

CROWN MEDIA HOLDINGS INC
Form 10-Q
May 10, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

or

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

For the transition period from _____ to _____ .

Commission File Number: 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.)

12700 Ventura Boulevard,

Suite 200

Studio City, California 91604

(Address of Principal Executive Offices and Zip Code)

(818) 755-2400

(Registrant's Telephone Number, Including Area Code)

(Former Name, Former Address, and Former Fiscal Year,

if Changed Since Last Report.)

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Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities 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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

As of May 4, 2007, the number of shares of Class A Common Stock, \$.01 par value outstanding was 74,117,654, and the number of shares of Class B Common Stock, \$.01 par value, outstanding was 30,670,422.

TABLE OF CONTENTS

PART I

Financial Information

<u>Item 1</u>	<u>Financial Statements (Unaudited)</u> <u>CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES</u> <u>Condensed Consolidated Balance Sheets - December 31, 2006 and March 31, 2007</u> <u>(Unaudited)</u> <u>Condensed Consolidated Statements of Operations and Comprehensive Loss (Unaudited)</u> <u>- Three Months Ended March 31, 2006 and 2007</u> <u>Condensed Consolidated Statements of Cash Flows (Unaudited)</u> <u>- Three Months Ended March 31, 2006 and 2007</u> <u>Notes to Unaudited Condensed Consolidated Financial Statements</u>
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<u>Item 2</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>
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<u>Item 3</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>
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<u>Item 4</u>	<u>Controls and Procedures</u>
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PART II

Other Information

<u>Item 1A</u>	<u>Risk Factors</u>
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<u>Item 6</u>	<u>Exhibits</u>
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<u>Signatures</u>	
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In this Form 10-Q the terms *Crown Media Holdings* and 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 United States, LLC* (*Crown Media United States*), and until the completion of the sale of our film library in December 2006, *Crown Media Distribution, LLC* (*Crown Media Distribution*). The term *common stock* refers to our *Class A common stock* and *Class B common stock*, unless the context requires otherwise.

The names *Hallmark*, *TOTAL CHOICE* 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

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value and number of shares)

	As of December 31, 2006	As of March 31, 2007
ASSETS		
Cash and cash equivalents	\$ 13,965	\$ 5,786
Accounts receivable, less allowance for doubtful accounts of \$246 and \$535, respectively	57,079	52,172
Program license fees - affiliates	115	115
Program license fees - non-affiliates	111,909	121,696
Receivable from buyer of international business	24	9
Prepaid and other assets	4,202	5,913
Prepaid program license fee assets	10,271	20,219
Total current assets	197,565	205,910
Accounts receivable	850	406
Program license fees - affiliates	274	245
Program license fees - non-affiliates	185,620	179,936
Subscriber acquisition fees, net	41,665	32,659
Property and equipment, net	16,313	15,958
Goodwill	314,033	314,033
Prepaid and other assets	11,463	9,547
Total assets	\$ 767,783	\$ 758,694

See accompanying notes to unaudited condensed consolidated financial statements.

	As of December 31, 2006	As of March 31, 2007
LIABILITIES AND STOCKHOLDERS DEFICIT		
LIABILITIES:		
Accounts payable and accrued liabilities	\$ 26,588	\$ 24,162
Accrued restricted stock units	1,513	2,873
Subscriber acquisition fees payable	2,071	1,838
License fees payable to affiliates	2,275	3,705
License fees payable to non-affiliates	96,085	87,959
Payables to RHI and related companies	168	
Payables to affiliates	13,777	14,146
Payable to buyer of international business	5,098	5,099
Interest payable	59	96
Capital lease obligations	672	688
Deferred credit from technical services agreement	1,213	1,143
Total current liabilities	149,519	141,709
Accrued liabilities	25,291	23,166
License fees payable to non-affiliates	88,951	104,890
Line of credit and interest payable to HC Crown	93,465	95,431
Line of credit and interest payable to Hallmark Cards affiliate	53,364	54,394
Payable to buyer of international business	4,771	3,793
Senior unsecured note to HC Crown, including accrued interest	562,167	576,435
Credit facility	87,633	93,633
Note and interest payable to Hallmark Cards affiliate	146,397	149,269
Capital lease obligations	15,498	15,320
Company obligated mandatorily redeemable preferred interest	16,483	17,035
Deferred credit from technical services agreement	3,188	2,771
Total liabilities	1,246,727	1,277,846
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS DEFICIT:		
Class A common stock, \$.01 par value; 200,000,000 shares authorized; 74,117,654 shares issued and outstanding as of December 31, 2006 and March 31, 2007	741	741
Class B common stock, \$.01 par value; 120,000,000 shares authorized; 30,670,422 shares issued and outstanding as of December 31, 2006 and March 31, 2007	307	307
Paid-in capital	1,457,032	1,457,032
Accumulated deficit	(1,937,024)	(1,977,232)
Total stockholders deficit	(478,944)	(519,152)
Total liabilities and stockholders deficit	\$ 767,783	\$ 758,694

See accompanying notes to unaudited condensed consolidated financial statements.

CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND
COMPREHENSIVE LOSS

(In thousands, except per share data)

	Three Months Ended March 31,	
	2006	2007
Revenue:		
Subscriber fees	\$ 6,232	\$ 7,495
Advertising	37,913	45,850
Advertising by Hallmark Cards	480	148
Film asset license fees	270	
Sublicense fees and other revenue	78	79
Total revenue, net	44,973	53,572
Cost of Services:		
Programming costs		
Affiliates	2,656	5,562
Non-affiliates	30,937	34,130
Amortization of film assets	8,864	
Subscriber acquisition fee amortization expense	7,790	7,848
Amortization of capital lease	289	289
Other costs of services	3,841	2,948
Total cost of services	54,377	50,777
Selling, general and administrative expense	9,030	14,193
Marketing expense	4,257	4,212
Depreciation and amortization expense	879	497
Loss from operations before interest expense	(23,570)	(16,107)
Interest income	857	388
Interest expense	(22,560)	(24,489)
Loss before discontinued operations and cumulative effect of change in accounting principle	(45,273)	(40,208)
(Loss) gain from sale of discontinued operations, net of tax	162	
Loss before cumulative effect of change in accounting principle	(45,111)	(40,208)
Cumulative effect of change in accounting principle	(2,099)	
Net loss and comprehensive loss	\$ (47,210)	\$ (40,208)
Weighted average number of Class A and Class B shares outstanding, basic and diluted	104,788	104,788
Loss per share before discontinued operations and cumulative effect of change in accounting principle, basic and diluted	\$ (0.43)	\$ (0.38)
(Loss) gain per share from discontinued operations, basic and diluted	(0.00)	
Cumulative effect of change in accounting principle, basic and diluted	(0.02)	
Net loss per share, basic and diluted	\$ (0.45)	\$ (0.38)

See accompanying notes to unaudited condensed consolidated financial statements.

CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Three Months Ended March 31,	
	2006	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (47,210)	\$ (40,208)
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss (gain) from sale of discontinued operations	(162)	
Depreciation and amortization	53,355	48,977
Accretion on company obligated mandatorily redeemable preferred interest	487	552
Provision for allowance for doubtful accounts	916	330
Cumulative effect of change in accounting principle	2,099	
Loss on sale of property and equipment		39
Stock-based compensation	(1,907)	1,596
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	7,406	5,022
(Increase) decrease in receivable from buyer of international business	305	15
Additions to program license fees	(35,399)	(43,766)
(Additions) deletions to subscriber acquisition fees	(421)	176
(Increase) decrease in prepaid and other assets	7,196	(10,163)
Increase (decrease) in accounts payable, accrued and other liabilities	(24,901)	2,858
Increase in interest payable	16,580	20,172
Increase (decrease) in subscriber acquisition fees payable	(8,054)	(233)
Increase (decrease) in license fees payable to affiliates	8,620	1,430
Increase (decrease) in payables to affiliates	243	369
Increase (decrease) in deferred revenues	487	
Net cash used in operating activities	(20,360)	(12,834)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(3)	(206)
Payments to buyer of international business	(4,019)	(977)
Net cash used in investing activities.	(4,022)	(1,183)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from the issuance of common stock upon exercise of stock options	114	
Proceeds from tax sharing agreement with Hallmark Cards	5,000	
Borrowings under the credit facility	10,000	6,000
Principal payments on capital lease obligations	(148)	(162)
Net cash provided by financing activities	14,966	5,838
Net (decrease) increase in cash and cash equivalents	(9,416)	(8,179)
Cash and cash equivalents, beginning of period	15,926	13,965
Cash and cash equivalents, end of period	\$ 6,510	\$ 5,786
Supplemental disclosure of cash and non-cash activities:		
Interest paid	\$ 4,288	\$ 2,206
Income taxes paid	\$ 3	\$

See accompanying notes to unaudited condensed consolidated financial statements.

CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Three Months Ended March 31, 2006 and 2007

1. Business and Organization

Organization

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Crown Media Holdings, Inc. (Crown Media Holdings, Crown Media or the Company), through its wholly-owned subsidiary, Crown Media United States, LLC (Crown Media United States), 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. 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).

Liquidity

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As of March 31, 2007, the Company had \$5.8 million in cash and cash equivalents on hand. As of March 31, 2007, the Company had borrowed \$93.6 million from a \$130.0 million revolving bank credit facility, which matures May 31, 2008.

The Company's principal sources of funds are cash on hand, cash generated by operations, tax sharing payments from Hallmark Cards and amounts available under the Company's revolving bank credit facility. Payments under the tax sharing agreement are affected by Hallmark Cards tax position and its ability to utilize the Company's tax losses. The Company received \$12.0 million in tax sharing payments in 2006 and does not currently expect to receive tax sharing payments during 2007. The Company currently has \$36.4 million of unused revolving credit capacity. The Company's ability to borrow additional amounts under the credit facility is not limited or restricted as long as no covenants have been violated.

The sufficiency of the existing sources of liquidity to fund the Company's operations is dependent upon continued growth in subscriber revenue and advertising revenue. Any decline in the popularity of the Hallmark Channel, any significant future adverse modifications to the Company's distribution agreements, an economic decline in the advertising market, an increase in program acquisition costs, an increase in competition or other adverse operating conditions would negatively impact the Company's liquidity and its ability to fund the current level of operations.

The Company expects to continue making investments in programming, marketing and distribution. However, the Company's recurring loss situation has demanded that all areas of expenses, including programming, marketing and distribution be closely monitored and controlled.

The Company anticipates that its principal uses of funds for 2007 will continue to include the payment of operating expenses, accounts payable and accrued expenses, license fees for programming, and interest under its bank credit facility.

The Company currently believes that cash on hand, cash generated by operations and borrowing availability under its bank credit facility, when combined with the deferral of any required payments on related-party debt and related interest mentioned below, will be sufficient to fund the Company's operations and meet its liquidity needs through May 31, 2008.

The Company intends to extend or refinance the Bank credit facility prior to or upon its maturity. Any such extension or refinancing might require a continuation of a letter of credit from Hallmark Cards or other

steps by the Company and, thus, is not assured. If the Company is not able to arrange for the extension, refinancing or replacement of the bank credit facility prior to its maturity and either (1) the bank draws down on the irrevocable letter of credit provided by Hallmark Cards in support of the bank credit facility or (2) Hallmark Cards purchases the interests of the lending banks, Hallmark Cards would have all obligations and rights of the lending banks under the bank credit facility. In that event, Hallmark Cards could demand payment of outstanding amounts at any time after May 31, 2008, under the terms of the waiver and standby purchase agreement (Waiver Agreement) described below.

Upon maturity of the credit facility on May 31, 2008, the lending group led by JP Morgan Chase has the right to elect to forego the receipt of cash to pay the principal amount of the credit facility in full, which is provided for under the terms of an irrevocable letter of credit provided by Hallmark Cards, but instead can elect to initiate a process to foreclose on the Company's assets. Such foreclosure proceedings, would adversely affect our ability to continue our operations. Prior to any such possible foreclosure proceedings, however, the Company, if it has not secured an extension of the credit facility or alternative financing, would cause Hallmark Cards pursuant to the terms of the Waiver Agreement to exercise its option to purchase all of the outstanding indebtedness under the credit facility and the credit facility would then be subject to terms of the Waiver Agreement.

Due to the Company's possible inability to meet its obligations when they come due on May 31, 2008, the Company anticipates that prior to May 31, 2008, it will be necessary to either extend or refinance (i) the bank credit facility and (ii) the promissory notes payable to affiliates of Hallmark Cards described in the Notes below. As part of a combination of actions and in order to obtain additional funding, the Company may consider various alternatives, including refinancing the bank credit facility, raising additional capital through the issuance of equity or debt securities, a sale of certain assets or other strategic alternatives.

2. Summary of Significant Accounting Policies and Estimates

Interim Financial Statements

In the opinion of management, the accompanying condensed consolidated balance sheets and related interim condensed 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 condensed 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, 2006, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Basis of Presentation

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The condensed 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.

In April 2005, the Company completed the sale of its international business and, accordingly, classified the operating results of the international business as discontinued operations in the accompanying condensed consolidated statements of operations for all periods presented. The Company's discontinued operations consisted of the international channel operations and the international rights to the film library assets.

In December 2006, the Company completed the sale of the domestic rights to the film library assets. The accompanying condensed consolidated statements of operations and cash flows do not reflect associated revenue and expenses as discontinued operations because the portions of advertising revenue and related cash collections that are derived from the Company's use of the film library assets to meet programming requirements of the Channel cannot be clearly distinguished from advertising revenue and cash collections derived from the use of programming licensed from third parties.

8

Use of Estimates

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The Company's condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). These accounting principles require the Company to make certain estimates, judgments and assumptions. The Company believes that the estimates, judgments and assumptions made when accounting for items and matters such as customer retention patterns, allowance for bad debts, useful lives of assets, ultimate revenue used in the film asset amortization calculations, cash flow projections used in various asset valuations, income taxes, reserves and other provisions for contingencies are reasonable, based on information available at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the condensed consolidated financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Actual results could differ from these estimates.

Allowance for Doubtful Accounts

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The allowance for doubtful accounts is based upon the Company's assessment of probable loss related to uncollectible accounts receivable. The Company uses a number of factors in determining the allowance, including, among other things, collection trends. The Company's bad debt expense was \$916,000 and \$330,000 for the three months ended March 31, 2006 and 2007, respectively.

Program License Fees

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Program license fees are paid in connection with the acquisition of the rights to air programs acquired from others. The cost of program rights are deferred and then amortized on a straight-line basis over the shorter of their contractual license periods or anticipated usage. On a quarterly basis, the Company evaluates the realizability of these deferred license fees in relation to the estimated future revenues. Estimates of net realizable value for program license fees are determined using future estimated advertising revenues and anticipated patterns of programming usage on a day part basis as it pertains to programming licensed to the channel. These estimates of expected annual future estimated revenues are compared to net book value of the program license fee assets to determine if the programming assets are expected to be recovered. Where the analysis indicates the costs are in excess of the estimated net realizable value, additional programming costs are recognized for the difference.

Subscriber Acquisition Fees

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Subscriber acquisition fees are generally required to be paid to obtain carriage on major domestic pay distributors systems. Under certain of these agreements with major pay distributors, Crown Media United States has in the past been obligated to pay subscriber acquisition fees if defined subscriber levels are met or in order to obtain additional carriage of the Hallmark Channel by those pay distributors. Such costs have been accrued when Crown Media United States received notice from the distributors that they had met the contractual penetration percentage or subscriber count.

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 cumulative subscriber fee revenue recognized, or to be 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 by comparing the net carrying amount to the estimates of future subscriber fee and advertising revenues. It also assesses the recoverability when events such as changes in distributor relationships occur or other indicators suggest impairment.

Long-Lived Assets

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The Company reviews long-lived assets, other than goodwill and other intangible assets with indefinite lives, for impairment whenever facts and circumstances indicate that the carrying amounts of the assets may not be recoverable. An impairment loss is recognized if the carrying amount of the asset is not recoverable

9

and exceeds its fair value. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset to the estimated undiscounted future net cash flows expected to be generated by the asset. If the asset's carrying value is not recoverable, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds its fair value. The Company determines fair values by using a combination of comparable market values and discounted cash flows, as appropriate.

Goodwill is reviewed for impairment annually on November 30 or whenever an event or a change in circumstances indicates fair value might be below carrying value. Goodwill is carried at historical cost if the estimated fair value is greater than the carrying amounts. However, if estimated fair value is less than the carrying amount, goodwill is reduced to estimated fair value through an impairment charge to the Company's consolidated statements of operations.

Revenue Recognition

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Subscriber revenue from pay television distributors is recognized 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 No. 01-9 (EITF No. 01-9), *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)*. If the amortization expense exceeds the revenue recognized on a cumulative per distributor basis, the excess amortization is included as a component of cost of services.

Advertising revenues are recognized as earned in the period in which the advertising is telecast. Revenue is recognized as commercial spots or long form programming are aired and as ratings guarantees to advertisers are achieved. 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.

Taxes on Income

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Pursuant to the tax sharing agreement entered into with Hallmark Cards in March 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 2003. However, the Company continues to account for income taxes on a separate return basis. Accordingly, the Company accounts for income taxes using an asset and liability method which 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 additional paid-in capital. Based on the tax sharing agreement, the Company may ultimately owe Hallmark Cards for its share of the consolidated federal tax liability caused by the inclusion of the Company in the consolidated group. Such payments would be treated as a reduction to paid-in capital to the extent of amounts previously received under the tax sharing agreement.

Stock-Based Compensation

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The Company accounts for its stock-based compensation under the provisions of the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards No. 123 revised 2004 (SFAS 123R), *Share-Based Payment*, which replaced Statement of Financial Accounting Standards No. 123 (SFAS 123), *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees*. Under the fair value recognition provisions of SFAS

10

123R, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the period during which the holder is required to provide services in exchange for the award, i.e., usually the vesting period. We elected the modified-prospective method, under which the periods prior to 2006 were not revised for comparative purposes. The valuation provisions of SFAS 123R apply to new grants and to grants that were outstanding as of the effective date and are subsequently modified. Estimated compensation for grants that were outstanding as of the effective date is recognized over the remaining service period using the compensation cost estimated for the SFAS 123 pro forma disclosures. See Note 12 for further information regarding our stock-based compensation assumptions and expenses.

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 anti-dilutive. Potential common shares consist of incremental common shares issuable upon the exercise of stock options. Approximately 864,000, and 360,000 stock options for the three months ended March 31, 2006 and 2007, respectively, have been excluded from the calculations of loss per share because their effect would have been anti-dilutive.

Concentration of Credit Risk

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Financial instruments, which potentially subject Crown Media Holdings to a concentration of credit risk, consist primarily of 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.

Recently Issued Accounting Pronouncements

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The Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), on January 1, 2007. FIN 48 requires a new evaluation process for all tax positions taken. If the probability for sustaining a tax position is greater than 50%, then the tax position is warranted and recognition should be at the highest amount which would be expected to be realized upon ultimate settlement. As of the date of adoption of FIN 48, the total amount of unrecognized tax benefits for uncertain tax positions was \$0. As a result of the implementation of FIN 48, the Company recognized no increase or decrease in the amount of unrecognized tax benefits for uncertain tax positions.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of the date of adoption and on March 31, 2007, we have no accrued interest related to uncertain tax positions.

The Company has been included in the consolidated federal income tax returns of Hallmark Cards since March 11, 2003. The Internal Revenue Service is currently examining the 2003-2004 tax returns of Hallmark Cards. The Company is subject to examination through its inclusion in the Hallmark Cards tax return for the tax periods subsequent to March 10, 2003. Pursuant to statutory provisions, net operating loss carryforwards (NOL s) are subject to examination in the year that they are utilized in a tax return regardless of whether the tax year in which they were generated has been closed by statute. The amount subject to disallowance is limited to the NOL utilized. Accordingly, the Company is subject to examination for NOL s generated prior to March 11, 2003 if and when such NOL s are utilized in future tax returns.

The Company files state tax returns in major jurisdictions such as California, Colorado and New York, and has also been included in the combined state tax returns of Hallmark or Hallmark Entertainment Holdings, Inc. The state returns are generally subject to examination for years after 2001.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 is effective for the Company as of January 1, 2008. The Company is currently evaluating the potential impact of adopting SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, including an amendment of SFAS No. 115 (SFAS No. 159). SFAS No. 159 permits entities to choose, at specified election dates, to measure eligible items at fair value (the fair value option). A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting period. This accounting standard is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The effect, if any, of adopting SFAS No. 159 on the Company's financial position and results of operations has not been finalized.

3. Residual and Participation Liabilities

On December 15, 2006, we completed the sale of domestic rights and certain international ancillary rights to our library of approximately 620 television movies, mini-series and series (the Crown Library) to RHI Entertainment LLC (RHI). The Company has retained the obligation to pay residuals and profit participations based on the domestic exploitation of the Crown Library by RHI for a period of ten years following the closing of the sale. Pursuant to Amendment No. 1 to the Purchase Agreement dated December 15, 2006, the parties agreed that RHI will assume any liabilities associated with such residuals and participations in excess of \$22.5 million in the aggregate. The cost to the Company of paying these residuals will depend on the level of RHI's library sales and its other uses of the library during this period. The Company estimated the fair value of the \$22.5 million maximum liability to be approximately \$10.9 million at March 31, 2007, which is included in long-term accrued liabilities in the accompanying condensed consolidated balance sheet, to pay the estimated residual and participation costs that RHI would otherwise be obligated to pay to third parties. The amount of this liability could fluctuate based upon the amount and timing of the sales of these films by the buyer. Any revisions to these estimated liabilities will be reflected as gain (loss) from the sale of the film assets and reflected in continuing operations in future periods.

Also, the Company estimated a liability of approximately \$4.6 million to pay the estimated residual and participation costs that the buyer of our international business (including international rights to our then film library) in April 2005 would otherwise be obligated to pay to third parties through April 2015 in connection with film library sales. The amount of this liability could fluctuate based upon the actual internal usage or sales of these films by the buyer. Any revisions to these estimated liabilities will be reflected as gain (loss) from the sale of discontinued operations in future periods.

4. Subscriber Acquisition Fees

Subscriber acquisition fees are comprised of the following:

	As of December 31, 2006 (In thousands)	As of March 31, 2007
Subscriber acquisition fees, at cost	\$ 189,391	\$ 182,774
Accumulated amortization	(147,726)	(150,115)
Subscriber acquisition fees, net	\$ 41,665	\$ 32,659

Of the net balance at March 31, 2007, the Company expects \$8.7 million will be recognized as a reduction of subscriber fee revenue and \$24.0 million will be recognized as subscriber acquisition fee expense in future periods.

As of December 31, 2006, and March 31, 2007, the condensed consolidated balance sheets also reflect subscriber acquisition fees payable of \$2.1 million and \$1.8 million, respectively. For the three months ended March 31, 2006 and 2007, the Company made cash payments of \$8.0 million and \$57,000, respectively, relating to current subscriber acquisition fee obligations.

5. Program License Fees

Program license fees are comprised of the following:

	As of December 31, 2006 (In thousands)	As of March 31, 2007
Program license fees RHI Entertainment Distribution	\$ 212,143	\$ 211,496
Program license fees NICC	197	197
Program license fees other affiliates	368	368
Program license fees other non-affiliates	326,552	357,871
Program license fees, at cost	539,260	569,932
Accumulated amortization	(241,342)	(267,940)
Program license fees, net	\$ 297,918	\$ 301,992

Programming costs for the three months ended March 31, 2006 and 2007, were \$33.6 million and \$39.7 million, respectively.

At December 31, 2006, and March 31, 2007, \$10.3 million and \$20.2 million of program license fees were included in prepaid program license fee assets on the accompanying condensed consolidated balance sheets as the Company made payments for the program license fees prior to commencement of the license period.

License fees payable are comprised of the following:

	As of December 31, 2006 (In thousands)	As of March 31, 2007
License fees payable RHI Entertainment Distribution	\$ 18,439	\$ 8,711
License fees payable NICC	2,275	3,705
License fees payable non-affiliates	166,597	184,138
Total license fees payable	187,311	196,554
Less current maturities	(98,360)	(91,664)
Long-term license fees payable	\$ 88,951	\$ 104,890

6. Property and Equipment

Property and equipment are comprised of the following:

	As of December 31, 2006 (In thousands)	As of March 31, 2007	Depreciable Lives (In years)
Technical equipment and computers	\$ 15,083	\$ 7,738	3-5
Leased assets	17,363	17,363	15
Furniture, fixtures and equipment	1,241	1,281	5
Leasehold improvements	2,853	1,656	3-7
Construction-in-progress	273	15	
Property and equipment, at cost	36,813	28,053	
Accumulated depreciation	(20,500)	(12,095)	
Property and equipment, net	\$ 16,313	\$ 15,958	

Depreciation expense related to property and equipment was \$783,000 and \$522,000, for the three months ended March 31, 2006 and 2007, respectively.

Software and other intangible assets of \$1.0 million as of both December 31, 2006, and March 31, 2007, respectively, have been included in prepaid and other assets in the accompanying condensed consolidated balance sheets.

7. Credit Facility

At March 31, 2007, the Company had an amended credit agreement with a syndicate of banks, led by JP Morgan Chase Bank, under which the banks have extended to the Company a secured revolving credit facility with availability of up to \$130.0 million. At March 31, 2007, the outstanding balance under the credit facility was \$93.6 million. The Company currently has \$36.4 million of unused revolving credit capacity. The Company's ability to borrow additional amounts under the credit facility is not limited or restricted. The Company and the lending banks originally entered into the facility in 2001 and have subsequently amended the terms of this facility, with the most recent amendment dated as of March 2, 2007. The facility is guaranteed by the Company's subsidiaries and is secured by all tangible and intangible property of Crown Media Holdings and its subsidiaries.

Each borrowing under the bank credit facility bears interest at a Eurodollar rate or an alternate base rate as the Company may request at the time of borrowing in accordance with the credit agreement. The Eurodollar rate is based on the London interbank market for Eurodollars, and remains in effect for the time period of the loan ranging from one, two, three, six or twelve months. The alternate rate is based upon the prime rate of JP Morgan Chase Bank, a certificate of deposit rate or the Federal Funds effective rate, which is adjusted whenever the rates change. The Company is required to pay a commitment fee of 0.15% per annum of the committed, but not outstanding, amounts under the revolving credit facility, payable in quarterly installments.

At December 31, 2006, and March 31, 2007, the Company had outstanding borrowings of \$87.6 million and \$93.6 million, respectively, under the credit facility and there were no letters of credit outstanding. At December 31, 2006, \$87.6 million of the outstanding balance bore interest at the Eurodollar rate (6.10% at December 31, 2006) and \$0 bore interest at the JP Morgan Chase Bank prime rate. At March 31, 2007, \$93.6 million of the outstanding balance bore interest at the Eurodollar rate (6.07% at March 31, 2007) and \$0 bore interest at the JP Morgan Chase Bank prime rate. Interest expense on borrowings under the credit facility for each of the three months ended March 31, 2006 and 2007, was \$2.9 million, and \$1.4 million, respectively.

Covenants

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The credit facility, as amended, contains affirmative and negative covenants. The Company's Annual Report on Form 10-K contains a detailed description of these covenants. The Company was in compliance with these covenants at March 31, 2007.

Amendment No. 12, dated as of March 2, 2007, extended the maturity date of the revolving credit facility to May 31, 2008. Additionally, the amendment provided for the Hallmark Cards letter of credit to be replaced by a JP Morgan Bank letter of credit for the \$130.0 million, with an expiration date of June 10, 2008.

8. Related Party Long-Term Obligations

Waiver and Standby Purchase Agreement

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Under the Waiver and Standby Purchase Agreement dated March 21, 2006, as last amended on March 2, 2007, Hallmark Cards agreed to defer all payments due on any of the following obligations and, except where noted, payment of interest thereon until May 31, 2008, or an earlier date as described below as the waiver termination date, whereupon all of these amounts become immediately due and payable (the "Waiver Period"):

14

- Line of credit and interest payable to HC Crown, dated December 14, 2001, in the original principal amount of \$75.0 million, payable to HC Crown. (Total amount outstanding at March 31, 2007, including accrued interest was \$95.4 million. See *Line of Credit and Interest Payable to HC Crown* below.)
- \$70.0 million line of credit and interest payable to Hallmark Cards affiliate arising out of the Company's purchase of the Hallmark Entertainment film library. (Total amount outstanding at March 31, 2007, including accrued interest was \$54.4 million. See *Line of Credit and Interest Payable to Hallmark Cards Affiliate* below.)
- 10.25% senior unsecured note, dated August 5, 2003, in the initial accreted value of \$400.0 million, payable to HC Crown. (Total amount outstanding at March 31, 2007, including accrued interest was \$576.4 million. See *Senior Unsecured Note* below.)
- Note and interest payable to Hallmark Cards affiliate, dated as of October 1, 2005, in the principal amount of \$132.8 million, payable to Hallmark Entertainment Holdings. (Total amount outstanding at March 31, 2007, including accrued interest was \$149.3 million. See *Note and Interest Payable to Hallmark Cards Affiliate* below.)
- All obligations of the Company under the bank credit facility by virtue of Hallmark Cards' deemed purchase of participations in all of the obligations under a letter of credit which Hallmark Cards has given in support of the facility or the purchase by Hallmark Cards of all these obligations pursuant to Amendment No. 9 to the bank credit facility.

Hallmark Cards has agreed that it will not accelerate the maturity of any of the foregoing obligations or initiate collection proceedings during the Waiver Period. Interest will continue to accrue on these obligations during the Waiver Period. The Company will continue to pay interest on the credit facility during the Waiver Period.

The waiver termination date is on May 31, 2008, or earlier upon occurrence of any of the following events: (a) the Company fails to pay any principal or interest, regardless of amount, due on any indebtedness to unrelated parties with an aggregate principal amount in excess of \$5.0 million or any other event or condition occurs that results in any such indebtedness becoming due prior to its scheduled maturity, provided that the waiver will not terminate if the Company reduces the principal amount of such indebtedness to \$5.0 million or less within five business days of a written notice of termination from Hallmark Cards; (b) certain bankruptcy events occur; (c) the Company defaults in its payment of licensing fees under the Second Amended and Restated Program License Agreement with RHI Entertainment Distribution (formerly known as Hallmark Entertainment Distribution at which time it was a wholly-owned subsidiary of Hallmark Cards); (d) a representation and warranty of the Company in the Waiver Agreement is false or misleading in any material respect; or (e) the Company fails to pay interest on the bank credit facility described above to the extent that Hallmark Cards has purchased all or a portion of the indebtedness thereunder or to perform any covenants in the Waiver Agreement.

Under the Waiver Agreement, if the bank's lenders under the bank credit facility accelerate any of the indebtedness under the bank credit facility or seek to collect any indebtedness under it, then the Company may elect to exercise its right to require that Hallmark Cards or its designated subsidiary exercise an option to purchase all the outstanding indebtedness under the bank credit facility as provided in the bank credit facility. All expenses and fees in connection with this purchase would be added to the principal amount of the credit facility obligations.

The Waiver Agreement does not limit any existing rights of Hallmark Cards or its affiliates to offset amounts owed to us under the Hallmark Tax Sharing Agreement and Hallmark Cards' share of the amounts payable under the December 1, 2005, agreement with NICC (described below) against these obligations. On September 1, 2006, Hallmark Cards elected to apply its \$3.1 million share of the NICC obligations against the amounts due under the \$70.0 million Promissory Note to Hallmark Entertainment Holdings (described below), thereby reducing the principal amount of that Note by \$3.1 million.

Additionally, during the third quarter of 2006, Hallmark Cards applied \$18.0 million of benefit from the Tax Sharing Agreement against the principal amount due under the March 21, 2006, promissory note with Hallmark Entertainment Holdings. Pursuant to the Waiver Agreement, the Company must make prepayments on the outstanding debt from 100% of any Excess Cash Flow during the Waiver Period. Excess Cash Flow is defined as 1) the net proceeds of any debt or equity financings or sale of assets; 2) the net cash proceeds from the incurrence by the Company of indebtedness; 3) the net cash proceeds from the sale, transfer or release by the Company of assets outside the ordinary course of business; and 4) if positive, the consolidated net cash flow from operations of Crown Holdings for any calendar quarter as shown in an SEC report, less cash funds used to pay current operating expenses and to pay or establish reasonable reserves for future expenses, indebtedness payments, and capital improvements and replacements as determined by the Board of Directors of the Company.

Hallmark Letter of Credit

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Pursuant to Amendment No. 12 to the bank credit facility, Hallmark Cards has provided an irrevocable letter of credit issued by JP Morgan Chase Bank in the amount of \$130.0 million, as credit support for our obligations under the credit facility with an expiration date of June 10, 2008.

Related Party Long-Term Obligations

The aggregate maturities of related party long-term debt for each of the five years subsequent to March 31, 2007, are as follows:

	Payments Due by Period					
	Total (In thousands)	1 year	2 years	3 years	4 years	5 years
Line of credit and interest payable to HC Crown, with principal due May 31, 2008 (8.37% Eurodollar rate at December 31, 2006 and 8.36% Eurodollar rate at March 31, 2007)	\$ 95,431	\$	\$ 95,431	\$	\$	\$
10.25 % Senior unsecured note to HC Crown, including accrued interest, due August 5, 2011	576,435					576,435
Note and interest payable to Hallmark Entertainment Holdings due May 31, 2008 (8.37% Eurodollar rate at December 31, 2006 and 8.36% Eurodollar rate at March 31, 2007)	149,269		149,269			
Note and interest payable to Hallmark Entertainment Holdings due May 31, 2008 (8.37% Eurodollar rate at December 31, 2006 and 8.36% Eurodollar rate at March 31, 2007)	54,394		54,394			
	\$ 875,529	\$	\$ 299,094	\$	\$	\$ 576,435

Interest Paid to HC Crown

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Interest expense paid to HC Crown was \$1.1 million for the three months ended March 31, 2006, and \$453,000 for the three months ended March 31, 2007.

9. Related Party Transactions

Tax Sharing Agreement

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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.

16

Accordingly, Hallmark Cards has benefited from past tax losses and may 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 by Hallmark Cards as a result of including Crown Media Holdings in its consolidated income tax return. These benefits are estimated and paid 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, this 25% balance may also be applied as an offset against any amounts owed by Crown Media Holdings to any member of the Hallmark Cards consolidated group under any loan, line of credit or other payable, subject to limitations under any loan indentures or contracts restricting such offsets.

The Company received \$5.0 million and \$0 under the Tax Sharing Agreement during and the three months ended March 31, 2006 and 2007, respectively. Any payments received from Hallmark Cards or credited against amounts owed by Crown Media Holdings to any member of the Hallmark Cards consolidated group under the tax sharing agreements are recorded as an addition to paid-in capital in the accompanying condensed consolidated balance sheets.

Services Agreement with Hallmark Cards

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Under a 2003 intercompany services agreement, Hallmark Cards provides Crown Media Holdings with tax, risk management, health safety, environmental, insurance, legal, treasury and cash management services and real estate consulting services. In 2006, the term of the agreement was extended to January 1, 2008. Under the agreement, the Company agreed to pay Hallmark Cards \$530,000 per year for each of 2006 and 2007 for these services, plus out-of-pocket expenses and third party fees, payable in arrears on the last business day of each quarter. However, the Company has not paid these amounts, as Hallmark Cards has not required payments.

For each of the three months ended March 31, 2006 and 2007, Crown Media Holdings had accrued \$133,000 under the agreement. At December 31, 2006, and March 31, 2007, non-interest bearing unpaid accrued service fees and unreimbursed expenses of \$11.5 million and \$11.8 million, respectively, were included in payable to affiliates in the accompanying condensed consolidated balance sheets. At December 31, 2006, and March 31, 2007, out-of-pocket expenses and third party fees were \$914,000 and \$170,000, respectively.

Trademark Agreement with Hallmark Cards

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Crown Media United States has a trademark license agreement with Hallmark Licensing, Inc. for use of the Hallmark mark for the Hallmark Channel and for the Hallmark Movie Channel. During the second quarter of 2006, Hallmark Cards extended the trademark license agreements for the Hallmark Channel and the Hallmark Movie Channel to September 1, 2007. The Company is not required to pay any fees under the trademark license agreements.

Intercreditor Agreement

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The Company has an intercreditor agreement that deals with residual and participation liabilities for the use of film assets by the buyer of the Company's membership interest in Crown Media Distribution. Under the intercreditor agreement, Hallmark Cards has agreed that any loan, debt or other amount payable by the Company to Hallmark Cards will be subordinate and subject in right of payment to the payment in full of such residual and participation liabilities, but only to the extent that any such residual and participation liabilities outstanding exceed \$22.5 million.

10. Company Obligated Mandatorily Redeemable Preferred Interest and NICC License Agreements

VISN (a subsidiary of NICC) 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

17

the Company in Crown Media United States. On November 13, 1998, the Company, Vision Group, VISN and Henson Cable Networks, Inc. signed an amended and restated agreement governing the operation of Crown Media United States, as amended at various times through December 1, 2005 (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. The preferred interest has a liquidation preference of \$25.0 million.

A December 2005 agreement between Crown Media Holdings and NICC replaced a prior program production agreement and settled various disputes which had arisen under the prior agreement. In the new agreement, the Company agreed to fund and license the following programming produced by NICC through the end of 2007:

- A Sunday Morning one-hour series entitled *New Morning with Naomi Judd* at a cost of \$4.6 million in 2006 and \$5.6 million in 2007. The 2007 amounts are payable quarterly.
- A weekday one-hour daily series entitled *New Morning* at a cost of \$4.2 million in 2006 and \$5.1 million in 2007. The 2005 amount included a deferred amount of \$535,000 to be paid as indicated below for deferred payments. The 2007 amounts are payable quarterly.
- A Sunday morning programming block, broadcast from 6 a.m. to 12 noon, at a cost of approximately \$5.8 million in 2006 and \$5.8 million in 2007, increased by a percentage equal to the increase in the Consumer Price Index, in 2007. These amounts include deferred payments of \$125,000 for 2005 and \$1.5 million for each of 2006 and 2007. The 2007 amounts not deferred are payable quarterly.

In addition, Crown Media Holdings agreed to finish funding four specials, the production of which had been commenced prior to the amendment, at a total additional cost of \$1.4 million in 2005 and 2006, and to fund an additional two non-dramatic specials, to be produced in 2006 and 2007, at a total cost of \$1.3 million. A quarter of the amounts for the additional two specials was paid in January 2006, another quarter was paid in June 2006 and the remaining one-half is payable in June 2007, or upon a change in control (that is, a sale or merger where the aggregate ownership of Crown Media Holdings by the current owners becomes less than 50%). The Hallmark Channel is not obligated to broadcast the latter two specials. Crown Media Holdings will also provide or has provided \$2.0 million in each of 2005, 2006 and 2007 to fund the development by NICC of made for television movies and will pay NICC an additional \$1.0 million if the movie *A Reason to Believe*, which was to be produced under the prior agreement, is not ultimately produced. The 2005 amount includes a deferred payment of \$1.8 million; the 2006 amount was paid semi-annually in 2006; and the 2007 amount was paid in January 2007. The Hallmark Channel will have a right of first negotiation to acquire broadcast rights to the movies resulting from this development and, if it elects not to acquire these rights, may still recover a portion of its funding if the movies are produced for others. In addition, NICC has received \$45,000 in consulting fees from a series which RHI Entertainment has produced, and will receive a deferred payment of \$750,000 as the last payment for certain terminated obligations.

The deferred payments mentioned above are payable to NICC on December 31, 2007 or upon a change in control, whichever comes first. Added to the deferred amounts will be (1) interest at the rate charged by NICC's prime lender or (2) if NICC sells Crown Media Holdings common stock to finance any deficit, the increase in the sale price of the common stock between the time NICC sells the stock to fund a deferred amount and a market price of the Crown Media Holdings common stock on the date the deferred amounts are paid by Crown Media Holdings.

In the event there is a change of control of Crown Media Holdings prior to the expiration of the agreement (i.e., December 31, 2007), NICC will immediately receive a \$15.0 million termination payment, any remaining portions of the payments for the non-dramatic specials and the made for television movie development described above and the deferred payments described above. The Hallmark Channel will be obligated to continue to broadcast and pay for the Sunday New Morning with Naomi Judd and weekday New Morning series and the Sunday morning programming block for an additional six months following the change in control, after which all funding and broadcast obligations to NICC will cease. Also, under existing obligations, Crown Media Holdings would be required to redeem the \$25.0 million preferred interest of NICC in Crown Media United States, LLC, for that amount plus accrued interest at LIBOR from November 27, 2005.

If there has not been a change of control of the Company by June 30, 2007, Crown Media Holdings is required to negotiate with NICC for a period of 60 days regarding continuation of the programming commitments. If at the end of the negotiating period the parties have not reached agreement and Crown Media Holdings is not willing to continue the programming commitments at the same levels NICC may compel Crown Media Holdings to buy all NICC's outstanding shares of Crown Media Holdings common stock at the then current market value by a written notice given no later than November 1, 2007 (Put Right). If NICC sells more than 50% of the shares of Crown Media Holdings common stock which it owned as of February 22, 2001, except as part of a sale of Crown Media Holdings, most of the commitments and obligations related to programming as described above cease (at the option of Crown Media United States) at the end of the then current broadcast season (approximately August 31).

The Company has, at NICC's request, started negotiations with NICC regarding the continuation of the programming commitments. In the event a new agreement is not reached or other resolution is not reached and NICC seeks to exercise its Put Right, the Company will endeavor to finance the purchase of the NICC stock through outside sources rather than from funds from operations. In the alternative, the Company can, if necessary, extinguish NICC's Put Right completely by offering to continue the programming commitments to NICC at the same level as in the current agreement.

During the three months ended March 31, 2006, and 2007, Crown Media United States paid NICC \$7.5 million and \$7.3 million, respectively, related to the company agreement as amended.

11. RHI Entertainment

Program License Agreements with RHI Entertainment Distribution

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Crown Media United States has licensed programming for distribution in the United States from Hallmark Entertainment Distribution, now RHI Entertainment Distribution, since 1998. It currently licenses this programming under a Second Amended and Restated Program License Agreement dated as of January 1, 2005 (Second Restated Agreement). This Second Restated Agreement expires on December 31, 2008.

Under the Second Restated Agreement, RHI Entertainment Distribution is required to produce and deliver to Crown Media United States, and Crown Media United States is required to order and license from RHI Entertainment Distribution, 31 original movies and 6 original mini-series in 2006 and 18 original movies and 3 original mini-series in 2007. Crown Media United States may, however, completely cancel the 2007 commitment to order 18 original movies and 3 original mini-series or it may reduce the number of original movies it is required to license in each of 2006 and 2007 by up to six movies per year. Crown Media United States exercised this option to reduce by six the number of original movies produced in 2006. It also elected not to exercise its right to cancel the 2007 original productions, but did exercise the option to reduce to twelve the number of original movies produced in 2007. Crown Media United States has exclusive rights to these original movies and mini-series during a three year exhibition window (the window is five years for certain holiday-themed movies and movies produced in 2005). Crown Media United States may exhibit the original

movies and mini-series in any television media in the United States, its territories and possessions (together with Puerto Rico), including pay per view and high definition television. Crown Media United States may also sublicense its exhibition rights in any television media regarding the original and other movies and mini-series covered by the agreement to third parties, subject to the reasonable consent of RHI Entertainment Distribution. The license fee payable for the original movies produced in 2006 is \$1,680,000 per movie and in 2007 is \$1,764,000 per movie. If the movies are produced for the Hallmark Channel's Mystery Movie series, the license fees are increased by \$200,000 and if they are holiday-themed movies, the license fees are increased by \$100,000. The license fees for mini-series produced in 2006 are \$840,000 per hour; and in 2007 are \$882,000 per hour. Crown Media United States must also share any revenues from video on demand or pay per view exploitation with RHI Entertainment Distribution.

In addition to the original movies and mini-Series, Crown Media United States has agreed to license from RHI Entertainment Distribution 15 off-network movies and mini-series in 2006 through 2013. These programs generally will not have been seen on cable television in the United States prior to their exhibition on the Hallmark Channel. The license fees payable for the off-network movies are \$281,420 per movie in 2006; \$295,491 per movie in 2007 and \$310,266 per movie in 2008 and subsequent years. The license fees payable for the off-network mini-series are \$351,775 per hour in 2006; \$369,364 per hour in 2007 and \$387,832 per hour in 2008 and subsequent years. Crown Media United States' initial exhibition period for these off-network movies and mini-series is three years and Crown Media United States' exhibition rights are exclusive in all television media in the United States, including Puerto Rico. Crown Media United States' exhibition rights to these off-network movies and mini-series do not, however, include pay per view or video on demand. RHI Entertainment Distribution has an option to require Crown Media United States to license these off-network movies and mini-series for an additional, consecutive three year period at a cost of 50% of the initial license fee.

Crown Media United States has also agreed to license up to 143 older movies and mini-series from the RHI Entertainment Distribution Library for a three year exclusive exhibition window, at an approximate total cost of \$57.5 million. Most of these movies and mini-series have previously been exhibited on the Hallmark Channel or Hallmark Movie Channel.

Under both the current and previous agreements with RHI Entertainment Distribution, if Crown Media United States sub-licenses any licensed program to a third party, it must equally share with RHI Entertainment Distribution the excess, if any, of the sublicensing fee over the initial program license fee paid by the Crown Media United States. Crown Media United States did not sub-license any licensed program to a third party during either of the three months ended March 31, 2006 and 2007.

Programming costs related to the RHI Entertainment Distribution program agreements were \$9.8 million and \$14.8 million for the three months ended March 31, 2006, and 2007, respectively. As of December 31, 2006, and March 31, 2007, \$18.4 million and \$8.7 million, respectively, are included in license fees payable to non-affiliates in the accompanying condensed consolidated balance sheets. Crown Media Holdings paid RHI Entertainment Distribution \$7.4 million and \$21.1 million for license fees during the three months ended March 31, 2006 and 2007, respectively.

12. Share-Based Compensation

Crown Media Holdings has one stock option plan, the Amended and Restated Crown Media Holdings, Inc. 2000 Long Term Incentive Plan (the Plan). The Plan covers three types of share-based compensation: Stock Options, Restricted Stock Units (RSU) and Share Appreciation Rights (SAR) that are subject to SFAS 123R. Compensation cost for stock options issued to employees represented the excess of the quoted market price of the Company's stock at the measurement date of the grant over the exercise price of the option.

Stock-Based Compensation

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We currently use the Black-Scholes option pricing model to determine the fair value of stock options. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends.

We estimate the expected term of options granted by taking the average of the vesting term and the contractual term of the option. We estimate the expected volatility of our common stock by using historical volatility. We base the risk-free interest rate that we use in the option valuation model on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on the options. We do not anticipate paying any cash dividends in the foreseeable future and therefore use an expected dividend yield of zero in the option valuation model. We are required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. The fair value of all stock-based payment awards is amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods.

The Company recorded a \$1.9 million compensation benefit related to restricted stock units and \$6,000 compensation expense related to stock options for the three months ended March 31, 2006, on our condensed consolidated statement of operations as a component of selling, general and administrative expense.

During the three months ended March 31, 2007, the Company recorded \$1.4 million of compensation expense associated with the Employment and Performance RSUs which has been included in selling, general and administrative expense in the accompanying condensed consolidated statements of operations

As of March 31, 2007, there was no unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock options granted to our employees. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

Stock Option Information

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A summary of the status of Crown Stock Option Plan at March 31, 2007, and changes during the period then ended is presented below:

	Shares (in thousands)	Exercise Price Per Option	Weighted- Average Exercise Price Per Option	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance, December 31, 2005	867		\$ 10.42		
Options forfeited	(57)	\$ 8.94 - 17.45	\$ 12.89		
Balance, December 31, 2006	810		\$ 10.24	2.09	\$ 0.00
Options forfeited	(450)	\$ 9.10	\$ 9.10		
Balance, March 31, 2007	360		\$ 11.67	4.24	\$ 0.00
Exercisable	360		\$ 11.67	4.24	\$ 0.00

Range of Exercise Prices Per Option	Options Outstanding		Weighted Average Exercise Price Per Option	Options Exercisable	
	Shares Outstanding (In thousands)	Weighted Average Remaining Contractual Life (In years)		Exercisable Shares (In thousands)	Weighted Average Exercise Price Per Option
\$6.30 - 10.50	67	2.9	\$ 9.09	67	\$ 9.09
\$10.51 - 12.60	235	4.8	\$ 11.47	235	\$ 11.47
\$12.61 - 14.70	24	3.1	\$ 14.00	24	\$ 14.00
\$14.71 - 21.00	34	4.0	\$ 16.52	34	\$ 16.52
	360			360	

Restricted Stock Unit Information

The Company's restricted stock units (RSUs) vest based on employment, performance and market conditions. Certain RSUs vest either in one-third increments on the anniversary of the grant date in each of the three years following the grant or all at one time on the third year anniversary of the grant date, in both cases based on continuing employment (Employment RSUs). Other RSUs granted prior to 2006 vest on the third anniversary date of the grant date, provided that the price of the Company's Class A common stock is at least \$14 or higher on that date (Performance RSUs).

The Company's RSUs are settled in either common stock or cash as determined by the Company's Board of Directors. The Company has historically settled the RSUs in cash, and considering such past practices, has classified its RSUs as liability awards for accounting purposes.

In January 2006, the Company settled vested Employment RSUs to one executive for approximately \$4.4 million. In June 2006, the Company settled vested 2003 and 2004 Employment RSUs for approximately \$1.5 million in cash. In June 2006, the Company settled vested 2003 and 2004 Board of Director RSUs for approximately \$80,000 in cash. In August 2006, the Company settled vested 2005 Employment RSUs for approximately \$442,000 in cash. The Company settled the CEO's RSUs for \$203,000 in November 2005, \$165,000 in February 2006 and \$76,000 in May 2006. The CEO's Performance RSUs lapsed without vesting. In August 2006, the Company settled vested 2005 Board of Director RSUs for approximately \$34,000 in cash. Additionally, in August 2006, one executive retired, and the Company settled vested Employment RSUs for approximately \$16,000 in cash.

In August 2006, the Company's Board of Directors approved a grant of Employment and Performance RSUs to the executive officers and other employees. The Employment RSUs will vest and be settled in stock or cash on August 17, 2009, the third anniversary of the grant date, provided the individual holding the RSUs is employed by the Company on that date. Performance RSUs become eligible to vest (Achieved Performance RSUs), in the range of 150% (which results in an award of additional Performance RSUs) to 0% of the Performance RSUs, depending upon the successful renewal of specific distributor agreements within certain time periods. Sixty-five percent of the Achieved Performance RSUs will fully vest upon the signing of the renewal agreements, which the Company intends to complete by November 2007. In a second vesting, 65% to 135% (the Modifier) of the Achieved Performance RSUs (less the Achieved Performance RSUs previously vested and settled) will vest on December 31, 2008, based upon a formula using subscriber revenue achieved for a specified time period.

The Compensation Committee of the Board of Directors has the discretion to increase or decrease the Modifier by 20% and also may extend the deadlines for satisfaction of the vesting conditions in the event that a renewal of the distribution agreements is delayed for factors beyond the control of the Company.

Under the 2006 Restricted Stock Units Agreement dated October 3, 2006, the Company granted restricted stock units to the Company's CEO. The Employment RSUs will vest and be settled on the fourth anniversary of the grant date, provided the CEO is employed by the Company on that date, or upon death or disability. Performance RSUs become eligible to vest (Achieved Performance RSUs), in the range of 150% (which results in an award of additional Performance RSUs) to 0% of the Performance RSUs, depending upon the successful renewal of specific distributor agreements within certain time periods. Once the final renewal which determines the amount of the Achieved Performance RSUs has occurred, 65% of the Achieved Performance RSUs will vest and be settled. In a second vesting, 65% to 135% (the Modifier) of the Achieved Performance RSUs (less the Achieved Performance RSUs previously vested and settled) will vest and be settled on December 31, 2008, based upon a formula using subscriber revenue achieved for a specified time period.

The Company's Compensation Committee has the discretion to increase or decrease the Modifier by 20% and also may extend the deadlines for satisfaction of the vesting conditions in the event that a renewal of the distribution agreements is delayed for factors beyond the control of the Company.

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Under SFAS 123R, the fair value of the 2004 and 2005 Employment RSU grants are estimated using a Black-Scholes option pricing model. The fair value of the 2004 and 2005 Performance RSU grants are estimated at each reporting date using a Monte Carlo Lattice option pricing model. The Company applies a forfeiture rate to the RSUs as required by SFAS No. 123R.

Employment RSUs	Units	Weighted-Average Remaining Contractual Term
Nonvested Balance, December 31, 2005	1,477,343	
Units issued	579,500	
Units settled in cash	(1,009,453)	
Units forfeited	(232,423)	
Nonvested Balance, December 31, 2006	814,967	2.27
Nonvested Balance, March 31, 2007	814,967	2.02

The closing price of a share of our common stock was \$6.34 on March 31, 2006, and was \$3.63 on December 31, 2006. The closing price of a share of our common stock was \$5.33 on March 31, 2007.

Performance RSUs	Units	Weighted-Average Remaining Contractual Term
Nonvested Balance, December 31, 2005	688,500	
Units issued	990,500	
Units forfeited	(374,300)	
Nonvested Balance, December 31, 2006	1,304,700	1.25
Nonvested Balance, March 31, 2007	1,304,700	1.01

At December 31, 2006, the 2004 Performance RSUs were valued at \$0.00 per unit and the 2005 Performance RSUs were valued at \$0.12 per unit. At March 31, 2007, the 2004 Performance RSUs were valued at \$0.00 per unit and the 2005 Performance RSUs were valued at \$0.58 per unit. The chief executive officer Performance grant expired in May 2006. Valuation of these Performance RSU grants is based upon market conditions.

The following table includes assumptions used to value the Performance RSUs at December 31, 2006.

	2004 Grant	2005 Grant		
Expected volatility	40.80	% 47.20	%	
Expected dividends	0	0		
Expected Term (in years)	0.41	1.63		
Risk-free rate	5.09	% 4.82	%	

The following table includes assumptions used to value the Performance RSUs at March 31, 2007.

	2004 Grant	2005 Grant		
Expected volatility	43.29	% 50.98	%	
Expected dividends	0	0		
Expected Term (in years)	0.16	1.38		
Risk-free rate	5.06	% 4.74	%	

Under SFAS 123R, the fair value of each 2006 Employment and Performance RSU grant is estimated using the fair value of \$3.63 based upon the closing price of a share of our common stock as of the December 31, 2006, reporting date. Under SFAS 123R, the fair value of each 2006 Employment and Performance RSU grant is estimated using the fair value of \$5.33 based upon the closing price of a share of

our common stock as of the March 31, 2007, reporting date. Valuation of the 2006 Employment RSUs is based solely on a service condition. Valuation of the 2006 Performance RSUs is based upon a service condition and a performance condition.

In connection with the adoption of SFAS 123R, we recorded total compensation costs related to RSUs granted under the Plan of \$2.1 million as a cumulative catch-up adjustment during the year ended December 31, 2006. Prior to January 1, 2006, the Performance RSUs were not recorded on the Company's financial statements as a liability, as it was not deemed probable that these units would be settled based on the performance of the Company's common stock. Additionally, the Company did not account for forfeitures. Commencing in 2006, the Company established a liability for the fair market value of the Performance RSUs based on an option-pricing model. Further, the Performance RSUs are reviewed quarterly for changes in the fair market value.

Board of Directors RSUs	Units	Weighted-Average Remaining Contractual Term
Nonvested Balance, December 31, 2005	32,468	
Units issued	103,549	
Units settled in cash	(28,710))
Units forfeited	(26,157))
Nonvested Balance, December 31, 2006	81,150	2.32
Nonvested Balance, March 31, 2007	81,150	2.08

Chief Executive Officer (CEO) Share Appreciation Rights Agreement

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Under Share Appreciation Rights Agreement dated October 3, 2006, the Company has agreed to grant stock appreciation rights (SARs) to the CEO upon occurrence of certain events. The value of each SAR corresponds to the value of one share of Class A common stock and will be settled at the Company's discretion in Class A common stock or cash. SARs will be granted during the term of employment the day after the fair market value of the Company's stock reaches the threshold price and stays at the threshold price or higher for 60 consecutive calendar days. SARs will then be granted each time that the fair market value of the Company's stock increases another incremental five dollars over the previous price at which a SAR grant was triggered and stays at such price or higher for 60 consecutive calendar days. Upon the occurrence of each event which triggers a SAR grant, the CEO will be granted that number of SARs with a value equal to 0.8% of the Enterprise Growth as of the grant date divided by the triggering Company stock price. Enterprise Growth equals the increase in market capitalization (compared to the market capitalization based on the Start Price or the last price triggering a grant of an SAR), adjusted upward or downward by the amount of debt incurred or paid down since the Start Date or last trigger date, as applicable. Threshold price shall mean the average of the fair market value for the 5 business days prior to the date of announcement of the CEO's employment (i.e., October 4, 2006) (Start Price) plus five dollars.

In the event of a change in control of the Company, then as of the change in control, (i) if there has been no prior SAR trigger and the change in control price (price of the Company's stock less transaction costs and certain other amounts) exceeds the Start Price, then the CEO shall be granted that number of SARs equal to 0.8% of the Enterprise Growth divided by the change in control price; or (ii) if there has been a previous SAR trigger and the change in control price exceeds the previous SAR trigger, then the CEO shall be granted that number of SARs equal to 0.8% of the Enterprise Growth divided by the change in control price. If the CEO's employment is terminated without cause by the Company or by him for good reason or because of his death or disability, and if a change in control occurs within 90 days after the termination of employment or an agreement that will result in a change of control is executed prior to the termination and the change of control occurs within 180 days after the termination, the CEO will receive a grant of SARs on the basis described above.

SARs will vest upon the earlier of (i) 3 years of employment after the grant date, (ii) termination of employment without cause by the Company, (iii) termination by the CEO for good reason or (iv) upon a change in control of the Company. The Company at its discretion may settle SARs in cash or in stock.

The fair value of the CEO's SAR grant is estimated at each reporting date using a Monte Carlo Lattice option pricing model. At December 31, 2006, and the CEO's SARs were valued at \$872,616 using the closing price of a share of our common stock on December 31, 2006, of \$3.63. At March 31, 2007, and the CEO's SARs were valued at \$2.0 million using the closing price of a share of our common stock on March 31, 2007, of \$5.33. Valuation of this SAR grant is based upon market and service conditions. The Company recorded \$59,000 in compensation expense related to SARs for the year ended December 31, 2006, on our consolidated statement of operations as a component of selling, general and administrative expense. The Company recorded \$236,000 in compensation expense related to SARs for the three months ended March 31, 2007, on our statement of operations as a component of selling, general and administrative expense. The SARs have been recorded in accounts payable and accrued liabilities in the accompanying consolidated balance sheet for the year ended December 31, 2006.

The following table includes assumptions used to value the SARs at December 31, 2006.

Expected volatility	46.91	%
Expected dividends	0	
Expected Term (in years)	3.56	
Risk-free rate	4.72	%
Average Number of SARs granted	240,390	

The following table includes assumptions used to value the SARs at March 31, 2007.

Expected volatility	40.71	%
Expected dividends	0	
Expected Term (in years)	3.25	
Risk-free rate	4.54	%
Average Number of SARs granted	369,409	

13. Employee Benefits

Deferred Compensation Plans

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The Company sponsors a deferred compensation plan for its management. Participants in this plan earn interest on their deferred compensation. Related liabilities of \$3.3 million and \$2.4 million at December 31, 2006, and March 31, 2007, respectively, are included in the accompanying condensed consolidated balance sheets among short and long-term accrued liabilities. The Company suspended this plan for 2006 and no deferral of employee compensation earned was allowed in 2006. The Company continued to pay interest on amounts deferred in previous years and paid out these amounts in accordance with the terms of the plan. The Company reactivated the plan in 2007.

The Company also sponsors a deferred compensation plan for its Board of Directors. Participants in this plan earn interest on their deferred compensation. Related liabilities of \$589,000 and \$292,000 at December 31, 2006, and March 31, 2007, respectively, are included in the accompanying condensed consolidated balance sheets among short and long-term accrued liabilities. The Company suspended this plan for 2006 and no deferral of director compensation earned was allowed in 2006. The Company continued to pay interest on amounts deferred in previous years and paid out these amounts in accordance with the terms of the plan. The Company reactivated this plan in 2007.

14. Customer and Segment Information

The Company's continuing operations are currently organized into one operating segment, the domestic channels. Five of our distributors each accounted for more than 10% of our condensed consolidated subscriber revenue for both the three months ended March 31, 2006 and 2007, and together accounted for a total of 90% and 92% of consolidated subscriber revenue for those periods, respectively. Three of our distributors each accounted for more than 15% of our consolidated subscribers for both the three months ended March 31, 2006 and 2007, and together accounted for 60% and 66% of our subscribers on those dates, respectively.

16. Commitments and Contingencies

In the normal course of business, the Company has entered into agreements that commit it to make cash payments in future periods with respect to non-cancelable leases and programming contracts.

In accordance with the Purchase and Sale Agreement dated February 23, 2005, Sparrowhawk Media Limited has made several warranty and indemnity claims against the Company of approximately \$2.0 million. The Company recorded an accrual related to this claim during the year ended December 31, 2006, which is included in accounts payable and accrued liabilities in the accompanying condensed consolidated balance sheet. The Company estimated that it may be liable within the range of \$500,000 to \$1.0 million related to these claims at both December 31, 2006, and March 31, 2007.

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

The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Description of Business and Overview

Current Business

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Crown Media Holdings, Inc. (Crown Media Holdings, Crown Media or the Company), through its subsidiary, owns and operates pay television channels (collectively the Hallmark Channel, the Hallmark Movie Channel, the channel or collectively the channels) dedicated to high-quality entertainment programming for adults and families, in the United States.

With 76.0 million subscribers (as provided by Nielsen Research) in the United States at March 31, 2007, the Hallmark Channel is the 39th most widely distributed advertising-supported cable channel in the United States. For the first quarter of 2007, the Hallmark Channel finished the quarter as the 11th highest rated advertising-supported cable channel for total day ratings and the 8th highest rated advertising-supported cable channel in prime time as measured by Nielsen Research.

The Hallmark Movie Channel focuses on movies and mini-series. It will generate advertising revenue in 2007, and as distribution continues to expand, the financial contribution of the Hallmark Movie Channel may grow. The Hallmark Movie Channel is operated through Crown Media Holdings existing infrastructure at a small incremental cost, which will increase since we have completed the sale of our domestic film library and will need to acquire more third-party programming for the Hallmark Movie Channel.

26

Current Challenges

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The Hallmark Channel faces numerous operating challenges. Among them are maintaining and expanding the distribution of the channels, broadening viewership demographics and improving viewership ratings, and increasing advertising sales revenue.

Distribution agreements are important because they affect our number of subscribers, which in turn has a major impact on our subscriber fees, the number of persons viewing our programming, and the rates charged for advertising. The current and long-term distribution challenges are renewing our distribution arrangements with the multiple system operators as they expire. Our major distribution agreements have terms which expire at various times through February 2012. Agreements which provide approximately two-thirds of our subscriber base at April 30, 2007, will expire and be the subject of renewal negotiations on or prior to December 31, 2007. While the economics of the renewals and potential cash incentive payments are unknown and could have a significant impact on our business, we believe that the ratings success of the Hallmark Channel and the positive family-friendly environment we have created with our programming schedule will assist us in our renewal discussions. Any renewals of these distribution agreements may also be significant as to whether we are able to maintain or increase our subscriber fees. Since January 1, 2007, the Company has renewed its agreements with three major distributors, accounting for 19% of our subscriber base at April 30, 2007. As previously announced, one of those renewal agreements was a multi-year agreement in March 2007 with EchoStar Communication Corporation that provides for a repositioning of the Hallmark Channel on the DISH Network, resulting in an addition of approximately 5.7 million Nielsen subscribers in April 2007, and for carrying the Hallmark Movie Channel on a package of the DISH Network, increasing distribution of that Channel by more than 4.0 million subscribers.

Our agreements with major distributors contain most favored nations clauses. These clauses typically provide that, in the event we enter into an agreement with another distributor on more favorable terms, these terms must be offered to the distributor, subject to various exceptions and conditions. These clauses cover matters such as subscriber fees, launch support, local advertising time and other financial and operating provisions. We take these provisions into account when renewing agreements.

Domestic telephone companies are entering the business of distributing television channels to households through their wire-lines. We have reached agreements with several telephone companies and cooperatives of telephone companies, which permit the carriage of the Hallmark Channel and the Hallmark Movie Channel, and are negotiating with others. We expect that subscribers to these telephone services will in large part be customers previously served by cable and satellite television companies, which continue to carry our programming. To date, subscribers and revenues through telephone companies have not been significant.

Three factors have contributed to the ratings improvements of the Hallmark Channel: acquired series and movies, original productions and marketing. Acquired series such as *Little House on the Prairie*, *Walker, Texas Ranger* and *M*A*S*H* have consistently delivered strong ratings across all day-parts. Original productions are our most high profile programs and generate the channel's highest ratings. Original productions are significant in helping our distribution and advertising sales teams sell the channel. Substantially all of our original programming has in the past been provided by RHI Entertainment, but in the future, we will acquire some of this programming from other producers. The Company typically incurs additional marketing expenses surrounding original productions and certain acquired movies.

We have extended our program license for *M*A*S*H*; however, commencing January 1, 2007, our rights became non-exclusive in cable television and we may only broadcast the series from 8 a.m. to 8 p.m. Previously, *M*A*S*H* has been aired on the Hallmark Channel during primetime on an exclusive basis. This change was made for cost savings. Beginning in the fourth quarter of 2006, we filled the late night programming position previously occupied by *M*A*S*H* with two-hour movies. To date, the ratings from this day part have not been significantly different from the ratings received when *M*A*S*H* filled this programming position.

To continue the ratings growth and enhance the demographics of our viewers, including attracting a younger audience, the Hallmark Channel must continue to invest in programming and marketing.

Delivering strong ratings growth to larger audiences has made it possible for our advertising sales to grow rapidly over the last few years. To advertisers, the Hallmark Channel offers a strong brand, positive environment and family friendly programming with a successful growth pattern. These characteristics have enabled the channel to sell to a broader range of advertisers, including those in the packaged goods and pharmaceutical industries.

We sold approximately 46% of our inventory for advertising on our Channels in the upfront market (generally sales in June, July and August for the last quarter of 2006 and the first three quarters of 2007), compared to 50% to 55% sold in the 2005 upfront market. We were able to achieve significant increases in our CPMs in the 2006 upfront market compared to the 2005 upfront market. The balance of advertising inventory has been made available in the scatter market, which in the past and in the first quarter of 2007 has yielded higher advertising rates than the upfront market.

Revenue from Continuing Operations

Our revenue consists of subscriber fees and advertising.

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 past, we have paid certain television distributors up-front subscriber acquisition fees to carry our channel. 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 among our distributors for many reasons, including the following:

- 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 and length of the contract term.

We are in continuous negotiations with our existing distributors to increase our subscriber base in order to enhance our advertising results. We have been subject to requests by major 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. 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. We believe that the need for these free carriage periods, payments for additional subscribers and similar concessions may diminish as the Hallmark Channel becomes more fully distributed. As we continue our efforts to renew our distribution agreements, however, subscriber fee revenues could be negatively affected by our distributors' emphasis on reducing their programming costs and moving programming services and subscribers to digital distribution systems. During the distributor's transition from analog to digital distribution systems, short-term subscriber losses could occur.

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; instead, we 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, the size of such distributors, and the program tiers on which our channel is carried by these distributors. From time to time, we experience decreases in the number of subscribers as promotional periods end or the Hallmark Channel is moved from analog to digital carriage or as a distribution agreement is amended or terminated by us or the distributor.

Advertising

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. We commit to provide advertisers certain rating (numbers of viewers and demographics) 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. Advertising rates also vary by time of year due to seasonal changes in television viewership.

Film Asset License Fees

Prior to our sale of Crown Media Distribution in December 2006, we generated revenue from film assets by granting licenses to third parties to exhibit the films in the United States. We also used the films as programming for the Hallmark Channel and the Hallmark Movie Channel. Customers for our film assets consisted of other television channels, home video distributors and brokers who resell rights to our film assets. License fees for our film assets were generally negotiated based, among other things, upon the size of the potential audience which will be viewing the programming and the term of the license.

Cost of Services

Our cost of services has consisted primarily of program license fees; subscriber acquisition fee expense; the cost of signal distribution; administration, 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 and improve our programming, marketing, and promotion to support our advertising strategy.

Critical Accounting Policies, Judgments and 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 further information regarding our critical accounting policies, judgments and estimates, please see the Notes to Unaudited Condensed Consolidated Financial Statements contained in Item 1 of this Report and *Critical Accounting Policies, Judgments and Estimates* in Item 7 of the Company's Annual Report on Form 10-K for the year ended December 31, 2006, as filed with the SEC.

Effects of Transactions with Related and Certain Other Parties

In 2007 and in prior years, we entered into a number of significant transactions with Hallmark Cards and its subsidiaries. These transactions include, among other things, programming, trademark licenses, administrative services, a line of credit, a tax sharing agreement, the issuance of four promissory notes and a waiver agreement. For information regarding such transactions and transactions with other related parties, please see *Effects of Transactions with Related and Certain Other Parties* in Item 7 of the Company's Annual Report on Form 10-K for the year ended December 31, 2006, filed with the SEC and Notes 8 and 9 of Notes to Unaudited Condensed Consolidated Financial Statements contained in Item 1 of this Report.

Selected Historical Consolidated Financial Data of Crown Media Holdings

In the table below, we provide selected historical condensed consolidated financial and other data of Crown Media Holdings and its subsidiaries. The following selected condensed consolidated statement of operations data for three months ended March 31, 2006 and 2007, are derived from the unaudited financial statements of Crown Media Holdings and its subsidiaries (except ratings and subscriber information). This data should be read together with the condensed consolidated financial statements and related notes included elsewhere in this Form 10-Q.

	Three Months Ended March 31,		Percent Change	
	2006	2007	2007 vs.	2006
Revenues:				
Subscriber fees	\$ 6,232	\$ 7,495	20	%
Advertising	38,393	45,998	20	%
Film asset license fees	270		-100	%
Sublicense fees and other revenue	78	79	1	%
Total revenues	44,973	53,572	19	%
Cost of Services:				
Programming costs	33,593	39,692	18	%
Amortization of film assets	8,864		-100	%
Subscriber acquisition fee amortization	7,790	7,848	1	%
Operating costs	4,130	3,237	-22	%
Total cost of services	54,377	50,777	-7	%
Selling, general and administrative expense	9,909	14,690	48	%
Marketing expense	4,257	4,212	-1	%
Loss from continuing operations before interest expense	(23,570)	(16,107)	-32	%
Interest expense	(21,703)	(24,101)	11	%
Loss from continuing operations	(45,273)	(40,208)	-11	%
Gain (loss) on sale of discontinued operations	162		-100	%
Cumulative effect of change in accounting principal	(2,099)		100	%
Net loss	\$ (47,210)	\$ (40,208)	-15	%
Other Data:				
Net cash used in operating activities	\$ (20,360)	\$ (12,834)	-37	%
Capital expenditures	\$ (3)	\$ (206)	6767	%
Net cash provided by financing activities	\$ 14,966	\$ 5,838	-61	%
Total domestic day household ratings (1)(3)	0.742	0.732	-1	%
Total domestic primetime household ratings (2)(3)	1.121	1.159	3	%
Subscribers at period end	71,852	76,240	6	%

(1) 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.

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

(3) These Nielsen ratings are for the time period January 1 through March 31.

Results of Operations

Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2007

Revenue. Our revenue from continuing operations, which is comprised of subscriber fees and advertising, increased 19% to \$53.6 million for the three months ended March 31, 2007. Our 20% increase to \$7.5 million in subscriber fee revenue for the three months ended March 31, 2007, was a result of the expiration of free carriage periods during 2006 for certain of our domestic distributors and an increase in our subscriber fees. Many of our distribution deals required us to provide a period of free carriage to the cable operator. Subscriber acquisition fee expense recorded as a reduction of revenue was \$982,000 for the three months ended March 31, 2007, and \$2.2 million for the comparable period in 2006, primarily due to the renewal of distribution agreements and the resulting reversal of certain subscriber acquisition fees associated with the previous agreements during the first quarter of 2007. Subscribers have increased as a result of previously amended distribution agreements in the United States, which provided for incentives for growth in distribution.

The increase in advertising revenue to \$46.0 million for the three months ended March 31, 2007, compared to \$38.4 million for the three months ended March 31, 2006, reflects the growth in domestic subscribers and an increase in advertising rates. Generally, as we have expanded our domestic subscribers and provided higher rated programming, our advertising revenue has increased. The number of advertisers was 439 at March 31, 2007, as compared to 427 at March 31, 2006.

Among the 69 ad-supported cable channels in the United States market, the Hallmark Channel ranked 11th in total day with a 0.732 household rating for the three months ending March 31, 2007 and 8th for primetime with a 1.159 household rating for the same period based on Nielsen ratings. This ratings performance is significant, particularly because the Hallmark Channel is not a fully distributed network. Most of the channels that rate above the Hallmark Channel have higher levels of distribution.

Revenue from the sale of our film assets totaled \$0 for the three months ended March 31, 2007, compared with \$270,000 for the comparable period in 2006. The Company sold its film assets in December 2006.

Cost of services. Cost of services as a percent of revenue decreased to 95% in 2007, as compared to 121% in 2006. This decrease was primarily due to changes in our cost of services as explained below.

Total programming costs for the three months ended March 31, 2007, increased 18% due directly to the expensing (instead of amortizing over a period of time) of certain NICC programming, higher amortization of more original programs produced to air on the Hallmark Channel in the current period as compared to the prior period, and \$1.7 million in write-offs of certain programming during the first quarter of 2007. The \$8.9 million decrease in amortization of film assets was primarily due to the sale of our film assets in December 2006.

The Company's bad debt expense was \$916,000 for the three months ended March 31, 2006, as compared to the Company's bad debt expense of \$330,000 for the three months ended March 31, 2007. This decrease in bad debt expense was due to the Company's increased collection efforts in 2007.

Subscriber acquisition fee amortization expense results from subscriber acquisition costs incurred previously by us and amortized over the remaining life of the relevant distribution agreement.

Selling, general and administrative expense. Our selling, general and administrative expense increased 48% due to a \$3.3 million increase and a \$236,000 increase in compensation expense related to the obligations of restricted stock units and stock appreciation rights, a \$702,000 increase in other benefits expense, and a \$1.2 million increase in commissions expense, offset in part by a \$382,000 decrease in depreciation and amortization expense related to assets becoming fully depreciated. Our closing stock price was \$9.17 at December 31, 2005, \$6.34 at March 31, 2006, \$3.63 at December 31, 2006 and \$5.33 at March 31, 2007. The closing stock prices are used to value both our restricted stock units and our stock appreciation rights. Any increases/decreases in our closing stock price causes increases/decreases in our compensation expense.

Interest expense. Interest expense increased for the three months ended March 31, 2007, compared to March 31, 2006, by \$2.4 million. This increase was due to the \$2.1 million increase in interest on our \$400.0 million senior unsecured note, the \$367,000 increase in interest on our \$132.8 million note payable to Hallmark Cards affiliates, the \$868,000 increase in interest on our \$70.4 million note payable to Hallmark Cards affiliates commencing March 21, 2006, the \$326,000 increase in interest on our \$86.3 million note payable to Hallmark Cards affiliates, and offset in part by the \$1.5 million decrease in interest on our bank credit facility due to a lower principal balance. The majority of the aforementioned increases occurred due to increases in principal balances.

Loss from Continuing Operations. Loss from operations for the three months ended March 31, 2007, was \$40.2 million. Loss from continuing operations for the three months ended March 31, 2006, was \$45.3 million. Our loss from continuing operations decreased primarily due to higher advertising and subscriber revenue and the elimination of film assets amortization, partially offset by higher expenses, primarily programming and interest expenses.

Cumulative effect of change in accounting principle. On January 1, 2006, we adopted SFAS 123R. The total compensation cost related to 2004 and 2005 performance RSUs granted under the Plan net of estimated forfeitures was \$2.1 million, which was recorded as a cumulative catch-up adjustment during the three months ended March 31, 2006. Under prior accounting treatment, the performance RSUs were not classified as a liability as it was deemed improbable that these RSUs would settle based upon the performance of our Class A common stock.

Liquidity and Capital Resources

Cash used in operating activities from continuing operations was \$20.4 million and \$12.8 million for the three months ended March 31, 2006 and 2007. Loss from operations for the three months ended March 31, 2006 and 2007, was \$45.3 million and \$40.2 million, respectively. During the three months ended March 31, 2006, the Company made payments of \$8.0 million for subscriber acquisition fees. During the three months ended March 31, 2007, the Company made payments of \$57,000 for subscriber acquisition fees.

Cash used in investing activities was \$4.0 million and \$1.2 million for the three months ended March 31, 2006 and 2007, respectively. During the three months ended March 31, 2006, the Company made payments to the buyer of the international business of \$4.0 million. During the three months ended March 31, 2007, the Company made payments to the buyer of the international business of \$977,000.

Cash provided by financing activities was \$15.0 million and \$5.8 million for the three months ended March 31, 2006 and 2007, respectively. During the three months ended March 31, 2006 and 2007, we received proceeds of \$5.0 million and \$0, respectively, from our tax sharing agreement with Hallmark Cards. We borrowed \$10.0 million and \$6.0 million under our credit facility to cover the cash we used in operating and investing activities during the three months ended March 31, 2006 and 2007, respectively.

Cash Flows

As of March 31, 2007, the Company had \$5.8 million in cash and cash equivalents on hand. As of March 31, 2007, the Company had borrowed \$93.6 million from a \$130.0 million revolving bank credit facility, which matures May 31, 2008.

The Company's principal sources of funds are cash on hand, cash generated by operations, tax sharing payments from Hallmark Cards and amounts available under the Company's revolving bank credit facility. Payments under the tax sharing agreement are affected by Hallmark Cards tax position and its ability to utilize the Company's tax losses. The Company received \$12.0 million in tax sharing payments in 2006 and does not currently expect to receive tax sharing payments during 2007. The Company currently has \$36.4 million of unused revolving credit capacity. The Company's ability to borrow additional amounts under the credit facility is not limited or restricted as long as no covenants have been violated. We are in compliance with all of our debt covenants at March 31, 2007.

The sufficiency of the existing sources of liquidity to fund the Company's operations is dependent upon continued growth in subscriber revenue and advertising revenue. Any decline in the popularity of the Hallmark Channel, any significant future adverse modifications to the Company's distribution agreements, an economic decline in the advertising market, an increase in program acquisition costs, an increase in competition or other adverse operating conditions would negatively impact the Company's liquidity and its ability to fund the current level of operations.

The Company expects to continue making investments in programming, marketing and distribution. However, the Company's recurring loss situation has demanded that all areas of expenses, including programming, marketing and distribution be closely monitored and controlled.

The Company anticipates that its principal uses of funds for 2007 will continue to include the payment of operating expenses, accounts payable and accrued expenses, license fees for programming, and interest under its bank credit facility.

The Company currently believes that cash on hand, cash generated by operations and borrowing availability under its bank credit facility, when combined with the deferral of any required payments on related-party debt and related interest mentioned below, will be sufficient to fund the Company's operations and meet its liquidity needs through May 31, 2008.

The Company intends to extend or refinance the Bank credit facility prior to or upon its maturity. Any such extension or refinancing might require a continuation of a letter of credit from Hallmark Cards or other steps by the Company and, thus, is not assured. If the Company is not able to arrange for the extension, refinancing or replacement of the bank credit facility prior to its maturity and either (1) the bank draws down on the irrevocable letter of credit provided by Hallmark Cards in support of the bank credit facility or (2) Hallmark Cards purchases the interests of the lending banks, Hallmark Cards would have all obligations and rights of the lending banks under the bank credit facility. In that event, Hallmark Cards could demand payment of outstanding amounts at any time after May 31, 2008, under the terms of the waiver and standby purchase agreement (*Waiver Agreement*) described below.

Upon maturity of the credit facility on May 31, 2008, the lending group led by JP Morgan Chase has the right to elect to forego the receipt of cash to pay the principal amount of the credit facility in full, which is provided for under the terms of an irrevocable letter of credit provided by Hallmark Cards, but instead can elect to initiate a process to foreclose on the Company's assets. Such foreclosure proceedings, would adversely affect our ability to continue our operations. Prior to any such possible foreclosure proceedings, however, the Company, if it has not secured an extension of the credit facility or alternative financing, would cause Hallmark Cards pursuant to the terms of the *Waiver Agreement* to exercise its option to purchase all of the outstanding indebtedness under the credit facility and the credit facility would then be subject to terms of the *Waiver Agreement*.

Due to the Company's possible inability to meet its obligations when they come due on May 31, 2008, the Company anticipates that prior to May 31, 2008, it will be necessary to either extend or refinance (i) the bank credit facility and (ii) the promissory notes payable to affiliates of Hallmark Cards described in the Notes below. As part of a combination of actions and in order to obtain additional funding, the Company may consider various alternatives, including refinancing the bank credit facility, raising additional capital through the issuance of equity or debt securities, a sale of certain assets or other strategic alternatives.

Bank Credit Facility, HC Crown Loans, and Tax Sharing Agreement

For information regarding our Bank Credit Facility, HC Crown Loans and Tax Sharing Agreement, please see *Bank Credit Facility, HC Crown Loans, and Tax Sharing Agreement* of the Company's Annual Report on Form 10-K for the year ended December 31, 2006, as filed with the SEC and Notes 7, 8 and 9 of Notes to Unaudited Condensed Consolidated Financial Statements contained in Item 1 of this Report.

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 in this Report below and in the Company's filings with the Securities and Exchange Commission, including the Risk Factors stated in the Company's Annual Report on Form 10-K for the year ended December 31, 2006. Such Risk Factors include, but are not limited to, the following: competition for distribution of channels, viewers, advertisers and the acquisition of programming; fluctuations in the availability of programming; fluctuations in demand for programming which we air on our channels; our ability to address our liquidity needs; our incurrence of losses; and our substantial indebtedness affecting our financial condition and results.

Stated below are certain Risk Factors which contain significant changes from those stated in the Company's Annual Report on Form 10-K for the year ended December 31, 2006. Crown Media Holdings will not update any forward-looking statements contained in that Form 10-K to reflect future events or developments.

If we do not successfully address the risks described below and in our prior Reports mentioned above, 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 liquidity is dependent on external funds.

Because we currently operate at a loss, we may have a negative cash flow and 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 such additional 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.

Further, as discussed in this Report under "Liquidity and Capital Resources" above, we need to (1) extend, refinance or replace our bank line of credit on or prior to May 31, 2008, or to extend or replace borrowings from Hallmark Cards by May 31, 2008, that would result from the banks drawing upon the irrevocable letter of credit supporting the bank credit facility, and (2) extend or refinance outstanding notes payables to Hallmark Cards and its subsidiaries on or prior to May 31, 2008.

Upon maturity of the credit facility on May 31, 2008, the lending group led by JP Morgan Chase has the right to elect to forego the receipt of cash to pay the principal amount of the credit facility in full, which is provided for under the terms of an irrevocable letter of credit provided by Hallmark Cards, but instead can elect to initiate a process to foreclose on the Company's assets. Such foreclosure proceedings, which we view as a remote possibility, could affect our ability to continue our operations. Prior to any such possible foreclosure proceedings, the Company would consider various alternatives as indicated above. The Company could also cause Hallmark Cards, pursuant to the terms of the Waiver Agreement, to exercise its option to purchase all of the outstanding indebtedness under the credit agreement. The credit facility would then be subject to Hallmark Cards agreement not to demand payment prior to May 31, 2008.

Available Information

We will make available free of charge through our website, www.hallmarkchannel.com, the Annual Report, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and amendments to such reports, as soon as reasonably practicable after we electronically file or furnish such material with the Securities and Exchange Commission.

Additionally, we will make available, free of charge upon request, a copy of our Code of Business Conduct and Ethics, which is applicable to all of our employees, including our senior financial officers. Requests for a copy of this code should be addressed to the General Counsel at 12700 Ventura Boulevard, Studio City, California 91604.

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 interest rates increase. If market interest rates were to increase immediately and uniformly by 10% from levels as of March 31, 2007, the decline of the fair value of the fixed income portfolio would not be material.

As of March 31, 2007, our cash, cash equivalents and short-term investments had a fair value of \$5.8 million, which were 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 March 31, 2007, 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 months ended March 31, 2007, 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 March 31, 2007, 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. 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 or equity investment prices.

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 \$5.8 million, or less than 1% of total assets, as of March 31, 2007. Our material liabilities subject to interest rate risk consisted of our bank credit facility, our line of credit and interest payable to HC Crown, our line of credit and interest payable to Hallmark Cards affiliate, and our note and interest payable to Hallmark Cards affiliate. The balance of those liabilities was \$392.8 million, or

31% of total liabilities, as of March 31, 2007. Net interest expense for the three months ended March 31, 2007, was \$24.1 million, 45%, 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.

If market interest rates were to increase or decrease by 1% from levels as of March 31, 2007, our interest expense for the quarter would change correspondingly by \$933,000.

Item 4. Controls and Procedures.

a. Disclosure Controls and Procedures

Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report on Form 10-Q.

b. Changes in Internal Control over Financial Reporting

There was no change in the Company's internal control over financial reporting that occurred during the quarter ended March 31, 2007, that materially affected, or was reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors

See "Risks Relating to Our Business" in Part I, Item 2 above for information on changes to risk factors.

Item 6. Exhibits

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 (File No. 000-30700; Film No. 1693331) 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).
31.1	Rule 13a-14(a) Certification executed by the Company's Acting 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.

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/ HENRY S. SCHLEIFF Henry S. Schleiff	Principal Executive Officer	May 10, 2007
By: /s/ BRIAN C. STEWART Brian C. Stewart	Principal Financial and Accounting Officer	May 10, 2007

37
