trust preferred securities of Crown Media Trust and related contingent appreciation certificates issued by the Company. The securities were repurchased for approximately $329.1 million. Funds for this repurchase were obtained from the proceeds from the issuance of a senior unsecured note issued to HC Crown in the amount of $400.0 million. After repayment of certain expenses for the issuance, including a fee of $3.0 million to HC Crown, the Company used the balance of the proceeds of the note, approximating $67.3 million, to pay principal, interest and prepayment penalties on its bank revolving credit loans. For information regarding our senior unsecured note, please see Note 6 to the Notes to Unaudited Consolidated Financial Statements.

NICC License Agreement

For information regarding our amendment to our license agreement with NICC, please see Note 6 to the Notes to Unaudited Consolidated Financial Statements.

Pramer Agreement

On January 30, 2003, Crown Media International entered into an agreement with Pramer S.C.A., a wholly-owned subsidiary of Liberty Media International, under which Pramer provides affiliate and advertising sales representation services, as well as programming, production and technical services in connection with the distribution of the Hallmark Channel in Central and South America. Pramer receives a 35% commission on advertising sales and a 20% commission on affiliate sales and is reimbursed for its costs of providing production and technical services. The agreement with Pramer will terminate on December 31, 2005, unless certain early termination rights arise and are exercised.

Selected Historical Consolidated Financial Data of Crown Media Holdings

In the table below, we provide selected historical consolidated financial and other data of Crown Media Holdings and its subsidiaries. The following selected consolidated statement of operations data for three and nine months ended September 30, 2003 and 2004, are derived from the unaudited financial statements of Crown Media Holdings and its subsidiaries. This data should be read together with the consolidated financial statements and related notes included elsewhere in this Form 10-Q.

	Three Months Ended September 30, 2003	Three Months Ended September 30, 2004	Percent Change 2004 vs. 2003	Nine Months Ended September 30, 2003	Nine Months Ended September 30, 2004	Percent Change 2004 vs. 2003
Revenues:						
Subscriber fees	$ 17,543	$ 20,038	14%	$ 51,433	$ 60,190	17%
Advertising	20,815	30,031	44%	66,845	91,533	37%
Film asset license fees	12,606	5,534	-56%	20,010	17,968	-10%
Other revenue	22	171	677%	79	256	224%
Total revenues	50,986	55,774	9%	138,367	169,947	23%
Cost of Services:						
Programming costs	29,727	32,746	10%	77,244	93,609	21%
Amortization of film assets	11,371	8,941	-21%	24,957	24,407	-2%
Impairment of film assets		57,931	100%		57,931	100%
Subscriber acquisition fee amortization expense	6,468	7,010	8%	19,074	19,042	0%
Operating costs	12,921	12,459	-4%	37,375	34,688	-7%
Total cost of services	60,487	119,087	97%	158,650	229,677	45%
Selling, general and administrative expense	20,291	21,846	8%	51,812	60,906	18%
Marketing expense	3,474	2,899	-17%	17,645	16,859	-4%
Loss from operations	$ (33,266)	$ (88,058)	165%	$ (89,740)	$ (137,495)	53%
Other Data:						
Net cash used in operating activities	$ 31,182	$ 17,422	-44%	$ 104,629	$ 44,096	-58%
Capital expenditures	$ 1,354	$ 19	-99%	$ 3,135	$ 1,225	-61%
Net cash provided by financing activities	$ 27,364	$ 15,468	-43%	$ 110,556	$ 48,308	-56%
Adjusted EBITDA (1)	$ (33,186)	$ (65,925)	99%	$ (53,124)	$ (75,319)	42%
Total domestic day household ratings (2)(4)	0.529	0.562	6%	0.489	0.588	20%
Total domestic primetime household ratings (3)(4)	0.715	0.862	21%	0.711	0.851	20%
Total subscribers at period end:						
Hallmark Channel International	56,556	60,653	7%	56,556	60,653	7%
Hallmark Channel U.S.	54,634	63,422	16%	54,634	63,422	16%
Total subscribers	111,190	124,075	12%	111,190	124,075	12%

(1) See reconciliation of Adjusted EBITDA below.

(2) Total day is the time period measured from the time each day the broadcast of commercially sponsored programming commences to the time such commercially sponsored programming ends.

(3) Primetime is defined as 8:00 - 11:00 P.M. in the United States.

(4) These Nielsen ratings are for the time period January 1 through September 30.

Crown Media Holdings evaluates operating performance based on several factors, including Adjusted EBITDA. Our measure of Adjusted EBITDA differs from the normal definition of EBITDA (earnings before interest, taxes, depreciation and amortization) used by most companies. We define Adjusted EBITDA as earnings before interest, taxes, depreciation, amortization, subscriber acquisition fee amortization and amortization of film assets. We believe Adjusted EBITDA is meaningful because it provides investors a means to evaluate the operating performance of our company on an ongoing basis using criteria that are used by other companies in our industry and investment bankers and analysts who track our industry. We believe that Adjusted EBITDA is a meaningful measure because it represents a transparent view of our recurring operating performance and allows our management and investors to readily view operating trends, perform analytical comparisons and benchmark our company to similar companies in our industry. Adjusted EBITDA is used by our management to monitor segment operations and to determine the allocation of resources to segments. Our credit facility also contains covenants that are based on an adjusted EBITDA measure. Consequently, management views Adjusted EBITDA as a critical measure of our operating performance to meet our debt covenants and monitors this measure closely. We disclose Adjusted EBITDA so that our investors can have some of the same information available to our management to evaluate their investment in our Company. We believe that Adjusted EBITDA provides an indication of the Company s ability to generate cash flows from operating activities since the majority of our non-cash expenses are excluded from our calculation of Adjusted EBITDA. A significant portion of the Company s cost structure relates to the amortization of film assets and subscriber acquisition costs, which are significant non-cash charges. The cash costs of acquiring film assets and adding subscribers are essentially discretionary expenditures. The adjusted EBITDA calculation allows the Company to assess how much is available to pay debt service and gives a further indication of how much remains to fund discretionary expenditures such as the acquisition of film assets or additional subscriber base. However, Adjusted EBITDA should be considered in addition to, not as a substitute for, historical operating income or loss, net loss, cash flow from operations and other measures of financial performance reported in accordance with accounting principles generally accepted in the United States.

Adjusted EBITDA differs significantly from cash flows from operating activities reflected in the consolidated statement of cash flows. Cash flow from operating activities is net of interest and taxes paid and is a more comprehensive determination of periodic income on a cash basis, exclusive of non-cash items of income and expenses such as depreciation and amortization. In contrast, Adjusted EBITDA is derived from accrual basis income and is not reduced for cash invested in working capital. Consequently, Adjusted EBITDA is not affected by the timing of receivable collections or when accrued expenses are paid. We are not aware of any uniform standards for determining EBITDA or our Adjusted EBITDA and believe presentations of EBITDA may not be calculated consistently by different entities in the same or similar businesses. In the table below, we provide a reconciliation of Adjusted EBITDA to net loss and to net cash used in operating activities of Crown Media Holdings and its subsidiaries.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	**2004**	**2003**	**2004**
Net loss	$ (72,717)	$ (105,763)	$ (168,804)	$ (187,826)
Amortization of film assets	11,371	8,941	24,957	24,407
Subscriber acquisition fee amortization expense	8,460	9,843	23,968	27,324
Depreciation and amortization	3,733	3,349	11,175	10,445
Guaranteed preferred beneficial interest expense			23,218	
Interest expense and accretion	15,374	16,801	30,230	48,483
Income tax provision	593	904	2,132	1,848
Adjusted earnings before interest, taxes, depreciation and amortization	$ (33,186)	$ (65,925)	$ (53,124)	$ (75,319)
Loss on early extinguishment of debt	39,812		39,812	
Cumulative effect of change in accounting principle	(16,328)		(16,328)	
Loss on impairment of film assets		57,931		57,931
Restricted stock unit and stock-based compensation	3,044	2,511	3,367	8,319
Programming, subtitling and dubbing amortization	29,505	34,045	77,764	97,497
Provision for allowance for doubtful account	980	82	2,546	71

Changes in operating assets and liabilities:				
Additions to program license fees	(112,016)	(45,467)	(177,829)	(90,147)
Additions to subscriber acquisition fees	(807)	(9,781)	(2,031)	(23,100)
Decrease in subscriber acquisition fees payable	(9,231)	(18,707)	(32,255)	(8,911)
Interest paid	(4,906)	(3,710)	(15,022)	(10,453)
Income taxes paid	(593)	(904)	(2,132)	(1,848)
Changes in other operating assets and liabilities, net of adjustments above	72,544	32,503	70,603	1,864
Net cash used in operating activities	$ (31,182)	$ (17,422)	$ (104,629)	$ (44,096)

33

Results of Operations

Three and Nine Months Ended September 30, 2004 Compared to Three and Nine Months Ended September 30, 2003

Revenue.

Our revenue, which is primarily comprised of subscriber fees, advertising and film asset license fees, increased 9% and 23% for the three and nine months ended September 30, 2004. Our 14% and 17% increases in subscriber fee revenue for the three and nine months ended September 30, 2004, were the result of the expiration of free carriage periods for certain of our domestic distributors. Subscriber acquisition fee amortization recorded as a reduction of revenue was $2.8 million and $8.3 million for the three and nine months ended September 30, 2004, and $2.0 million and $4.9 million for the comparable periods in 2003. Although the number of subscribers to the Hallmark Channel increased as of September 30, 2004, compared to September 30, 2003, subscriber revenue was also affected by a number of other, offsetting factors, including discounts for new subscribers, the waiver of subscriber fees and bulk discounts resulting from the attainment of certain subscriber levels and a decrease in subscriber rates for our international channel. Eighty-seven percent of subscriber fee revenue for each of the three and nine months ended September 30, 2004, and 91% of subscriber fee revenue for each of the three and nine months ended September 30, 2003, was earned internationally. Subscriber fee revenue was $2.6 million and $8.0 million for the domestic Hallmark Channel for the three and nine months ended September 30, 2004, and $1.7 million and $4.7 million for the three and nine months ended September 30, 2003.

The increase in advertising revenue reflects the following during 2004: the 12% growth in domestic and international subscribers; higher ratings in the United States; higher advertising rates resulting from the increase in distribution and viewership; and expanded sales of advertising time primarily in the United States. Our domestic advertising revenue increased to $24.6 million and $74.8 million for the three and nine months ended September 30, 2004, compared to $16.3 million and $53.2 million for the three and nine months ended September 30, 2003. Additionally, the number of advertisers on our domestic channel rose from 300 at September 30, 2003, to 380 at September 30, 2004. Our international advertising revenue, primarily from the United Kingdom, increased to $16.8 million for the nine months ended September 30, 2004, compared to $13.7 million for the nine months ended September 30, 2003. Among the 52 ad-supported cable channels in the United States market, the Hallmark Channel ranked 10th in total day with a 0.6 household rating for the third quarter of 2004 and 15th for primetime with a 0.9 household rating for the same quarter based on Nielsen ratings.

Revenue from the sale of our film assets totaled $5.5 million and $18.0 million for the three and nine months ended September 30, 2004, compared with $12.6 million and $20.0 million for the comparable periods in 2003. The decrease reflects a decrease in international sales, due in part to softer market conditions and uncertainty surrounding the potential sale of the international business and international rights to the film assets.

Cost of services. Cost of services as a percent of revenue increased to 214% and 135% for the three and nine months ended September 30, 2004, as compared to 119% and 115% in the prior year s periods. These increases were primarily due the changes in operating expenses explained below.

As a result of the Company s analysis of its film assets based upon current projections for sales and internal use, and based upon outside indications of fair value, the Company recorded a non-cash impairment charge of $57.9 million in the third quarter of 2004. Amortization of film assets decreased 21% and 2% for the three and nine months ended September 30, 2004, compared to the same periods in 2003 primarily because of a recalculation of the amortization from January 1, 2004, through September 30, 2004, as a result of the impairment analysis described above. Total programming costs for the three and nine months ended September 30, 2004, increased 10% and 21% due to the increased costs associated with the amortization of certain programming such as *MASH*, *Matlock* and *Little House on the Prairie,* for our domestic channel.

Operating costs for the three months ended September 30, 2004, remained flat. Operating costs for the nine months ended September 30, 2004, decreased $2.7 million primarily due to a $2.5 million decrease in bad debt expense.

Selling, general and administrative expense. Our general and administrative expense increased for the three months ended September 30, 2004 because of a $2.2 million of retention program expense related to the proposed sale of the international business. For the nine month period, general and administrative expense was higher due to our retention program expense of $2.2 million, an increase in salary expense of $1.2 million, and an increase in benefits expense of $4.0 million. We commenced recording compensation expense for our RSUs in June 2003.

Loss from Operations. Losses from operations for the three and nine months ended September 30, 2004, were $88.1 million and $137.5 million, which were comprised of a losses from operations of our domestic segment of $21.9 million and $59.1 million, losses from operations of our international segment of $4.3 million and $12.0 million, and losses from operations of our film distribution segment of $61.9 million and $66.4 million. The film distribution segment losses include the impairment charge of $57.9 million. Losses from operations for the three and nine months ended September 30, 2003, were $33.3 million and $89.8 million, which were comprised of a losses from operations of our domestic segment of $25.6 million and $63.6 million, losses from operations of our international segment of $7.9 million and $17.6 million, and income and a loss from operations of our film distribution segment of $0.2 million and $8.6 million.

Guaranteed preferred beneficial interest accretion. This expense related to future obligations on our debentures issued on December 17, 2001, in connection with the trust preferred securities of Crown Media Trust. The 2003 expense only included guaranteed preferred beneficial interest accretion for a partial year due to the repurchase of our preferred securities on August 5, 2003.

Interest expense. Interest expense increased for the three and nine months ended September 30, 2004, compared to September 30, 2003, by $1.4 million and $18.3 million. This increase was primarily due to interest on our $400.0 million senior unsecured note payable commencing August 5, 2003, which amounted to $11.1 million and $32.5 million for the three and nine months ended September 30, 2004. The terms of our senior unsecured note payable do not require any cash payment for interest or principal until August 2007.

Liquidity and Capital Resources

Cash used in operating activities was $44.1 million and $104.6 million for the nine months ended September 30, 2004 and 2003, respectively. Cash was used primarily to fund operating expenditures related to net losses of $187.8 million and $168.8 million for the nine months ended September 30, 2004 and 2003, respectively. The decrease in cash flow used in operations was primarily due to higher domestic advertising revenue and resulting cash receipts.

Cash used in investing activities was $1.0 million and $3.1 million for the nine months ended September 30, 2004 and 2003, respectively. Cash used in investing activities decreased primarily due to expenditures in our Network Operations Center to accommodate the launch of our domestic channel in the first quarter 2003 and our new domestic and international channel websites being placed into service during that period.

Cash provided by financing activities was $48.3 million and $110.6 million for the nine months ended September 30, 2004 and 2003, respectively. During the nine months ended September 30, 2004 and 2003, we received proceeds of $39.5 million and $32.0 million, respectively, from our Tax Sharing Agreement with Hallmark Cards. We borrowed $70.0 million under our line of credit with HC Crown to meet our operating demands during the nine months ended September 30, 2003.

The following table aggregates all of our contractual commitments as of September 30, 2004.

		Scheduled Payments by Period			
Contractual Obligations	**Total**	**Less than 1 Year**	**2-3 Years**	**4-5 Years**	**After 5 Years**
Credit Facility and Interest Payable (a)	$ 310.5	$ 310.5	$	$	$
Company Obligated Mandatorily Redeemable Preferred Interest	25.0		7.6	10.0	7.4
HC Crown Line of Credit	75.0		75.0		
Senior Unsecured Note to HC Crown, including accretion	596.6				596.6
Capital Lease Obligations	25.5	2.2	5.0	4.2	14.1
Operating Leases	51.4	14.8	19.8	12.0	4.8
Other Obligations					
Program license fees payable to non-affiliates and NICC	148.9	77.9	56.9	14.1	
Program license fees payable to Hallmark Entertainment Distribution	108.2	105.4	2.8		
Program license fees payable for future windows	254.3	145.2	65.7	23.0	20.4
Subscriber acquisition fees (b)	18.9	18.0	0.9		
Deferred compensation and interest	2.0		2.0		
Payable to Hallmark Entertainment Holdings (a)	52.1	52.1			
Payable to Hallmark Entertainment (a)	47.9	47.9			
Total Contractual Cash Obligations	$ 1,716.3	$ 774.0	$ 235.7	$ 63.3	$ 643.3

(a) Due to the amendment to the credit agreement, which among other things, accelerated the maturity date to September 1, 2005, these obligations are anticipated to be repaid or otherwise refinanced within less than one year.

(b) Current domestic distribution agreements could significantly increase subscriber acquisition fees payable in the future by a maximum amount of $149.0 million, which would result if 42.0 million additional subscribers were provided with the Hallmark Channel.

Potential Sale of the International Business

In April 2004, the Company announced that it is exploring strategic alternatives for its international operations and the international rights to its film library, including, but not necessarily limited to, a sale or other corporate transaction in an effort to maximize shareholder value.

The Company is in current negotiations for the sale of its international operations and the international rights to its film library. However, the Company has not reached a final agreement regarding the terms of any such sale. The Company cannot provide assurance that an agreement for any such sale will be executed or that such a sale will be executed or consummated. In addition, any sale would require the consent of existing lenders under the bank credit facility. The Company is required under its amended debt agreements to use substantially all of the net proceeds from such a sale to pay down its credit facility and certain of its obligations to affiliates. Under the amendment to the credit facility executed on October 28, 2004, the Company agreed (in the event of a sale of the international business) to a reduction in the maximum borrowings under the facility from the current allowable borrowings of $320.0 million to $180.0 million.

Cash Flows

As of September 30, 2004, the Company had $7.6 million in cash and cash equivalents on hand and $10.0 million available under its bank credit facility. The Company s principal sources of funds are currently cash inflows from operations, cash on hand, periodic cash inflows expected under the tax sharing agreement with Hallmark Cards and amounts available for borrowing under its bank credit facility. On October 28, 2004, the Company received an additional tax sharing payment of $9.3 million.

The Company s principal uses of funds during 2004 and 2005 have been, and are expected to be, the payment of operating expenses, payments for licensing of programming and subscriber acquisition fees, and interest payments under its bank credit facility. As part of the Company s growth strategy, the Company expects to continue making investments in programming and distribution during 2004 and 2005.

As of September 30, 2004, the Company believes that cash inflows from its operations, cash on hand, remaining availability under its credit facility and payments anticipated under the tax sharing agreement with Hallmark Cards, all of which are currently its principal sources of funds, will be sufficient to meet its liquidity needs through the amended maturity date of its credit facility. As disclosed in note 8, subsequent to the end of the third quarter, the Company amended its credit facility which included an acceleration of the maturity and termination date of the facility from August 2006 to September 1, 2005. This revision, along with agreements with certain affiliates of Hallmark Cards, has resulted in approximately $470.0 million of obligations becoming due and payable on September 1, 2005. Of this amount, $130.0 million of outstanding obligations will become due and payable, if earlier, upon the sale of the Company s international operations and international film rights.

The Company is currently negotiating for the sale of the international operations which would provide cash resources to retire a portion of these obligations due and payable on September 1, 2005. The Company intends to either extend or refinance the credit facility prior to its maturity date. In addition, other financing alternatives could include the issuance of additional equity or debt securities. There can be no assurance, however, that the credit facility can or will be extended or refinanced or that additional funding will be available, if at all, on terms acceptable to the Company.

If the Company is unable to successfully complete the sale of the international business and restructure its obligations that become due in September 2005, the Company will not have sufficient available funds to repay such obligations.

Bank Credit Facility; Private Placement and HC Crown Line of Credit

Our bank credit facility, the HC Crown line of credit and the senior unsecured note to HC Crown are described in detail in Item 7 of Management s Discussion and Analysis of Historical Financial Condition and Results of Operation in our Annual Report on Form 10-K for the year ended December 31, 2003, and earlier in this Report. As a result of these agreements, we are subject to a number of affirmative and negative covenants. As a result of the film asset impairment charge recorded in the third quarter 2004, the Company was not in compliance with the trailing 12-month EBITDA (as defined) financial covenant at September 30, 2004. On October 28, 2004, the Company entered into Amendment No. 7 to the agreement for its bank credit facility. This Amendment No. 7 is attached as an exhibit to this Report and incorporated herein by reference. Amendment No. 7 makes a number of significant changes to the bank credit facility including changes to the financial covenants. Specifically, the amendment to the credit facility allows for the exclusion of the film asset impairment charge from the calculation of trailing 12-month EBITDA. Such amendment cures the Company s non-compliance with this covenant at September 30, 2004.

As amended, the term loan of $100.0 million is payable on the earlier of a Foreign Asset Sale Effective Date or September 1, 2005. A Foreign Asset Sale Effective Date is generally the date on which the Company sells its international operations and international rights to its film library. On a Foreign Asset Sale Effective Date, the revolving line of credit under the bank credit facility will be reduced from $220.0 million to $180.0 million. The line of credit matures on September 1, 2005. The lending banks must also approve the final terms of any sale of the international business as described above. In addition, effective only on a Foreign Asset Sale Effective Date, certain financial covenants in the bank credit facility (regarding limitations on capital expenditures, required levels of EBITDA at the end of each quarter and limitations on subscriber acquisition fees as well as the deletion of required leverage and interest coverage ratios) are revised and proceeds of the sales are to be used to pay down the revolving line of credit in a priority over other uses so that the outstanding amount under the revolving line of credit does not exceed $180.0 million.

Under the Note Purchase Agreement for the senior unsecured note to HC Crown, the Company and its subsidiaries are restricted from, among others, incurring additional indebtedness, repurchasing or otherwise acquiring its own stock and making investments in other parties and incurring additional liens.

Risk Factors and Forward-Looking Statements

The discussion set forth in this Form 10-Q contains statements concerning potential future events. Such forward-looking statements are based on assumptions by Crown Media Holdings management, as of the date of this Form 10-Q including assumptions about risks and uncertainties faced by Crown Media Holdings. Readers can identify these forward-looking statements by their use of such verbs as expects, anticipates, believes, or similar verbs or conjugations of such verbs. If any of management s assumptions prove incorrect or should unanticipated circumstances arise, Crown Media Holdings actual results, levels of activity, performance, or achievements could materially differ from those anticipated by such forward-looking statements. Among the factors that could cause actual results to differ materially are those discussed below in this Form 10-Q. Crown Media Holdings will not update any forward-looking statements contained in this Form 10-Q to reflect future events or developments.

If we do not successfully address the risks described below, our business, prospects, financial condition, results of operations or cash flow could be materially adversely affected. The trading price of our Class A common stock could decline because of any of these risks.

Risks Relating to Our Business

Our business has incurred net losses since inception and may continue to incur losses.

Both our international and domestic channels have a history of net losses and we expect to continue to report net losses for the foreseeable future. As of September 30, 2004, we had an accumulated deficit of approximately $1.2 billion, total stockholders equity of approximately $165.4 million, goodwill of approximately $314.0 million, and film assets of $672.1 million.

We cannot assure you that we will achieve or sustain profitability. If we are not able to achieve or sustain profitability, the trading price of our Class A common stock may fall significantly. To diminish our losses and become profitable, we will need to substantially increase our revenue, particularly advertising and licensing revenue. This will require, among other things, increasing the distribution of our channels, attracting more viewers to our channels, attracting more advertisers, and increasing our advertising rates. Risks associated with these areas of our business are described below.

In addition, in order to accomplish these goals, the management of Crown Media Holdings continues to believe that it is necessary to increase subscribers and enhance our programming, which results in increased subscriber acquisition fees and higher costs for programming. Over the last three years, these actions have resulted in increased net losses for Crown Media Holdings.

Our substantial indebtedness could adversely affect our financial health, and the restrictions imposed by the terms of our debt instruments may severely limit our ability to plan for or respond to changes in our business.

We have a substantial amount of indebtedness. As of September 30, 2004, our total debt was $859.1 million and we had $7.6 million of cash and cash equivalents. In addition, we may borrow the remaining $10.0 million available borrowing under our bank credit facility to cover the negative cash flow resulting from our current operations. Subject to restrictions under our debt agreements, we may also seek equity or debt financing from time to time to cover our operating losses, to finance acquisitions or capital expenditures or for other purposes.

As a result of our level of debt and the terms of our debt instruments:

our vulnerability to adverse general economic conditions is heightened;

we will be required to dedicate a portion of our cash flow from operations to repayment of debt, limiting the availability of cash for other purposes;

we are and will continue to be limited by financial and other restrictive covenants in our ability to borrow additional funds, consummate asset sales, enter into transactions with affiliates or conduct mergers and acquisitions;

our flexibility in planning for, or reacting to, changes in our business and industry will be limited;

we are sensitive to fluctuations in interest rates; and our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions, general corporate purposes or other purposes may be impaired.

Our ability to meet our debt and other obligations and to reduce our total debt depends on our future operating performances and on economic, financial, competitive and other factors. There can be no assurance that our leverage and such restrictions will not materially and adversely affect our ability to finance our future operations or capital needs or to engage in other business activities.

As a result of Amendment No. 7 to our bank credit facility, approximately $470.0 million in obligations are currently due on September 1, 2005. The Company s ability to meet these obligations by September 2005 is dependent, in part, upon the successful sale of the international business and the restructuring of the bank credit facility.

We have increasing interest expense, which may impact our future operations.

High levels of interest expense could have negative effects on our future operations. Interest expense, which is net of interest income and includes amortization of debt issuance costs and interest expense on borrowings under our senior and demand notes and bank credit facility, increased substantially over the past year. The increase in interest expense in the past twelve months resulted from an increase in the average borrowings outstanding, due to cash generated from operations being insufficient to cover operating expenses and capital expenditures. A substantial portion of our cash flow from operations must be used to pay our interest expense and will not be available for other business purposes. In addition, we may need to incur additional indebtedness in the future. We cannot assure you that our business will generate sufficient cash flow or that future financings will be available to provide sufficient proceeds to meet our obligations or to service our total debt.

Our liquidity is dependent on external funds.

Because we currently operate at a loss and may have a negative cash flow, any unanticipated significant expense or any development that hampers our growth in revenue or decreases any of our revenue, would result in the need for additional external funds in order to continue operations. We have no arrangements for any external financings, whether debt or equity, and are not certain whether any such new external financing would be available on acceptable terms. Any new debt financing would require the cooperation and agreement of existing lenders.

Modification of any existing agreements with United States distributors could result in an increased obligation to pay subscriber acquisition fees.

Several of the Crown Media United States existing distribution agreements contain most favored nations clauses. These clauses typically provide that, in the event Crown Media United States enters into an agreement with another distributor on more favorable terms, these terms must be offered to the existing distributor, subject to certain exceptions and conditions. Distribution agreements which we may enter into in the future may also contain similar most favored nation clauses. In the past, Crown Media United States was asked to comply with such clauses and modify its distribution agreements with certain distributors after entering into new distribution agreements. Any claims under these clauses in the future could result in the payment of cash or the issuance of stock by us to our distributors and would negatively affect subscriber revenues; however, if our subscription base is increased as a result of such modification, it could result in higher advertising revenue.

If we are unable to obtain programming from third parties, we may be unable to increase our subscriber base.

We compete with other pay television channel providers to acquire programming. If we fail to continue to obtain programming on reasonable terms for any reason, including as a result of competition, we could be forced to incur additional costs to acquire such programming or look for alternative programming, which may hinder the growth of our subscriber base.

If our programming declines in popularity, our subscriber fees and advertising revenue could fall and the additional revenue we expect as a result of the acquisition of film assets from Hallmark Entertainment Distribution may be lower than we anticipate.

Our success depends partly upon unpredictable and volatile factors beyond our control, such as viewer preferences, foreign exchange rates, competing programming and the availability of other entertainment activities. We may not be able to anticipate and react effectively to shifts in tastes and interests in our markets. In particular, our ability to react effectively may be limited by our obligation to license programming from Hallmark Entertainment Distribution, which has standards that limit the types of programming that it will provide to us. Our competitors may have more flexible programming arrangements, as well as greater amounts of production, better distribution, and greater capital resources, and may be able to react more quickly to shifts in tastes and interests. As a result, we may be unable to maintain the commercial success of any of our current programming, or to generate sufficient demand and market acceptance for our new programming. A shift in viewer preferences in programming or alternative entertainment activities could also reduce the amount of revenue we anticipate receiving from licensing of our film assets and cause a decline in both advertising and subscriber fees revenue. The decline in revenue could hinder or prevent us from achieving profitability and could adversely affect the market price of our Class A common stock.

We are currently dependent on Hallmark Entertainment to distribute and maximize licensing fees from the film assets.

Currently, we are dependent on Hallmark Entertainment, a related party, to distribute and license our film assets to third parties for us under a services agreement, which will expire on December 31, 2006. This arrangement reduces our control over the sales and distribution of the film assets and might delay our realization of the full revenue stream from the film assets. We and Hallmark Entertainment each have the right to terminate the service agreement on a yearly basis. If Hallmark Entertainment elects to terminate the agreement before we have established our own distribution network, we may not be able to establish our own or obtain alternative distribution services of equivalent quality or on terms as favorable to us. Termination of this services agreement could hinder our ability, at least in the short-term, to achieve the amount of additional revenue anticipated from these activities and could adversely affect the market price of our Class A common stock.

We anticipate that in due course we will develop our own distribution/sales network and hire employees to perform the services currently performed by Hallmark Entertainment under the service agreement. Our ability to do so is unproven and will require financial, operational and management resources. We may not be able to hire the number of employees, or employees who are sufficiently qualified, to perform these services, or do so in a cost efficient manner. If the cost to develop and maintain this employee base is greater, or if this process takes longer than anticipated, it could have a negative impact on the revenue we anticipate generating from the film assets.

If we are unable to increase our advertising revenue, we may be unable to achieve profitability.

Although it is expected over time that our advertising revenue will increase, if we fail to increase significantly our advertising revenue, we may be unable to achieve or sustain profitability or to expand our business. A failure to increase advertising revenue may be a result of any or all of the following: (i) we have a limited history of marketing and selling advertising time, particularly internationally; (ii) we may be unable to identify, attract and retain experienced sales and marketing personnel with relevant experience for our U.S. channel; (iii) our sales and marketing organization may be unable to successfully compete against the significantly more extensive and well-funded sales and marketing operations of our current or potential competitors; (iv) the advancement of technologies such as Digital Video Recording may cause industry-wide changes concerning the frequency in which individuals are exposed to advertising on television; and/or (v) we will not be able to increase our advertising sales rate-card or may be required to run additional advertising spots which affect the availability of advertising inventory for future sales. Success in increasing our advertising revenue also depends upon the number and coverage of the distributors who carry our channels, our number of subscribers, and the viewership ratings for our programming.

The international cable advertising market is much less developed than in the United States, the United Kingdom and Central Europe. We believe that only certain international markets have the potential for growth in advertising revenues and intend to emphasize those markets but cannot assure success.

Hallmark Entertainment Investments controls us and this control could create conflicts of interest or inhibit potential changes of control.

Hallmark Entertainment Investments controls all of our outstanding shares of Class B common stock and owns shares of our Class A common stock, representing in the aggregate approximately 96.1% of the outstanding voting power on all matters submitted to our stockholders. Hallmark Entertainment Holdings, a subsidiary of Hallmark Cards, controls the voting of all our shares held by Hallmark Entertainment Investments. Hallmark Entertainment Investments control could discourage others from initiating potential merger, takeover or other change of control transactions that may otherwise be beneficial to our business or holders of Class A common stock. As a result, the market price of our Class A common stock could suffer, and our business could suffer. Hallmark Entertainment Investments control relationship with us also could give rise to conflicts of interest in certain situations.

We could lose the right to use the name Hallmark because we have limited-duration trademark license agreements, which could harm our business.

We license the name Hallmark from Hallmark Cards and Hallmark Licensing, Inc., for various uses, including in the name of our international and domestic channels, and this license will expire on September 1, 2005. If Hallmark Cards determines not to renew the trademark license agreements for any reason, including our failure to meet minimum programming thresholds dependent on programming provided by affiliates of Hallmark Cards or to comply with Hallmark Cards programming standards, we would be forced to significantly revise our business plan and operations, and could experience a significant erosion of our subscriber base and advertising revenue, particularly in the United States.

If our third-party suppliers fail to provide us with network infrastructure services on a timely basis, our costs could increase and our growth could be hindered.

We currently rely on third parties to supply key network infrastructure services, including uplink, playback, transmission and satellite services to certain of our markets, which are available only from limited sources. We have occasionally experienced delays and other problems in receiving communications equipment, services and facilities and may, in the future, be unable to obtain such services, equipment or facilities on the scale and within the time frames required by us on terms we find acceptable, or at all. If we are unable to obtain, or if we experience a delay in the delivery of, such services, we may be forced to incur significant unanticipated expenses to secure alternative third party suppliers or adjust our operations, which could hinder our growth and reduce our revenue and potential profitability.

If our Network Operations Center fails, its operations are disrupted, or sold, our costs could increase and our growth could be hindered.

We are currently using the Network Operations Center for the origination and playback of signals for the Hallmark Channel both domestically and internationally. Like other single-point facilities, the Network Operations Center is subject to interruption from fire, tornadoes, lightning and other unexpected natural causes. Although we have redundant systems in place, equipment failure, employee misconduct or outside interference could also disrupt the Network Operations Center s services. We currently do not have and are not planning a duplicate operations facility for the international channels, but do have certain backup facilities for the domestic channels. Any significant interruption at the Network Operations Center affecting the distribution of our channels could have an adverse effect on our operating results and financial condition.

We anticipate that a possible sale of our international business would also include our Network Operations Center. If such a sale is consummated, we would have to negotiate the use of this facility with the purchaser of the facility or arrange for these services from another party since we would no longer control these services. Any significant interruption of such services affecting the distribution of our channels could have an adverse effect on our operating results and financial condition.

If our local distribution partner for the Latin American region fails to perform, our operations could be disrupted and our business harmed.

In the first quarter of 2003, we moved the majority of our operations concerning the distribution of the Hallmark Channel in Mexico, Central and South America to a local distribution partner in Argentina, Pramer, primarily to substantially reduce our expenses for operations in this region. If Pramer is unable to adequately perform the functions of selling our channel to local operators, to gain sufficient advertising sales and to appropriately market the channel, or, if Pramer s services are significantly interrupted for any reason, we may not improve our performance in Latin America.

If we are unable to retain key executives and other personnel, our growth could be inhibited and our business harmed.

Our success depends on the expertise and continued service of our executive officers and key employees of our subsidiaries. If we fail to attract, hire or retain the necessary personnel, or if we lose the services of our key executives, we may be unable to implement our business plan or keep pace with developing trends in our industry.

We are subject to the risks of doing business outside the United States.

Historically, a significant portion of our revenue has been generated from foreign operations. In order to maintain or expand our presence in foreign markets, we have entered and may in the future enter into strategic relationships with local operators in those markets. Certain foreign laws, regulations and judicial procedures may not be as protective of programmer rights as those applicable in the United States. In addition, many foreign countries have currency and exchange laws regulating the international transfer of currencies. To the extent that significant currency fluctuations result in materially higher costs to any of our foreign customers, those customers may be unable or unwilling to make the required payments. We may be subject to delays in access to courts and to the remedies local laws impose in order to collect our payments and recover our assets. We also may experience problems with collecting accounts due from foreign customers, which would adversely affect our revenue and income. Our growth and profitability may also suffer as a result of, among other matters, competitive pressures on video delivery, labor stoppages, recessions and other political or economic events adversely affecting world or regional trading markets or affecting a particular customer.

Our current and future operations in emerging markets may be harmed by the increased political and economic risks associated with these markets.

We currently broadcast in several foreign markets where market economies have only recently begun to develop, and we may expand these operations in the future. If the governments in these markets adopt more restrictive economic policies, we may not be able to continue operating, or to implement our expansion plans, in those markets. More generally, we are exposed to certain risks, many of which are beyond our control, inherent in operating in emerging market countries. These risks include changes in laws and policies affecting trade, investment and taxes (including laws and policies relating to the repatriation of funds and to withholding taxes), differing degrees of protection for intellectual property and the instability of emerging market economies, currencies, and governments.

The amount of our goodwill, as well as our film costs, may hinder our ability to achieve profitability.

As a result of our acquisitions of all the common interests in Crown Media United States, we have generated a significant amount of goodwill. We ceased the amortization of this acquired goodwill, and we are required to periodically review whether the value of our goodwill has been impaired. If we are required to write down our goodwill, our results of operations, stockholders equity or profitability could be materially adversely affected.

We also have a film cost relating to the amortization of the purchase price for the film assets that we use and license to others. This film cost is, and will continue to be, a significant component of our cost of services each quarter.

Our stock price may be volatile and could decline substantially.

The stock market has, from time to time, experienced extreme price and volume fluctuations. Many factors may cause the market price for our Class A common stock to decline, including:

our operating results failing to meet the expectations of securities analysts or investors in any quarter;

material announcements by us or our competitors;

governmental regulatory action;

technological innovations by competitors or competing technologies;

investor perceptions of our industry or prospects, or those of our customers; and

changes in general market conditions or economic trends.

Additionally, of the approximately 73.9 million shares of the Company s outstanding Class A common stock, only 9.6 million shares (approximately 13%) are not held by affiliates of the Company. This stock ownership structure may also be a cause of volatility in the market price of the Company s Class A common stock.

Any non-compliance with the Sarbanes-Oxley Act of 2002, and specifically section 404 of the Act, could have a negative impact on our stock price.

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we establish and maintain an adequate internal control structure and procedures for financial reporting and assess on an on-going basis the design and operating effectiveness of our internal control structure and procedures for financial reporting. Although we believe that the ongoing review of our internal controls will enable us to provide an assessment of our internal controls and our external auditors to provide their audit opinion as of December 31, 2004 as required by Section 404, we can give no assurance that these efforts will be completed on a timely and successful basis. Any inability to complete our process of assessing our internal controls will affect our auditors ability to render their opinions.

Risks Relating to Our Industry

The proposed change in television ratings in the United States could reduce our channel revenue and our ability to achieve profitability.

Our domestic advertising revenues are partially dependent on television ratings provided by Nielsen Media Research. Nielsen is currently modifying its ratings system by increasing its household sample size. Our ratings could either be positively or negatively affected by these changes, depending on the demographic characteristics of the households added to the Nielsen sample.

Competition could reduce our channel revenue and our ability to achieve profitability.

We operate in the pay television business, which is highly competitive. If we are unable to compete effectively with large diversified entertainment companies that have substantially greater resources than we have, our operating margins and market share could be reduced, and the growth of our business inhibited. In particular, we compete for distribution with other pay television channels and, when distribution is obtained, for viewers and advertisers with pay television channels, broadcast television networks, radio, the Internet and other media. We also compete, to varying degrees, with other leisure-time activities such as movie theaters, the Internet, radio, print media, personal computers and other alternative sources of entertainment and information. Future technological developments may affect competition within this business.

A continuing trend towards business combinations and alliances in both the domestic and foreign communications industries may create significant new competitors for us or intensify existing competition. Many of these combined entities have more than one channel and resources far greater than ours. These combined entities may provide bundled packages of programming, delivery and other services that compete directly with the products we offer. These entities may also offer services sooner and at more competitive rates than we do. In addition, these alliances may benefit from both localized content and the local political climate.

We may need to reduce our prices or license additional programming to remain competitive, and we may be unable to sustain future pricing levels as competition increases. Our failure to achieve or sustain market acceptance of our programming at desired pricing levels could impair our ability to achieve profitability or positive cash flow, which would harm our business.

Distributors in the United States may attempt to increasingly pressure smaller pay TV channels in terms of viewership, such as our domestic Hallmark Channel, to accept decreasing amounts for subscriber fees, to pay higher subscriber acquisition fees or to allow carriage of the channel without the payment of subscriber fees. Factors that may lead to this pressure include the number of competing pay TV channels, the limited space available on services of distributors in the United States and the desire of distributors to maintain or reduce costs. Any reduction in subscriber fees revenue now or in the future could have a material impact on our ability to achieve profitability and cash flow.

New distribution technologies may fundamentally change the way we distribute our channels and could significantly decrease our revenue or require us to incur significant capital expenditures.

Our future success will depend, in part, on our ability to anticipate and adapt to technological changes and to offer, on a timely basis, services that meet customer demands and evolving industry standards. The pay television industry has been, and is likely to continue to be, subject to:

rapid and significant technological change, including continuing developments in technology which do not presently have widely accepted standards; and

frequent introductions of new services and alternative technologies, including new technologies for providing video services.

For example, the advent of digital technology is likely to accelerate the convergence of broadcast, telecommunications, Internet and other media and could result in material changes in the economics, regulations, intellectual property usage and technical platforms on which our business relies, including lower retail rates for video services. These changes could fundamentally affect the scale, source, and volatility of our revenue streams, cost structures, and profitability, and may require us to significantly change our operations.

We also rely in part on third parties for the development of, and access to, communications and network technology. As a result, we may be unable to obtain access to new technology on a timely basis or on satisfactory terms, which could harm our business and prospects.

Moreover, the increased capacity of digital distribution platforms, including the introduction of digital terrestrial television, may reduce the competition for the right to carry channels and allow development of extra services at low incremental cost. These lower incremental costs could lower barriers to entry for competing channels, and place pressure on our operating margins and market position. In addition, a greater number of channels would likely increase competition among channels for viewers and advertisers, which could affect our ability to attract advertising and new distribution at desired pricing levels, and could therefore hinder or prevent the growth of our subscriber base.

If we fail to comply with applicable government regulations, our business could be harmed.

If, as a provider of television channels, we fail to comply with applicable present or future government regulations in any markets in which we operate, we could be prohibited from operating in those markets and could be subject to monetary fines, either of which would increase our operating costs, reduce our revenue and limit our ability to achieve profitability. The scope of regulation to which we are subject varies from country to country, although in many significant respects a similar approach is taken to the regulation of broadcasting across all of the markets in which we operate. Typically, broadcasting regulation in each of the countries in which we operate requires that domestic broadcasters and platform providers secure broadcasting licenses from the domestic broadcasting authority. Additionally, many nations have broadcasting legislation and regulations, which set minimum standards regarding program content, and prescribe minimum standards for the content and scheduling of television advertisements. Some countries require that a certain portion of programming carried by broadcasters be produced domestically.

Moreover, broadcasting regulations are generally subject to periodic and on-going governmental review and legislative initiatives, which may, in the future, affect the nature of programming we are able to offer and the means by which it is distributed. The timing, scope or outcome of these reviews could be unfavorable to us, and any changes to current broadcasting legislation or regulations could require adjustments to our operations.

The Federal Communications Commission or Congress may enact requirements that cable program services be offered to subscribers on an a la carte basis, i.e. be made available for purchase separately and not as part of a package of services. Such requirements could result in a reduction in the total number of subscribers to our domestic program services and adversely affect advertising revenue.

Item 3. ***Quantitative and Qualitative Disclosures About Market Risk***

We only invest in instruments that meet high credit and quality standards, as specified in our investment policy guidelines. These instruments, like all fixed income instruments, are subject to interest rate risk. The fixed income portfolio will decline in value if there is an increase in interest rates. If market interest rates were to increase immediately and uniformly by 10% from levels as of September 30, 2004, the decline of the fair value of the fixed income portfolio would not be material.

As of September 30, 2004, our cash, cash equivalents and short-term investments had a fair value of $7.6 million, which was invested in cash and short-term commercial paper. The primary purpose of these investing activities has been to preserve principal until the cash is required to fund operations. Consequently, the size of this portfolio fluctuates significantly as cash is provided by and used in our business.

The value of certain investments in this portfolio can be impacted by the risk of adverse changes in securities and economic markets and interest rate fluctuations. At September 30, 2004, all of our investments in this category were in fixed rate instruments or money market type accounts. A decrease in interest rates has the effect of reducing our future annual interest income from this portfolio, since funds would be reinvested at lower rates as the instruments mature. Over time, any net percentage decrease in our interest rates could be reflected in a corresponding net percentage decrease in our interest income. For the three and nine months ended September 30, 2004, the impact of interest rate fluctuations, changed business prospects and all other factors did not have a material impact on the fair value of this portfolio, or on our income derived from this portfolio.

We have not used derivative financial instruments for speculative purposes. As of September 30, 2004, we are not hedged or otherwise protected against risks associated with any of our investing or financing activities.

We are exposed to market risk.

We are exposed to market risk, including changes to interest rates and foreign currency exchange rates. To reduce the volatility relating to these exposures, we may enter into various derivative investment transactions in the near term pursuant to our investment and risk management policies and procedures in areas such as hedging and counterparty exposure practices. We have not and will not use derivatives for speculative purposes.

Though we intend to use risk management control policies, there will be inherent risks that may only be partially offset by our hedging programs should there be any unfavorable movements in interest rates, foreign currency exchange rates or equity investment prices.

The estimated exposure discussed below is intended to measure the maximum amount we could lose from adverse market movements in interest rates, foreign currency exchange rates and equity investment prices, given a specified confidence level, over a given period of time. Loss is defined in the value at risk estimation as fair market value loss.

Our interest income and expense is subject to fluctuations in interest rates.

Our material interest bearing assets consisted of cash equivalents and short-term investments. The balance of our interest bearing assets was $7.6 million, or less than 1% of total assets, as of September 30, 2004. Our material liabilities subject to interest rate risk consisted of a capital lease obligation, our bank credit facility, our line of credit with HC Crown and our note payable to HC Crown. The balance of those liabilities was $848.3 million, or 65% of total liabilities, as of September 30, 2004. Net interest expense for the three and nine months ended September 30, 2004, was $16.8 million, 30%, of our total revenue and $48.5 million, 29% of our total revenue. Our net interest expense of these liabilities is sensitive to changes in the general level of interest rates, primarily U.S. and LIBOR interest rates. In this regard, changes in U.S. and LIBOR interest rates affect the fair value of interest bearing liabilities.

We are exposed to risks relating to foreign currency exchange rates and foreign economic conditions.

We evaluate our foreign currency exposure on a net basis. We receive subscriber fees and advertising revenue from countries throughout the world. Increasingly, however, expenses arising from our foreign facilities as well as non-U.S. denominated dollar expenses are offsetting these revenues. Generally, payments required under our agreements are denominated in U.S. dollars and, therefore, unaffected by foreign currency exchange rate fluctuations. We have some exposure to changes in exchange rates in Latin America, Europe, Asia, and Africa. However, our exposure to foreign exchange rates primarily exists with the British pound. When the U.S. dollar strengthens against the currencies in these countries, the U.S. dollar value of non-U.S. dollar denominated revenue decreases; when the U.S. dollar weakens, the U.S. dollar value of non-U.S. dollar denominated revenue increases. Accordingly, changes in exchange rates, and in particular, a strengthening of the U.S. dollar, may adversely affect our revenue as expressed in U.S. dollars.

Item 4. ***Controls and Procedures.***

Disclosure Controls and Procedures

The Company, under the supervision and with the participation of the Company s management, including its Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of September 30, 2004. Based upon this evaluation, the Company s Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures are effective as of that date for purposes of recording, processing, summarizing and timely reporting material information required to be disclosed in reports that the Company files under the Exchange Act.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company s internal control over financial reporting that occurred during the quarter ended September 30, 2004, that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 6. ***Exhibits***

(a)

INDEX TO EXHIBITS

Exhibit Number	Exhibit Title
3.1	Amended and Restated Certificate of Incorporation (previously filed as Exhibit 3.1 to our Registration Statement on Form S-1/A (Amendment No. 2), Commission File No. 333-95573, and incorporated herein by reference).
3.2	Amendment to the Amended and Restated Certificate of Incorporation (previously filed as Exhibit 3.2 to our Quarterly Report on Form 10-Q filed on July 31, 2001 and incorporated herein by reference).
3.3	Amended and Restated By-Laws (previously filed as Exhibit 3.2 to our Registration Statement on Form S-1/A (Amendment No. 3), Commission File No. 333-95573, and incorporated herein by reference).
10.1	Trademark License Extension Agreement, dated as of August 1, 2004, by and between Crown Media International, LLC and Hallmark Cards, Incorporated.
10.2	Trademark License Extension Agreement, dated as of August 1, 2004, by and between Crown Entertainment Limited and Hallmark Cards, Incorporated.
10.3	Amendment No. 7 dated October 28, 2004, to the Credit, Security, Guaranty and Pledge Agreements with JP Morgan Chase Bank as Administrative Agent and Issuing Bank.
10.4*	Letter Agreement dated July 2, 2004 between Crown Media Holdings, Inc. and Jeff Henry.
10.5	Trademark License Extension Agreement, dated as of August 1, 2004, by and between Crown Media United States, LLC and Hallmark Cards, Incorporated.
31.1	Rule 13a-14(a) Certification executed by the Company s President and Chief Executive Officer.
31.2	Rule 13a-14(a) Certification executed by the Company s Executive Vice President and Chief Financial Officer.
32	Section 1350 Certifications.

* Management contract or compensating plan or arrangement.

48

SIGNATURES

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

CROWN MEDIA HOLDINGS, INC.

Signature	Title	Date
By: /s/ DAVID J. EVANS David J. Evans	Director and Principal Executive Officer	November 15, 2004
By: /s/ WILLIAM J. ALIBER William J. Aliber	Principal Financial and Accounting Officer	November 15, 2004

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