

CROWN MEDIA HOLDINGS INC  
Form 10-Q  
November 06, 2008  
[Table of Contents](#)

# 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 September 30, 2008

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.)

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, a non-accelerated filer or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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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 November 3, 2008, 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.

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Table of Contents

**TABLE OF CONTENTS**

		<b>Page</b>
<b><u>PART I</u></b>	<b><u>Financial Information</u></b>	
<u>Item 1</u>	<u>Financial Statements (Unaudited)</u>	3
	<u>CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES</u>	
	<u>Condensed Consolidated Balance Sheets December 31, 2007 and September 30, 2008</u>	3
	<u>(Unaudited)</u>	
	<u>Condensed Consolidated Statements of Operations and Comprehensive Loss (Unaudited)</u>	
	<u>- Three and Nine Months Ended September 30, 2007 and 2008</u>	5
	<u>Condensed Consolidated Statements of Cash Flows (Unaudited)</u>	
	<u>- Nine Months Ended September 30, 2007 and 2008</u>	6
	<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	7
<u>Item 2</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
<u>Item 3</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	33
<u>Item 4</u>	<u>Controls and Procedures</u>	34
<b><u>PART II</u></b>	<b><u>Other Information</u></b>	34
<u>Item 1A</u>	<u>Risk Factors</u>	34
<u>Item 6</u>	<u>Exhibits</u>	35
<u>Signatures</u>		36

Table of Contents

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 including *Crown Media United States, LLC* ( *Crown Media United States* ). The term *common stock* refers to our *Class A common stock* and *Class B common stock*, unless the context requires otherwise.

The name *Hallmark* 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, 2007	As of September 30, 2008
<b>ASSETS</b>		
Cash and cash equivalents	\$ 1,974	\$ 4,298
Accounts receivable, less allowance for doubtful accounts of \$242 and \$261, respectively	68,603	55,715
Program license fees - affiliates	166	1,055
Program license fees - non-affiliates	119,523	92,077
Prepaid and other assets	4,478	4,021
Prepaid program license fee assets	8,361	15,657
Total current assets	203,105	172,823
Program license fees - affiliates	653	8,107
Program license fees - non-affiliates	129,268	176,564
Subscriber acquisition fees, net	3,333	3,984
Property and equipment, net	15,962	15,942
Goodwill	314,033	314,033
Prepaid and other assets	9,887	7,739
Total assets	\$ 676,241	\$ 699,192

See accompanying notes to unaudited condensed consolidated financial statements.



Table of Contents**CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

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

(continued)

	As of December 31, 2007	As of September 30, 2008
<b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>		
<b>LIABILITIES:</b>		
Accounts payable and accrued liabilities	\$ 25,255	\$ 19,961
Audience deficiency reserve liability	15,620	14,438
Accrued restricted stock units	4,609	3,141
License fees payable to affiliates	1,628	1,408
License fees payable to non-affiliates	107,749	115,697
Payables to affiliates	18,951	17,253
Credit facility and interest payable	19,583	35,215
Note and interest payable to Hallmark Cards		5,915
Other current liabilities	5,979	3,813
<b>Total current liabilities</b>	<b>199,374</b>	<b>216,841</b>
Accrued liabilities	18,056	15,345
License fees payable to affiliates		7,923
License fees payable to non-affiliates	56,521	87,207
Payables to affiliates	4,041	1,869
Credit facility	50,000	
Note and interest payable to HC Crown	101,360	107,449
Note and interest payable to Hallmark Cards affiliate	57,868	61,338
Senior secured note to HC Crown, including accrued interest	621,266	669,682
Note and interest payable to Hallmark Cards affiliate	158,753	168,273
Note and interest payable to Hallmark Cards	22,075	
Company obligated mandatorily redeemable preferred interest	18,690	20,355
Other liabilities	19,232	16,920
Obligation to NICC for the repurchase of Class A common stock, extinguished without cash on January 2, 2008, per the agreement, \$.01 par value; 4,357,066 and 0 shares issued and outstanding as of December 31, 2007 and September 30, 2008, respectively	32,765	
<b>Total liabilities</b>	<b>1,360,001</b>	<b>1,373,202</b>
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS DEFICIT:</b>		
Class A common stock, \$.01 par value; 200,000,000 shares authorized; 69,760,588 and 74,117,654 shares issued and outstanding as of December 31, 2007 and September 30, 2008, respectively	698	741
Class B common stock, \$.01 par value; 120,000,000 shares authorized; 30,670,422 shares issued and outstanding as of December 31, 2007 and September 30, 2008	307	307
Paid-in capital	1,411,291	1,459,500
Accumulated deficit	(2,096,056)	(2,134,558)
<b>Total stockholders deficit</b>	<b>(683,760)</b>	<b>(674,010)</b>
<b>Total liabilities and stockholders deficit</b>	<b>\$ 676,241</b>	<b>\$ 699,192</b>

See accompanying notes to unaudited condensed consolidated financial statements.



Table of Contents**CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND  
COMPREHENSIVE LOSS**

(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
<b>Revenue:</b>				
Subscriber fees	\$ 7,389	\$ 14,240	\$ 21,391	\$ 42,672
Advertising	47,819	49,950	142,750	162,836
Advertising by Hallmark Cards			390	157
Other revenue	104	292	260	901
Total revenue, net	55,312	64,482	164,791	206,566
<b>Cost of Services:</b>				
Programming costs				
Affiliates	11,247	842	21,149	1,777
Non-affiliates	35,148	35,811	103,327	105,922
Amortization of film assets	(4,739)	(1,148)	(5,260)	(1,148)
Subscriber acquisition fee amortization expense	7,048		22,728	
Amortization of capital lease obligation	289	289	868	868
Other costs of services	2,933	3,318	8,193	9,802
Total cost of services	51,926	39,112	151,005	117,221
Selling, general and administrative expense	11,578	12,640	39,828	37,966
Marketing expense	3,565	4,633	11,850	13,091
Depreciation and amortization expense	377	506	1,270	1,430
(Loss) income from operations	(12,134)	7,591	(39,162)	36,858
Interest income	343	23	1,087	1,225
Interest expense	(26,086)	(25,477)	(83,672)	(76,585)
Net loss and comprehensive loss	\$ (37,877)	\$ (17,863)	\$ (121,747)	\$ (38,502)
Weighted average number of Class A and Class B shares outstanding, basic and diluted				
	104,788	104,788	104,788	104,772
Net loss per share, basic and diluted	\$ (0.36)	\$ (0.17)	\$ (1.16)	\$ (0.37)

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

	<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2008</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (121,747)	\$ (38,502)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	153,195	111,738
Accretion on company obligated mandatorily redeemable preferred interest	1,655	1,665
Provision for allowance for doubtful accounts	95	43
Residuals and participations	(5,260)	(1,052)
Impairment of film asset		176
Loss on sale of property and equipment	36	
Stock-based compensation	5,671	1,650
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(870)	12,846
Additions to program license fees	(101,576)	(135,893)
Deletions (additions) to subscriber acquisition fees	858	(2,693)
Increase in prepaid and other assets	(1,124)	(5,929)
Decrease in accounts payable, accrued and other liabilities	(1,561)	(12,343)
Increase in interest payable	70,915	66,700
(Decrease) increase in subscriber acquisition fees payable	(1,206)	1,183
Increase in license fees payable to affiliates	1,635	7,702
(Decrease) increase in license fees payable to non-affiliates	(5,208)	38,633
Increase (decrease) in payables to affiliates	1,723	(3,870)
Decrease in deferred revenue		(475)
Net cash (used in) provided by operating activities	(2,769)	41,579
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(970)	(1,772)
Payments to buyer of international business	(3,028)	(2,597)
Proceeds from disposition of property and equipment	3	
Net cash used in investing activities	(3,995)	(4,369)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Borrowings under the credit facility	7,145	18,761
Principal payments on the credit facility	(13,845)	(53,100)
Principal payments on capital lease obligations	(498)	(547)
Net cash used in financing activities	(7,198)	(34,886)
Net (decrease) increase in cash and cash equivalents	(13,962)	2,324
Cash and cash equivalents, beginning of period	13,965	1,974
Cash and cash equivalents, end of period	\$ 3	\$ 4,298
<b>Supplemental disclosure of cash and non-cash activities:</b>		
Interest paid	\$ 6,721	\$ 3,882
Reclassification of additional paid-in capital for obligation to return amounts previously received as capital contributions under tax sharing agreement	\$ 25,192	\$
Tax sharing payment from Hallmark Cards applied to note payable to Hallmark Cards	\$ 6,510	\$ 15,488
Reclassification of Redeemable Common Stock to common stock and paid-in capital	\$	\$ 32,765
Interest payable converted to principal on note payable to Hallmark Card affiliates	\$ 18,778	\$ 24,747

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

**CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**For the Three and Nine Months Ended September 30, 2007 and 2008**

**1. Business and Organization**

*Organization*

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 Channels or the channels ) 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 ).

The Company s continuing operations are currently organized into one operating segment, the domestic channels.

*Liquidity*



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As of September 30, 2008, the Company had \$4.3 million in cash and cash equivalents on hand and \$14.8 million of current borrowing capacity under the bank credit facility. Day-to-day cash disbursement requirements have typically been satisfied with cash on hand and operating cash receipts supplemented with the borrowing capacity available under the bank credit facility and forbearance by Hallmark Cards and its affiliates.

Operating activities for the year ended December 31, 2007, yielded positive cash flow as have the nine months ended September 30, 2008. However, there can be no assurance that the Company's operating activities will continue to generate positive cash flow.

The Company's principal sources of funds are cash on hand, cash generated by operations and amounts available under the Company's revolving bank credit facility through May 31, 2009. Another significant aspect of the Company's liquidity is the deferral of payments on obligations owed to Hallmark Cards and its subsidiaries. In March 2008, the Company and Hallmark Cards entered into an Amended and Restated Waiver Agreement which changed the maturity date of three obligations and deferred payments under certain obligations. Under an amendment in October 2008, the deferred payments under these obligations were extended to October 1, 2009. However, under the Waiver Agreement, interest on the 2001, 2005 and 2006 Notes that accrues from November 16, 2008, through December 31, 2008, is payable in cash in January 2009; subsequent quarterly accrued interest is payable in cash 5 days after each quarterly period. See Note 6 Related Party Long-Term Obligations Waiver and Standby Purchase Agreement.

The Waiver Agreement requires that Excess Cash Flow as defined in the Waiver Agreement be used to make payments due under the bank credit facility or to pay obligations subject to the Waiver Agreement. The Company has budgeted and anticipates that it will have substantial Excess Cash Flow for the year ended December 31, 2008 and that this amount will be used to make a reduction in the bank credit facility during the first quarter of 2009. See Note 6. However, the existence and amounts of any Excess Cash Flow depend on the Company's results and cash flow for the remainder of 2008.

The Company may incur a tax liability to Hallmark Cards in 2009 pursuant to the Tax Sharing Agreement that could result in a cash amount being payable to Hallmark Cards in the second quarter of 2009 unless Hallmark Cards agrees to defer any such tax liability. Additionally, we expect to repay the remaining balance under the Tax Note before its due date of July 27, 2009, through non-cash sources. See Note 7 Related Party Transactions Tax Sharing Agreement.

The Company believes that cash on hand, cash generated by operations, and borrowing availability under its bank credit facility through May 31, 2009, when combined with the deferral of any required payments on related-party debt and related interest described under the Waiver Agreement, and, if necessary, Hallmark Cards' purchase of any outstanding indebtedness under the bank credit facility in May 2009 as described

Table of Contents

below, will be sufficient to fund the Company's operations and enable the Company to meet its liquidity needs through October 1, 2009.

In March 2008, the bank credit facility was extended to May 31, 2009, and the bank's lending commitment was reduced to \$50.0 million on September 30, 2008, at which time the Company owed \$35.2 million on the facility. The bank's commitment will decrease further to \$45.0 million on March 31, 2009. Such decrease was made in accordance with the March 2008 amendment to the bank credit facility. The Company plans to use cash flows from operations to reduce outstanding borrowings under the facility and expects this cash flow to be sufficient to maintain outstanding borrowings under the commitment levels throughout the remaining term of the facility. Accordingly, the Company's ability to comply with the scheduled reduction in the Bank credit facility and to pay any amounts outstanding upon the maturity is highly dependent upon the Company's ability to generate sufficient cash flows from operations between September 30, 2008, and May 31, 2009. See Note 5 Credit Facility.

The Company will endeavor to extend or refinance the bank credit facility prior to or upon its maturity. Any such extension or refinancing could require the continuation of a letter of credit from Hallmark Cards in support of the bank credit facility or other steps by the Company and, thus, is not assured. Upon maturity of the credit facility on May 31, 2009, if the facility has not been paid in full, renewed or replaced (1) JP Morgan Chase Bank, N.A., would have the right to draw down on Hallmark Cards' irrevocable letter of credit or (2) Hallmark Cards could purchase the interest of the lending bank in the facility. In either case, Hallmark Cards would have all the obligations and rights of the lending bank under the bank credit facility and could demand payment of outstanding amounts at any time after October 1, 2009 under the terms of the Waiver Agreement. Upon maturity of the credit facility on May 31, 2009, if not paid in full, renewed or replaced, the lending bank could forego drawing down on Hallmark Cards' irrevocable letter of credit and, alternatively, foreclose on the Company's assets. Such foreclosure proceedings would adversely affect our ability to continue our operations. However, prior to any such possible foreclosure, if the Company had not secured a refinancing of the credit facility or alternative financing, the Company would require Hallmark Cards to exercise its option, pursuant to the terms of the Waiver Agreement, to purchase all of the outstanding indebtedness under the credit facility. The amount purchased would then be subject to terms of the Waiver Agreement.

The sufficiency of the existing sources of liquidity to fund the Company's operations is dependent upon maintaining subscriber revenue at or above the amount of such revenue for the nine months ended September 30, 2008, and continuing growth in advertising revenue. A significant decline in the popularity of the Hallmark Channel, a significant economic decline in the advertising market, an increase in program acquisition costs, an increase in competition or other adverse changes in operating conditions could negatively impact the Company's liquidity and its ability to fund the current level of operations. During the second and third quarters of 2008 the Company experienced a softening of advertising rates in the direct response and scatter market. Despite the significant decline in economic conditions nationally, and within the advertising industry, these conditions did not materially impact the Company's ability to fund current and expected levels of cash needed for operations. The Company expects this softening to continue through at least the second quarter of 2009, but, similarly, does not currently expect these changing market conditions to materially impact the Company's ability to pay its obligations as they become due.

The Company's long-term obligations include notes payable to Hallmark Cards or affiliates of Hallmark Cards which are the subject of the Waiver Agreement. These obligations include Notes issued in 2001, 2005 and 2006 which mature on December 31, 2009, and amounts currently due under these notes at September 30, 2008, are \$337.0 million. Additionally, at September 30, 2008, non-interest bearing unpaid accrued service fees and unreimbursed expenses of \$14.8 million were included in payable to affiliates on the accompanying condensed consolidated balance sheet.

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Because of the Company's possible inability to meet its obligations when they come due on and after October 1, 2009 and through December 31, 2009, the Company anticipates that prior to October 1, 2009, 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. 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



Table of Contents

additional capital through the issuance of equity or debt securities, or other strategic alternatives. If the current credit market conditions continue, a refinancing could be difficult.

Upon maturity of the bank credit facility on May 31, 2009, the Company will not have a comparable credit facility. In that case, the Company would be solely dependent upon day-to-day operating cash receipts to meet its cash requirements.

***Transactions with NICC***

On October 28, 2007, NICC purportedly exercised the Put Right, described below in Note 8, by making formal demand that the Company purchase all of the 4,357,066 shares of Class A common stock owned by NICC. The Company subsequently informed NICC that exercise of the Put Right constituted a breach of a binding agreement in September 2007 whereby NICC agreed not to exercise the Put Right.

NICC proposed that its purchase demand be settled on January 4, 2008. If the Company repurchased the shares as requested, the settlement amount would have been \$32.8 million, based on the 30-day average closing price from October 8, 2007 through November 16, 2007, inclusive.

As more fully described below in Note 8, the Company and NICC signed the Modification Agreement on January 2, 2008 whereby the Company's obligation under the Put Right was immediately extinguished. The Modification Agreement also resolved a related dispute with respect to expiration or survival of a prior provision which would have required the Company to pay NICC \$15.0 million upon a change in control of the Company. Pursuant to the Modification Agreement, the Company will pay NICC a total of \$3.8 million in equal installments of \$1.3 million on each January 20 of 2008, 2009 and 2010. In addition, the Company will provide NICC with two-hours of broadcast time each Sunday morning during 2008 and 2009 at no cost to NICC. We estimate the value of the broadcast time to be \$1.5 million. Its discounted value was recorded as deferred revenue at December 31, 2007 and will be amortized to revenue ratably over NICC's two year use. The Company is also obligated to pay NICC an estimated \$3.7 million in quarterly installments at the rate of 6% of the outstanding liquidation preference of the CMUS preferred interest owned by VISN Management Corp. ( VISN ), a wholly-owned subsidiary of NICC, through December 31, 2010.

NICC has made a claim stemming from certain provisions in the 2005 NICC Agreement that had not previously been resolved. The Company has conducted extensive negotiations with NICC on this issue and expects to sign a final settlement during the fourth quarter of 2008. The Company expects that as a result of this settlement, NICC will receive full ownership of The Note, a Hallmark Channel original movie currently co-owned by NICC and the Company with the Company maintaining certain broadcast rights on its Channels. In expectation of such settlement, the Company recognized settlement expense of approximately \$500,000 during the third quarter of 2008.

***Classification of Redeemable Common Stock***



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At December 31, 2007, the Company classified 4,357,066 shares of Class A common stock and \$32.8 million associated with the purported exercise of the Put Right referred to above as redeemable common stock. The shares and related amount were reclassified to common stock and paid-in capital on January 2, 2008, in connection with the NICC Modification Agreement discussed above and in Note 8.

### **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

Table of Contents

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, 2007, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

***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.

### *Net Loss per Share*

Basic net loss per share is computed by dividing the net loss for the period by the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed based on the weighted average number of common shares and potentially dilutive common shares outstanding. The calculation of diluted net loss per share excludes potential common shares if the effect would be antidilutive. Potential common shares consist of incremental common shares issuable upon the exercise of stock options. Approximately 356,000 and 341,000 stock options for the three and nine months ended September 30, 2007 and 2008, respectively, have been excluded from the calculations of loss per share because their effect would have been anti-dilutive.

The 4,357,066 shares related to NICC's purported exercise of the Put Right have been excluded from the determination of weighted average shares outstanding through January 1, 2008.

### *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.

Five and four of our distributors each accounted for more than 10% of our consolidated subscriber revenue for both the three months ended September 30, 2007 and 2008, and together accounted for a total of 93% and 68% of consolidated subscriber revenue for those periods, respectively. Four and three of our distributors each accounted for more than 15% of our subscribers for the three months ended September 30, 2007 and 2008, and together accounted for 77% and 61% of our subscribers on those dates, respectively.

Five and four of our distributors each accounted for more than 10% of our consolidated subscriber revenue for both the nine months ended September 30, 2007 and 2008, and together accounted for a total of 92% and 68% of consolidated subscriber revenue for those periods, respectively. Four and three of our distributors each accounted for more than 15% of our subscribers for the nine months ended September 30, 2007 and 2008, and together accounted for 77% and 61% of our subscribers on those dates, respectively.

### ***Reclassifications***

Certain reclassifications have been made to conform the prior period's financial information to the current presentation.

The Company is a co-owner of The Note, which the Company intends to transfer to NICC during the fourth quarter of 2008. The portion of the film asset retained by the Company will be reclassified as a program license fee asset upon execution of an agreement with NICC. See Note 10, Commitments and Contingencies, below.



Table of Contents

*Recently Issued Accounting Pronouncements*



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In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 ( SFAS 157 ), *Fair Value Measurements*, in order to establish a single definition of fair value and a framework for measuring fair value in generally accepted accounting principles that is intended to result in increased consistency and comparability in fair value measurements. SFAS 157 also expands disclosures about fair value measurements, with the intention of improving the quality of information provided to users of financial statements. The standard applies whenever other authoritative literature requires (or permits) certain assets or liabilities to be measured at fair value, but does not expand the use of fair value.

SFAS 157 was originally effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years with early adoption permitted. In early 2008, the FASB issued Staff Position (FSP) FAS-157-2, which delayed by one year, the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The delay pertains to items including, but not limited to, non-financial assets and non-financial liabilities initially measured at fair value in a business combination, reporting units measured at fair value in the first step of evaluating goodwill for impairment under SFAS 142, *Goodwill and Other Intangible Assets*, indefinite-lived intangible assets measured at fair value for impairment assessment under SFAS 142, and long-lived assets measured at fair value for impairment assessment under SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The Company adopted the portion of SFAS 157 that has not been delayed by FSP FAS-157-2 as of January 1, 2008, and plans to adopt the balance of its provisions as of January 1, 2009.

The Company does not have balance sheet items carried at fair value on a recurring basis (to which SFAS 157 applies in 2008) such as derivative financial instruments which are valued primarily based on quoted prices in active or brokered markets for identical as well as similar assets and liabilities. Significant balance sheet items which are subject to non-recurring fair value measurements (to which SFAS 157 will apply in 2009) consist of goodwill, property and equipment, and subscriber acquisition fees. The adoption of SFAS 157 in 2008 has had no effect on the measurement of the Company's financial assets and liabilities. The Company is continuing to evaluate the impact the standard will have on the determination of fair value related to non-financial assets and non-financial liabilities in post-2008 years.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 ( SFAS 159 ), *Establishing the Fair Value Option for Financial Assets and Liabilities*. The FASB has issued SFAS 159 to permit all entities to elect, at specified election dates, to measure eligible financial instruments at fair value. An entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date, and recognize upfront costs and fees related to those items in earnings as incurred and not deferred. SFAS 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of SFAS 157. An entity is prohibited from retrospectively applying SFAS 159, unless it chooses early adoption. SFAS 159 also applies to eligible items existing at November 15, 2007 (or early adoption date). The Company adopted SFAS 159 effective January 1, 2008. The Company has not elected to measure eligible financial instruments at fair value. Accordingly, SFAS 159 has had no effect on the Company's condensed consolidated balance sheets or results of operations.

In April 2008, the FASB issued FASB Staff Position ( FSP ) No. 142-3, *Determination of the Useful Life of Intangible Assets* ( FSP 142-3 ). FSP 142-3 amends the factors to be considered in developing renewal or extension assumptions used to determine the useful life of intangible assets under SFAS No. 142, *Goodwill and Other Intangible Assets*. Its intent is to improve the consistency between the useful life of an intangible asset and the period of expected cash flows used to measure its fair value. This FSP is effective for us on January 1, 2009. The Company is still in the process of evaluating the impact FSP 142-3, but does not expect it to have a material impact on its condensed consolidated balance sheets or results of operations.

The FASB issued Statement of Financial Accounting Standards No. 162 ( SFAS 162 ), *The Hierarchy of Generally Accepted Accounting Principles*, in May 2008. This Statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in



Table of Contents

the United States (the GAAP hierarchy). This Statement will become effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The Company does not expect that the adoption of this statement will have a material effect on the Company's condensed consolidated financial statements.

In October 2008, the FASB issued Staff Position No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active* (FSP 157-3). FSP 157-3 clarifies the application of SFAS 157, which the Company adopted as of January 1, 2008, in cases where a market is not active. The Company has not elected to measure eligible financial instruments at fair value. The Company is still in the process of evaluating the impact FSP 157-3, but does not expect it to have a material impact on our condensed consolidated financial statements.

**3. Subscriber Acquisition Fees**

Subscriber acquisition fees are comprised of the following:

	As of December 31, 2007	As of September 30, 2008
	(In thousands)	
Subscriber acquisition fees, at cost	\$ 9,837	\$ 11,530
Accumulated amortization	(6,504)	(7,546)
Subscriber acquisition fees, net	\$ 3,333	\$ 3,984

*Of the net balance at September 30, 2008, the Company expects \$4.0 million will be recognized as a reduction of subscriber fee revenue in future periods.*

As of December 31, 2007, and September 30, 2008, the condensed consolidated balance sheets also reflect subscriber acquisition fees payable of \$29,000 and \$1.2 million, respectively, as a component of accounts payable and accrued liabilities. For the three months ended September 30, 2007 and 2008, the Company made cash payments of \$250,000 and \$0, respectively, relating to current subscriber acquisition fee obligations. For the nine months ended September 30, 2007 and 2008, the Company made cash payments of \$348,000 and \$1.5 million, respectively, relating to current subscriber acquisition fee obligations.

**4. Program License Fees**

Program license fees are comprised of the following:

As of December 31, 2007	As of September 30, 2008
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		(In thousands)	
Program license fees	RHI Entertainment Distribution	\$ 244,920	\$ 275,327
Program license fees	NICC	197	180
Program license fees	Hallmark Cards affiliates	918	9,818
Program license fees	other non-affiliates	297,816	267,572
Program license fees, at cost		543,851	552,897
Accumulated amortization		(294,241)	(275,094)
Program license fees, net		\$ 249,610	\$ 277,803

At December 31, 2007, and September 30, 2008, respectively, an additional \$8.4 million and \$15.7 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.

Table of Contents

License fees payable are comprised of the following:

	As of December 31, 2007	As of September 30, 2008
	(In thousands)	
License fees payable RHI Entertainment Distribution	\$ 21,427	\$ 59,284
License fees payable NICC	1,078	358
License fees payable Hallmark Cards affiliates	550	8,973
License fees payable other non-affiliates	142,843	143,620
Total license fees payable	165,898	212,235
Less current maturities	(109,377)	(117,105)
Long-term license fees payable	\$ 56,521	\$ 95,130

**5. Credit Facility**

By Amendment No. 14 in March 2008, the maturity date of the bank credit facility was extended to May 31, 2009. Under this Amendment, the amounts available under this facility have been, and will continue to be, reduced from \$130.0 million as follows:

Date	Revolving Credit Commitment	
March 10, 2008	\$	90,000,000
June 30, 2008	\$	60,000,000
September 30, 2008	\$	50,000,000
March 31, 2009	\$	45,000,000
May 31, 2009		-0-

The Company had at September 30, 2008, \$14.8 million of unused revolving credit capacity. Other than with respect to the scheduled decreases in borrowing capacity described above, 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 10, 2008. 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. 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, 2007, and September 30, 2008, the Company had outstanding borrowings of \$69.5 million and \$35.2 million, respectively, under the credit facility and there were no letters of credit outstanding. At December 31, 2007, \$69.5 million of the outstanding balance bore interest at the Eurodollar rate (5.60% at December 31, 2007) and \$0 bore interest at the JP Morgan Chase Bank prime rate. Under the credit facility, \$1.1 million bore interest at the JP Morgan Chase Bank prime rate of 7.75% for three days during September 2007. At September 30, 2008, \$35.2 million of the outstanding balance bore interest at the Eurodollar rate (4.45% at September 30, 2008) and \$0 bore interest at the JP

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Morgan Chase Bank prime rate. Under the credit facility, \$1.3 million bore interest at the JP Morgan Chase Bank prime rate (7.25%) for five days during January 2008, \$5.8 million bore such interest at 7.25% for four days in January 2008, \$2.6 million bore such interest at 6.50% for six days in January 2008, \$362,000 bore such interest at 6.00% for six days in January and February 2008, \$387,000 bore such interest at 6.00% for six days in January and February 2008, \$6.8 million bore such interest at 6.00% for six days in February 2008, and \$1.6 million bore such interest at 6.00% for four days in February 2008. Interest expense on borrowings under the credit facility for each of the three months ended September 30, 2007 and 2008, was \$1.4 million and \$389,000,



Table of Contents

respectively. Interest expense on borrowings under the credit facility for each of the nine months ended September 30, 2007 and 2008, was \$4.3 million and \$1.8 million, respectively.

*Covenants*

The credit facility, as amended, contains affirmative and negative covenants. The Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, contain a detailed description of these covenants. The Company was in compliance with these covenants at September 30, 2008.

**6. Related Party Long-Term Obligations**

*Waiver and Standby Purchase Agreement*

On March 10, 2008, the Company, Hallmark Cards and affiliates of Hallmark Cards who hold obligations of the Company entered into an Amended and Restated Waiver and Standby Purchase Agreement, which was most recently amended on October 30, 2008 to extend the waiver period (the "Waiver Agreement"). The Waiver Agreement replaced a previous version of the Waiver and Standby Purchase Agreement dated March 21, 2006 as amended through October 2007. The Waiver Agreement as amended extends to October 1, 2009 the period during which the Hallmark Cards and its affiliates will defer the payment of obligations listed below. The March 2008 agreement also included the following changes: The annual addition of interest to principal on the obligations described below (except the 10.25% Note continues to add interest semi-annually to the principal); the extension of the maturity dates of three notes (the 2001, 2005 and 2006 notes mentioned below) to December 31, 2009; fixing the interest rate of these three notes to a rate of LIBOR plus 5%, adjusted quarterly; the accrual and addition to principal of interest through November 15, 2008 on these three notes; a requirement that interest on these three notes will be payable in cash, quarterly in arrears five days after the end of each calendar quarter commencing November 16, 2008; and a change to the definition of Excess Cash Flow. As revised, the Waiver Agreement defers all payments due on any of the following obligations (the "Subject Obligations") and, except as noted above, payment of interest thereon until October 1, 2009, 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"):

- Note 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 December 31, 2007, and September 30, 2008, including accrued interest was \$101.4 million and \$107.4 million, respectively. See *Note and Interest Payable to HC Crown* below.)
- \$70.0 million note and interest payable to Hallmark Cards affiliate, dated as of March 21, 2006, arising out of the sale to Crown Media Holdings of the Hallmark Entertainment film library. (Total amount outstanding at December 31, 2007, and September 30, 2008, including accrued interest was \$57.9 million and \$61.3 million, respectively. See *Note and Interest Payable to Hallmark Cards Affiliate* below.)
- 10.25% senior secured note, dated August 5, 2003, in the initial accreted value of \$400.0 million, payable to HC Crown. (Total amount outstanding at December 31, 2007, and September 30, 2008, including accrued interest was \$621.3 million and \$669.7 million, respectively. See *Senior Secured Note* below.)

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- Note and interest payable to Hallmark Cards affiliate, dated as of October 1, 2005, in the principal amount of \$132.8 million. (Total amount outstanding at December 31, 2007, and September 30, 2008, including accrued interest was \$158.8 million and \$168.3 million, respectively. See *Note and Interest Payable to Hallmark Cards Affiliate* below.)
- Note and interest payable to Hallmark Cards in the amount of \$33.1 million, dated as of July 27, 2007. (Total amount outstanding at December 31, 2007, and September 30, 2008,

Table of Contents

including accrued interest was \$22.1 million and \$5.9 million, respectively. See *Tax Note* 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 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 and will be payable as indicated above. The Company will continue to pay interest on the bank credit facility during the Waiver Period.

The waiver termination date is October 1, 2009, 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; (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; or (f) the security agreements granted to the Hallmark parties shall not remain perfected.

Under the Waiver Agreement, if the bank lender under the bank credit facility accelerates any of the indebtedness under the bank credit facility or seeks to collect any indebtedness under it, 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 or as otherwise agreed by us against these obligations. Additionally, during the Waiver Period, Hallmark Cards is permitted to offset future tax benefits it realizes pursuant to the Tax Sharing Agreement, first against accrued and unpaid interest and then to the unpaid principal balance of the Tax Note until the earlier of such time as the balance reaches zero or the maturity date of the Tax Note.

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; 2) the net cash proceeds from the sale, transfer or release by the Company of assets outside the ordinary course of business; and 3) if positive, the consolidated net cash flow from operations calculated in the same manner (and subject to the same restrictions on selling, general and administrative expenses, capital expenditures and similar items) as Cash Flow Before Interest, Taxes (including tax sharing payments) and Principal as set forth in the Crown Media Holdings 2008 budget as approved by the Board of Directors of Crown Media Holdings and provided to the Hallmark parties. For 2009, the restrictions will be those contained in the 2009 budget to be approved by the Board of Directors of Crown Media Holdings and reasonably acceptable to the Hallmark parties. Any such Excess Cash Flow for 2008 will be used, within one business day of the determination of the amount (anticipated to be in the first quarter of 2009), to repay amounts outstanding under the bank credit facility; any Excess Cash Flow for 2008 remaining after such a payment would be applied to the Subject Obligations listed above. We expect that there will be Excess Cash Flow sufficient to make a payment on the bank credit facility but not for payments to reduce the Subject Obligations. See Note 1 Business and Organization Liquidity for additional information on the Excess Cash Flow for 2008. Similarly, any such Excess Cash Flow for 2009 will be payable to Hallmark Cards or its affiliates in the first quarter of 2010.



Table of Contents

Additionally, the Waiver Agreement contains the following covenants: (1) compliance with obligations in the loan documents for the bank credit facility; (2) execution of additional documents as necessary to implement the waiver agreement; (3) commercially reasonable efforts to refinance the obligations subject to the Waiver Period as listed above; and (4) ratification of the security interests granted to the Hallmark affiliates in personal property of the Company.

***Hallmark Letter of Credit***

Concurrent with the execution of Amendment No. 14, the existing Hallmark Cards support letter of credit was reissued by JP.Morgan in the face amount of \$90.0 million and with an expiration date of June 10, 2009. On July 1, 2008, the face amount was reduced to \$60.0 million, the amount of the bank revolving credit commitment. On October 1, 2008, the face amount was reduced to \$50.0 million, the amount of the bank revolving credit commitment.

***Senior Secured Note***

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

In accordance with the Waiver Agreement, cash payments are not required until October 1, 2009. The principal amount of the senior secured note accretes at 10.25% per annum, compounding semi-annually, to \$596.6 million at August 5, 2007. From that date, interest at 10.25% per annum was scheduled to be payable semi-annually on the accreted value of the senior note to HC Crown, but now interest accrued after October 1, 2009, will be payable semi-annually in arrears on August 5 and February 5 of each year until maturity. The note matures on August 5, 2011, and is pre-payable without penalty. At December 31, 2007, and September 30, 2008, \$621.3 million and \$669.7 million, respectively, of principal and interest were included in the senior note payable in the accompanying condensed consolidated balance sheets. The note purchase agreement for the senior note contains certain restrictive covenants which, among other things, prevent the Company from incurring any additional indebtedness, purchasing or otherwise acquiring shares of the Company's stock, investing in other parties and incurring liens on the Company's assets. As a fee for the issuance of the notes, the Company paid \$3.0 million to HC Crown, which was initially capitalized and is being amortized as additional interest expense over the term of the note payable.

***Note and Interest Payable to HC Crown***

On December 14, 2001, the Company executed a \$75.0 million promissory note with HC Crown. Due to the Waiver Agreement, the note is not due until December 31, 2009. Under the Waiver Agreement, interest on this 2001 Note accrues and is added to principal through November 15, 2008. Commencing November 16, 2008, interest will be payable in cash, quarterly in arrears five days after the end of each calendar quarter. This note is subordinate to the bank credit facility. The rate of interest under this note was equal to LIBOR plus 3% and is currently LIBOR plus 5% per annum pursuant to the March 2008 amendment to the Waiver Agreement. At December 31, 2007, and September 30, 2008, borrowings under the note were \$93.5 million and \$101.3 million, respectively. Accrued interest on the note of \$7.9 million and \$6.1 million are included in note and interest payable to HC Crown on the accompanying condensed consolidated balance sheets as of December 31, 2007, and September 30, 2008, respectively. At December 31, 2007, \$93.5 million of the outstanding balance bore interest at the Eurodollar rates of

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8.23%. At September 30, 2008, \$101.3 million of the outstanding balance bore interest at the Eurodollar rates of 7.79%. At December 31, 2007, and September 30, 2008, \$101.4 million and \$107.4 million, respectively, are each reported as note and interest payable to HC Crown on the accompanying condensed consolidated balance sheets.

### *Note and Interest Payable to Hallmark Cards Affiliate*

On October 1, 2005, the Company converted approximately \$132.8 million of its license fees payable to Hallmark affiliates to a promissory note. The rate of interest under this note was equal to LIBOR plus 3% and is currently LIBOR plus 5% per annum pursuant to the March 2008 amendment to the Waiver Agreement Pursuant to the Waiver Agreement, the promissory note is payable in full on December 31, 2009. Under the Waiver Agreement, interest on this 2005 Note accrues and is added to principal through November 15, 2008. Commencing November

Table of Contents

16, 2008, interest will be payable in cash, quarterly in arrears five days after the end of each calendar quarter. At December 31, 2007, and September 30, 2008, borrowings under the note were \$146.4 million and \$158.8 million, respectively. Accrued interest on the note of \$12.4 million and \$9.5 million is included in note and interest payable to Hallmark Cards affiliate on the accompanying condensed consolidated balance sheets as of December 31, 2007, and September 30, 2008, respectively. At December 31, 2007, \$146.4 million of the outstanding balance bore interest at the Eurodollar rates of 8.23%. At September 30, 2008, \$158.8 million of the outstanding balance bore interest at the Eurodollar rates of 7.79%. At December 31, 2007, and September 30, 2008, \$158.8 million and \$168.3 million, respectively, are each reported as note and interest payable to Hallmark Cards affiliate in the accompanying condensed consolidated balance sheets.

***Note and Interest Payable to Hallmark Cards Affiliate***

On March 21, 2006, the Company converted approximately \$70.4 million of its payable to a Hallmark Cards affiliate to a promissory note. The rate of interest under this note was equal to LIBOR plus 3% and is currently LIBOR plus 5% per annum pursuant to the March 2008 amendment to the Waiver Agreement. Pursuant to the Waiver Agreement, the promissory note is payable in full on December 31, 2009. Under the Waiver Agreement, interest on this 2006 Note accrues and is added to principal through November 15, 2008. Commencing November 16, 2008, interest will be payable in cash, quarterly in arrears five days after the end of each calendar quarter. At December 31, 2007, and September 30, 2008, borrowings under the note were \$53.4 million and \$57.9 million, respectively. Accrued interest on the note of \$4.5 million and \$3.5 million is included in note and interest payable to Hallmark Cards affiliate on the accompanying condensed consolidated balance sheet as of December 31, 2007, and September 30, 2008, respectively. At December 31, 2007, \$53.4 million of the outstanding balance bore interest at the Eurodollar rates of 8.23%. At September 30, 2008, \$57.9 million of the outstanding balance bore interest at the Eurodollar rates of 7.79%. At December 31, 2007, and September 30, 2008, \$57.9 million and \$61.3 million, respectively, are each reported as note and interest payable to Hallmark Cards affiliate in the accompanying condensed consolidated balance sheets.

***Tax Note***

On July 27, 2007, the Company replaced a payable to Hallmark Cards under the Tax Sharing Agreement with a \$33.1 million promissory note payable to Hallmark Cards due in July 2009 with interest at LIBOR plus 3% per annum (the "Tax Note"). The Tax Note may be prepaid in whole or in part with no penalty. The Company is not required to make any cash payments prior to maturity. Until the Tax Note and related interest is paid in full, Hallmark Cards will offset any future tax benefits it realizes pursuant to the Tax Sharing Agreement, first against accrued and unpaid interest and then against the unpaid principal balance. In September 2007, Hallmark Cards offset \$6.5 million against \$508,000 of accrued and unpaid interest and \$6.0 million of unpaid principal. Additionally, in September 2007, the Company recorded an additional \$85,000 charge to interest expense related to the receipt of an invoice for the actual amount owed in regard to the return of tax benefits under the Tax Sharing Agreement. In December 2007, Hallmark Cards offset \$5.7 million against \$571,000 of accrued and unpaid interest and \$5.1 million of unpaid principal. In March 2008, Hallmark Cards offset \$5.1 million against \$429,000 of accrued and unpaid interest and \$4.6 million of unpaid principal. In June 2008, Hallmark Cards offset \$5.1 million against \$233,000 of accrued and unpaid interest and \$4.8 million of unpaid principal. In September 2008, Hallmark Cards offset \$5.3 million against \$164,000 of accrued and unpaid interest and \$5.2 million of unpaid principal.

On April 14, 2008, the Internal Revenue Service refunded to Hallmark Cards a portion of the interest previously paid in connection with the disallowance of certain net operating losses. In July 2008, Hallmark Cards notified the Company that they had reduced the Company's indebtedness as of April 14, 2008, under the Tax Note by \$1.5 million in consideration of the Company's applicable portion of such refund. Accordingly, the Company reduced interest expense during the three months ended June 30, 2008.

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At December 31, 2007, and September 30, 2008, interest was paid to the respective balance sheet dates. At December 31, 2007, \$22.1 million of the outstanding balance bore interest at the Eurodollar rates of 8.23%. At September 30, 2008, \$5.9 million of the outstanding balance bore interest at the Eurodollar rates of 5.79%. At December 31, 2007, and September 30, 2008, borrowings under the note were \$22.1 million and \$5.9 million, respectively, and are each reported as note and interest payable to Hallmark Cards in the accompanying condensed consolidated balance sheets.



Table of Contents

The Tax Note and all payments thereunder are subordinated to the bank credit facility extended to the Company by JP Morgan Chase Bank.

***Interest Paid to HC Crown***

Interest expense paid to HC Crown was \$457,000 for the three months ended September 30, 2007, and \$241,000 for the three months ended September 30, 2008. Interest expense paid to HC Crown was \$1.4 million for the nine months ended September 30, 2007, and \$953,000 for the nine months ended September 30, 2008.

***Related Party Long-Term Obligations***

The aggregate maturities of related party long-term debt for each of the five years subsequent to September 30, 2008, are as follows:

	Total	2008	Payments Due by Period		2011	2012
			2009	2010		
			(In thousands)			
Note and interest payable to HC Crown, with principal due December 31, 2009	\$ 107,449	\$	\$ 107,449	\$	\$	\$
10.25 % Senior secured note to HC Crown, including accrued interest, due August 5, 2011	669,682				669,682	
Note and interest payable to Hallmark Cards affiliate with principal due December 31, 2009	168,273		168,273			
Note and interest payable to Hallmark Cards affiliate with principal due December 31, 2009	61,338		61,338			
Note and interest payable to Hallmark Cards due July 27, 2009	5,915		5,915			
	\$ 1,012,657	\$	\$ 342,975	\$	\$ 669,682	\$

In addition to amounts in the table, any Excess Cash Flow for 2008 and 2009 as defined in the Waiver Agreement must be paid on bank debt or the Subject Obligations, and any tax liability under the Tax Sharing Agreement must be paid in cash to Hallmark Cards, unless Hallmark Cards defers such required payment.

**7. Related Party Transactions*****Tax Sharing Agreement***

*Overview*

On March 11, 2003, Crown Media Holdings became a member of Hallmark Cards consolidated federal tax group and entered into a federal tax sharing agreement with Hallmark Cards (the "tax sharing agreement"). Hallmark Cards includes Crown Media Holdings in its consolidated federal income tax return. Accordingly, Hallmark Cards has benefited from past tax losses and 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. A final true-up calculation is completed within 15 days after Hallmark Cards files its consolidated federal income tax return for the year. Pursuant to the true-up calculation, Crown Media Holdings is obligated to reimburse Hallmark Cards the amount that any estimated payments have exceeded the actual benefit realized by Hallmark Cards and Hallmark Cards is obligated to pay Crown Media Holdings the amount that any actual benefit exceeds the estimated payments. Under the tax sharing agreement, at Hallmark Cards' option, the non-interest bearing balance of the 25% in federal tax benefits may be applied as

Table of Contents

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 \$6.5 and \$5.3 million (including the \$6.5 million offset against the Tax Note during the third quarter of 2007 and the \$5.3 million offset against the Tax Note during the third quarter of 2008) under the Tax Sharing Agreement during three months ended September 30, 2007 and 2008, respectively. The Company received \$6.5 and \$15.5 million (including the \$6.5 million offset against the Tax Note during 2007 and the \$15.5 million offset against the Tax Note during 2008) under the Tax Sharing Agreement during nine months ended September 30, 2007 and 2008, 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.

*Accounting for Uncertainty in Income Taxes*

Under FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ), if the probability for sustaining a tax position is at least more likely than not, then the tax position is warranted and recognition should be at the highest amount which is greater than 50% likely of being realized upon ultimate settlement. At September 30, 2008, the total amount of unrecognized tax benefits for uncertain tax positions was \$0. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of the date of adoption and on September 30, 2008, we have no accrued interest related to uncertain tax positions.

By virtue of its inclusion in Hallmark Cards consolidated tax returns, the Company is subject to examination by the Internal Revenue Service for periods subsequent to March 10, 2003. Further, net operating loss carryforwards ( NOL s ) are subject to examination in the year they are utilized 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 2003.

*Services Agreement with Hallmark Cards*

The Company has an intercompany services agreement with Hallmark Cards, which was entered into in 2003 for a term of three years and then extended for additional years through December 31, 2009. Under the 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. Under the agreement, the Company agreed to pay Hallmark Cards \$546,000 in 2007 and \$541,000 in 2008 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 with concurrence of Hallmark Cards.

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For the year ended December 31, 2007, Crown Media Holdings had accrued \$546,000 under the agreement. For the three and nine months ended September 30, 2008, the Company has accrued \$135,000 and \$406,000 under the agreement. At December 31, 2007, and September 30, 2008, non-interest bearing unpaid accrued service fees and unreimbursed expenses of \$13.3 million and \$14.8 million, respectively, were included in payable to affiliates on the accompanying consolidated balance sheets. At December 31, 2007, and September 30, 2008, out-of-pocket expenses and third party fees were \$1.2 million and \$1.1 million, respectively.

Table of Contents

***Hallmark Hall of Fame Programming License Agreement***

In May 2008, Crown Media United States entered into an agreement with Hallmark Hall of Fame Productions, Inc. to license 58 Hallmark Hall of Fame movies, consisting of 16 contemporary Hallmark Hall of Fame titles (i.e., produced from 2003 to 2008) and 42 older titles, for exhibition on the Hallmark Channel and Hallmark Movie Channel. These titles are licensed for ten year windows, with windows commencing at various times between 2007 and 2010, depending on availability. This agreement makes the Hallmark Channel and Hallmark Movie Channel the exclusive home for these movies. The total license fee for these movies is \$17.2 million and is payable in equal monthly installments over each movie's 10 year exhibition window.

The Company aired one title during 2007 and has recorded \$550,000 as a license fee payable to affiliate related to this title at December 31, 2007. Windows opened for additional titles in the amount of \$800,000 and \$8.9 million during the three and nine months ending September 30, 2008.

**8. Company Obligated Mandatorily Redeemable Preferred Interest and NICC License Agreements**

VISN owns a \$25.0 million company obligated mandatorily redeemable preferred membership interest in Crown Media United States (the preferred interest) issued in connection with an investment by 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 company agreement governing the operation of Crown Media United States (the company agreement), which agreement was further amended on February 22, 2001, January 1, 2002, March 5, 2003, January 1, 2004, November 15, 2004, December 1, 2005 (the December 2005 NICC Settlement Agreement) and January 2, 2008.

Under the company agreement, the members agreed that if during any year ending after January 1, 2005 and on or prior to December 31, 2009, Crown Media United States has Federal taxable income (with possible adjustments) 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 Federal taxable income; (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 no later than 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 *Statement of Financial Accounting Standards No. 150: Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (as amended)* (SFAS 150).

During the three months ended September 30, 2007, and 2008, Crown Media United States paid NICC \$4.0 million and \$0, respectively, related to the company agreement as amended. During the nine months ended September 30, 2007, and 2008, Crown Media United States paid NICC \$15.3 million and \$6.4 million, respectively, related to the company agreement as amended.

**9. Share-Based Compensation**

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The Company recorded \$784,000 and \$649,000 of compensation expense associated with the Employment and Performance RSUs during the three month periods ended September 30, 2007 and 2008, respectively, and has included such amounts in selling, general and administrative expense on the accompanying condensed consolidated statements of operations and comprehensive loss. The Company recorded \$4.2 million and \$2.4 million of compensation expense associated with the Employment and Performance RSUs during the nine month periods ended September 30, 2007 and 2008, respectively, and has included such amounts in selling, general and administrative expense on the accompanying condensed consolidated statements of operations and comprehensive loss.

The Company issued cash settlements of \$1.5 million during the year ended December 31, 2007. Additionally, following the December 2007 death of one of the members of the Company's Board of Directors, the Company settled 5,820 vested RSUs for approximately \$35,000 in cash in January 2008.

Table of Contents

Sixty-five percent of the Achieved Performance RSUs (that portion of the Performance RSUs that were earned based on meeting the plan's performance criteria - Achieved Performance RSUs ) granted in 2006 became fully vested in March 2008 after all major distribution agreements were renewed. In a second vesting, 65% to 135% ( the Modifier ) of the Achieved Performance RSUs (less the Achieved Performance RSUs previously vested) 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 order to be eligible for vesting and settlement of the Achieved Performance RSUs, the individual holding them must either be employed at the time of the first vesting or have been terminated without cause within 90 days of a vesting date.

On March 13, 2008, the Compensation Committee determined that the first vesting of the 2006 Performance RSUs would be paid out in accordance with the vesting criteria as if all the major distribution agreements had been renewed prior to each agreement's expiration date, and accordingly, 100% of the first vesting of the Performance RSUs were deemed Achieved Performance RSUs. The settlement of 571,578 vested units valued at approximately \$3.3 million was paid on April 4, 2008.

In August 2008, the Company issued cash settlements of \$397,000 related to the vesting of the 2005 Employment RSUs. The Company also issued cash settlements of \$151,000 related to the vesting of the 2005, 2006 and 2007 Board of Directors RSUs. Additionally, the Company granted 52,129 RSUs in August 2008 to members of its Board of Directors who were not employees of the Company or Hallmark Cards and its subsidiaries. These RSUs are part of the compensation of directors consisting of the grant annually of RSUs valued at \$40,000.

In August 2008, 255,000 of the 2005 Performance RSUs expired, as the stock price targets were not met as required in the agreement, which terminated in August 2008.

At December 31, 2007, the CEO's SARs were valued at \$4.6 million based on that day's \$6.50 per share closing stock price of our common stock. At September 30, 2008, the CEO's SARs were valued at \$1.4 million based on that day's \$5.03 per share closing stock price of our common stock. The Company recorded \$358,000 in compensation expense and \$42,000 in compensation benefit related to SARs for the three months ended September 30, 2007 and 2008, respectively, on our condensed consolidated statement of operations and comprehensive loss as a component of selling, general and administrative expense. The Company recorded \$1.4 million in compensation expense and \$730,000 in compensation benefit related to SARs for the nine months ended September 30, 2007 and 2008, respectively, on our condensed consolidated statement of operations and comprehensive loss as a component of selling, general and administrative expense. The SARs of \$1.4 million and \$697,000 have been recorded in accounts payable and accrued liabilities on the accompanying condensed consolidated balance sheets at December 31, 2007, and September 30, 2008, respectively.

## **10. 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.

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On July 27, 2007, a lawsuit was brought against Crown Media Holdings, Inc. and our former Chief Financial Officer, William Aliber, in the U.S. District Court for the Northern District of Illinois. The plaintiff, Robert Lieblang, claims to have purchased our common shares on the market from August 31, 2005 to April 13, 2006 and to have sold those shares in April 2006 and in August 2006. The plaintiff alleges that he relied to his detriment on allegedly false and misleading statements by the defendants regarding the possible sale of Crown Media Holdings. We announced the exploration of strategic alternatives including the possibility of selling the Company in August 2005; in April 2006, we announced the termination of an extensive review of strategic alternatives including a possible sale. Plaintiff alleges claims under Section 10(b) of the Securities Exchange Act (and Rule 10b-5), the Illinois Consumer Fraud Act and common law fraud. The complaint seeks compensatory damages of approximately \$2.0 million plus interest and \$6.0 million in punitive damages. The Company has retained counsel to defend Mr. Aliber and the Company and has submitted the claims to an insurer under an insurance policy. The insurer is paying



Table of Contents

costs of this lawsuit, subject to certain reservations or exclusions. Prior to December 31, 2007, the Company had incurred legal expense equal to its deductible of \$500,000 under its insurance policy. In January 2008, the court ruled against the defendant's motion to dismiss the lawsuit, although the court's ruling also narrowed the securities law claims to purchases after a certain date in 2006.

NICC has made a claim stemming from certain provisions in the 2005 NICC Agreement that had not previously been resolved. The Company has conducted extensive negotiations with NICC on this issue and expects to sign a final settlement during the fourth quarter of 2008. The Company expects that as a result of this settlement, NICC will receive full ownership of The Note, a Hallmark Channel original movie currently co-owned by NICC and the Company with the Company maintaining certain broadcast rights on its Channels. In expectation of such settlement, the Company has recognized settlement expense of approximately \$500,000 during the third quarter of 2008.

**11. Residual and Participation Liabilities**

During the second quarter of 2007, the Company reduced its estimate of a residual and participation liability related to the Company's use of the film assets prior to the sale to RHI for \$521,000 less than it had originally accrued. Therefore, the Company recognized negative amortization of film assets in this amount during this time period.

During the third quarter of 2007, the Company completed an analysis of its residual and participation liability, related to the Company's licenses of the film assets prior to the sale to RHI. Using new information that became available during this time period, the Company more accurately estimated amounts due and made payments on certain obligations, as well as analyze and determine potential amounts due for exploitation of the films during the applicable period. The Company determined that it needed to reduce its liability by \$4.7 million, and thus, recorded a negative amortization of film assets in this amount during this time period.

The Company also completed an analysis during the third quarter of 2008 of its residual and participation liability, related to the Company's licenses of the film assets prior to the sale to RHI. Using new information that became available during this time period, the Company determined that it needed to reduce its liability by \$1.1 million, and thus, recorded a negative amortization of film assets in this amount during this time period.

Table of Contents

**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, 2007.

**Description of Business and Overview**

*Current Business*

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

With 84.8 million subscribers (as provided by Nielsen Research) in the United States at September 30, 2008, the Hallmark Channel is the 38<sup>th</sup> most widely distributed advertising-supported cable channel in the United States. For the third quarter of 2008, the Hallmark Channel finished the quarter as the 10<sup>th</sup> highest rated advertising-supported cable channel for total day ratings and the 9<sup>th</sup> highest rated advertising-supported cable channel in prime time as measured by Nielsen Research.

We launched our second 24-hour linear channel, the Hallmark Movie Channel, during the first quarter of 2005. Programming on the Hallmark Movie Channel consists of movies and mini-series. The Hallmark Movie Channel generated advertising revenue in 2007 and has generated subscriber fees and advertising revenue in 2008. As distribution continues to expand, the financial contribution of the Hallmark Movie Channel may grow, including increases in advertising and subscription revenue. The Hallmark Movie Channel is operated through Crown Media Holdings' existing infrastructure at a small incremental cost. In April 2008, we began distributing the Hallmark Movie Channel HD in high definition format, which has resulted in additional costs, but is expected to result in subscriber growth for the Hallmark Movie Channel.

Our Annual Report on Form 10-K for the year ended December 31, 2007, in Item 2, summarizes information regarding principal real property leases. The leases for the New York City office and the Greenwood Village, Colorado office have been extended from expirations in 2009 to 2016 for the New York City office and from expiration in 2008 to 2013 for the Greenwood Village office.

*Current Challenges and Developments*

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

We have recently completed the 2008 upfront marketing process during which we entered into deals with major advertising firms for approximately 50% of our advertising inventory for the last quarter of 2008 and first three quarters of 2009. The deals for these inventory units provide the Company with modestly higher CPMs than the inventory guaranteed in the 2007 upfront. The balance of the inventory will be sold in the scatter market. Continued weakness in the economy could result in lower demand and pricing for our inventory, and limit our ability to continue to grow advertising revenue at historical rates. See Results of Operations Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2008 Revenue for additional information on advertising revenues.

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 long-term distribution challenges are renewing our distribution arrangements with the multiple system operators as they expire on favorable terms. Our major distribution agreements have

Table of Contents

terms which expire at various times from December 31, 2008, through, with options to renew, December 2023.

Since January 1, 2007, through April 2008, the Company has renewed its agreements with seven major distributors, accounting for 95% of our subscriber base at September 30, 2008. Each renewal agreement has a multi-year term. The March 2007 agreement with EchoStar Communication Corporation provided for a repositioning of the Hallmark Channel on the DISH Network, resulting in an addition of approximately 6.4 million Nielsen subscribers in May 2007. It further provided 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. In May 2007, we executed a renewal of our distribution agreement with the National Cable Television Cooperative ( NCTC ). Under the terms of the renewal, we continue to be available to NCTC s 1,100 member companies. In November 2007, we executed a renewal agreement with Comcast Corporation, providing Comcast with rights to distribute the Hallmark Channel, the Hallmark Movie Channel and the Hallmark Movie Channel HD. In the first quarter of 2008, we renewed distribution agreements with Time Warner Cable and DirecTV for multi-year distribution of the Hallmark Channel. In April 2008, we renewed our distribution agreement with Cablevision Systems, which was the final major distribution agreement which originally expired in 2007. The renewal agreement covers the Hallmark Channel as well as the Standard Definition and High Definition versions of the Hallmark Movie Channel, resulting in an increase in distribution of the Hallmark Movie Channel of more than 2 million subscribers.

In September, 2008, we renewed our distribution agreement with Charter Communications Inc. Under the agreement, Charter continues to deliver the Hallmark Channel and the Hallmark Movie Channel to approximately 4.4 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 have entered the business of distributing television channels to households through their wire-lines. We have agreements with several telephone companies and cooperatives of telephone companies, which permit the carriage of the Hallmark Channel and the Hallmark Movie Channel and Hallmark Movie Channel HD, and are negotiating with others.

The universe of cable TV subscribers in the United States is approximately 100 million homes. The top 30 cable TV networks in the United States, measured by the number of subscribers, have 90 million or more subscribers. Our goal is to reach 90 million subscribers in the next one to two years.

Three factors have contributed to the ratings of the Hallmark Channel: acquired series and movies, original productions and marketing and promotional efforts. Certain acquired series have consistently delivered strong ratings across all day-parts. Original productions are our most high profile programs and generate the Hallmark Channel s highest ratings. Their ratings success is of significant help to our distribution and advertising sales teams in selling the Hallmark Channel. The Company typically incurs additional marketing and promotional expenses

surrounding original productions and certain acquired movies.

Historically, Nielsen cable television ratings were based on viewing of networks programming content. Beginning in the fourth quarter of 2007, Nielsen began measuring and providing performance data based on viewing of commercial content as well as programming content. The new ratings information also includes data on viewing of program content through digital recording devices (*i.e.*, DVR s), if that viewing occurs within three days of the program s air date. From the beginning of the fourth quarter of 2007 through the second quarter of 2008, we experienced a decrease in viewers of approximately 5% under the new ratings measurement system. We have factored the new rating information into our advertising rates, and at this time we do not expect a significant impact from the new rating information on our net advertising rates.

Table of Contents

At September 30, 2008, the Hallmark Movie Channel was distributed to over 6.8 million subscribers, an increase of nearly 600,000 subscribers from June 30, 2008. This increase in distribution has and will continue to improve the Company's ability to generate advertising revenue from the Hallmark Movie Channel in 2008.

**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, for the most part, 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 with changes in the following factors, among others:

- 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.

*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 to the advertiser. We commit to provide advertisers certain rating levels in connection with their advertising. Advertising rates may vary by time of year due to seasonal changes in television viewership. Revenue is recorded net of estimated delivery shortfalls, which are usually settled by providing the advertiser additional advertising time. The remainder of the revenue is recognized as the make-good advertising time is delivered.

**Cost of Services**

Our cost of services consists primarily of the amortization of program license fees, subscriber acquisition fee expense, the cost of signal distribution, and the cost of promotional segments that are aired between programs. We expect cost of services to decrease in 2008 as compared to 2007 as subscriber acquisition fee expense is, and will continue to be, zero in 2008, based primarily upon distribution agreements renewed in 2007 and to date in 2008.

**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

Table of Contents

the reported amounts of revenue 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 as filed with the SEC for the year ended December 31, 2007.

**Effects of Transactions with Related and Certain Other Parties**

In 2008 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 as filed with the SEC for the year ended December 31, 2007. Also, please see Notes 6, 7 and 8 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 and nine months ended September 30, 2007 and 2008, are derived from the unaudited financial statements of Crown Media Holdings and its subsidiaries. Ratings and subscriber information is unaudited. 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 September 30,		Percent Change 2008 vs. 2007	Nine Months Ended September 30,		Percent Change 2008 vs. 2007
	2007	2008		2007	2008	
<b>Revenue:</b>						
Subscriber fees	\$ 7,389	\$ 14,240	93%	\$ 21,391	\$ 42,672	99%
Advertising	47,819	49,950	4%	143,140	162,993	14%
Other revenue	104	292	181%	260	901	247%
Total revenue	55,312	64,482	17%	164,791	206,566	25%
<b>Cost of Services:</b>						
Programming costs	46,395	36,653	-21%	124,476	107,699	-13%
Subscriber acquisition fee amortization	7,048	0	-100%	22,728	0	-100%
Operating costs	(1,517)	2,459	-262%	3,801	9,522	151%
Total cost of services	51,926	39,112	-25%	151,005	117,221	-22%
<b>Selling, general and administrative expense</b>						
Marketing expense	11,955	13,146	10%	41,098	39,396	-4%
	3,565	4,633	30%	11,850	13,091	10%
	(12,134)	7,591	-163%	(39,162)	36,858	-194%



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(Loss) income from operations before interest expense								
Interest expense	(25,743)	(25,454)	-1%	(82,585)	(75,360)	-9%		
Net loss	\$ (37,877)	\$ (17,863)	-53%	\$ (121,747)	\$ (38,502)	-68%		

**Other Data:**

Net cash (used in) provided by operating activities	\$ 5,368	\$ 24,580	358%	\$ (2,769)	\$ 41,579	-1602%		
Capital expenditures	\$ (387)	\$ (505)	30%	\$ (970)	\$ (1,772)	83%		
Net cash used in investing activities	\$ (1,428)	\$ (1,083)	-24%	\$ (3,995)	\$ (4,369)	9%		
Net cash used in financing activities	\$ (10,870)	\$ (19,476)	79%	\$ (7,198)	\$ (34,886)	385%		
Total domestic day household ratings (1)(3)	0.710	0.657	-7%	0.700	0.689	-2%		
Total domestic primetime household ratings (2)(3)	1.137	1.115	-2%	1.129	1.128	0%		
Subscribers at period end	84,535	84,761	0%	84,535	84,761	0%		

Table of Contents

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- (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 July 1 through September 30 and January 1 through September 30, respectively.

***Results of Operations***

***Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2008***

*Revenue.* Our revenue from continuing operations, comprised of subscriber fees and advertising, increased 17% to \$64.5 million for the three months ended September 30, 2008. Our 93% increase to \$14.2 million in subscriber fee revenue for the three months ended September 30, 2008, was a result of higher net effective rates on average, primarily due to increases in the number of paying subscribers from renewed distribution agreements and reductions in subscriber acquisition fees netted against gross subscriber revenue. We anticipate that these same factors will result in substantial increases in subscriber fees during the remainder of 2008, compared to the corresponding period in 2007; subscriber revenue growth beyond 2008 will be limited. Subscriber acquisition fee expense recorded as a reduction of revenue was \$1.9 million for the three months ended September 30, 2007, and \$702,000 for the comparable period in 2008. The number of paying subscribers at September 30, 2008, when compared to September 30, 2007, has increased as a result of previously amended distribution agreements.

The increase in advertising revenue to \$50.0 million for the three months ended September 30, 2008, compared to \$47.8 million for the three months ended September 30, 2007, reflects an increase in advertising rates. The number of advertisers was 438 at September 30, 2008, as compared to 448 at September 30, 2007. In addition, approximately \$450,000 of the increase in advertising revenue is due to advertising on the Hallmark Movie Channel.

We have experienced in the second and third quarters of 2008 a softening of advertising rates in the scatter and direct response markets, primarily due to deteriorating economic conditions. There have also been a limited number of cancellations by advertisers as permitted by their contracts. We expect this softening to continue in the fourth quarter of 2008 and possibly the first two quarters of 2009. This decrease in rates has resulted in lower advertising revenues in the third quarter of 2008 compared to the second quarter of 2008, in excess of a normal decline in advertising revenue typically experienced by us between the second and third quarters. In response to the lower advertising rates, starting in the third quarter of 2008 we have eliminated some on-air promotions of our programs in order to have more advertising inventory available for sale.

As a result of the economic conditions, we expect a slowing in the growth of our advertising revenues for the remaining quarter in 2008 and the first and second quarters of 2009 when compared to the same quarters in the prior year. Nevertheless, we still expect advertising revenues for those quarters to be higher percentage-wise, in the single digit range, than those revenues in the same period of the prior year. If economic conditions improve in the second half of 2009, we would expect to benefit from that improvement and possibly have again double digit growth in advertising revenues. Our expectations are supported, in part, by advertising revenues which we receive from our clients in the packaged

goods, discount retail, pharmaceuticals and entertainment industries. A majority of our advertising clients are in these areas which have not had to date the significant downturn in ad dollars like the automotive and financial sectors.

Table of Contents

Among the 73 ad-supported cable channels in the United States market, the Hallmark Channel ranked 10<sup>th</sup> in total day with a 0.657 household rating for the three months ending September 30, 2008 and 9<sup>th</sup> for primetime with a 1.115 household rating for the same period based on Nielsen ratings. Although we had an increase in distribution to the Nielsen Universe of 5% in the third quarter of 2008 versus the third quarter of 2007, our household ratings were virtually even (or down slightly) for the third quarter of 2008 compared to the third quarter of 2007. We believe that the reasons for this circumstance include significant sample adjustments to viewers in determining ratings, the 2008 Summer Olympics, and a shift of viewers to cable news channels during the unprecedented media coverage of the national elections and the economic crisis. We do not expect these temporary events to impact our overall ratings for the balance of 2008.

*Cost of services.* Cost of services as a percent of revenue decreased to 61% in 2008, as compared to 94% in 2007. This decrease results from the combined effects of the 17% increase in revenue, discussed above, and the 100% decrease in subscriber amortization fee amortization expense discussed below.

Total programming costs for the three months ended September 30, 2008, decreased 21% following the December 31, 2007, expiration of our programming agreement with NICC and because of the Company's effort to monitor costs. This was offset in part by the Company licensing Hallmark Hall of Fame movies under a new 2008 agreement with Hallmark Cards that provides 10-year exhibition windows for all licensed films. During the third quarter of 2008, we entered into amendments to two significant programming agreements which added programming and deferred payments of certain programming costs to periods beyond 2008.

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. Subscriber acquisition fee amortization expense decreased 100% as all of the expense was net against revenue during three months ended September 30, 2008. The Company's three largest affiliation agreements became fully amortized during the fourth quarter of 2007.

During the third quarter of 2007, the Company recorded \$4.7 million negative amortization of film assets related to a change in estimate of the Company's residual and participation liability resulting from an analysis of the Company's third-party licenses and use of the film assets prior to the sale to RHI using information that became available during the third quarter of 2007. During the third quarter of 2008, the Company recorded \$1.1 million negative amortization of film assets related to a change in estimate of the Company's residual and participation liability using information that became available during the third quarter of 2008.

*Selling, general and administrative expense.* Our selling, general and administrative expense increased 10% quarter over quarter. This increase is primarily due to the increase in salary and benefits expense for officers and employees and an increase in settlement expense related to the potential NICC settlement.

*Marketing expense.* Our marketing expense increased 30% due to increased media costs and increased promotional activities in the third quarter of 2008 as compared to the third quarter of 2007. The Company had one marketing promotion for *Avenging Angel* in July 2007. The Company also had one marketing promotion for *A Gunfighter's Pledge* in July 2008. *A Gunfighter's Pledge* had a larger national off-air campaign than the one executed in 2007. In

addition to radio, television, print and online advertising, we executed a multi-market event to drive press coverage and viewer awareness.

*Interest expense.* Interest expense for the three months ended September 30, 2008, decreased \$289,000 compared to the three months ended September 30, 2007. The principal balance of our credit facility went from \$54.5 million at June 30, 2008, to \$35.2 million at September 30, 2008 (the balance decreased from \$91.7 million at June 30, 2007, to \$80.9 million at September 30, 2007) and a decrease in the bank credit facility interest rate from 5.88% at September 30, 2007, to 4.45% at September 30, 2008, offset in part by higher principal balances on four of the five notes payable to Hallmark Cards affiliates.

*Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2008*

*Revenue.* Our revenue from continuing operations, comprised of subscriber fees and advertising, increased 25%

Table of Contents

to \$206.6 million for the nine months ended September 30, 2008. Our subscriber fee revenue for the nine months ended September 30, 2008, increased \$42.7 million or 99%, as a result of higher net effective rates on average, primarily due to increases in the number of paying subscribers from renewed distribution agreements and reductions in subscriber acquisition fees netted against gross subscriber revenue. Subscriber acquisition fee expense recorded as a reduction of revenue was \$4.8 million for the nine months ended September 30, 2007, and \$2.0 million for the comparable period in 2008. The number of paying subscribers has increased as a result of previously amended distribution agreements.

The increase in advertising revenue to \$163.0 million for the nine months ended September 30, 2008, compared to \$143.1 million for the nine months ended September 30, 2007, reflects an increase in advertising rates. In addition, approximately \$2.5 million of the increase in advertising revenue is due to advertising on the Hallmark Movie Channel.

Among the 73 ad-supported cable channels in the United States market, the Hallmark Channel ranked 11<sup>th</sup> in total day with a 0.689 household rating for the nine months ending September 30, 2008 and 9<sup>th</sup> for primetime with a 0.700 household rating for the same period based on Nielsen ratings.

*Cost of services.* Cost of services as a percent of revenue decreased to 57% in 2008, as compared to 92% in 2007. This decrease results from the combined effects of the 25% increase in revenue, discussed above, and the 100% decrease in subscriber amortization fee amortization expense discussed below.

Total programming costs for the nine months ended September 30, 2008, decreased 13% following the December 31, 2007, expiration of our programming agreement with NICC and because of the Company's effort to monitor costs. This was offset in part by the Company licensing Hallmark Hall of Fame movies under a new 2008 agreement with Hallmark Cards that provides 10-year exhibition windows for all licensed films.

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. Subscriber acquisition fee amortization expense decreased 100% as all of the expense was net against revenue during nine months ended September 30, 2008. The Company's three largest affiliation agreements became fully amortized during the fourth quarter of 2007.

During the second quarter of 2007, the Company reduced its estimate of a residual and participation liability for \$521,000 less than it had originally accrued for it in conjunction with the sale of its film library. During the third quarter of 2007, the Company recorded \$4.7 million negative amortization of film assets related to a change in estimate of the Company's residual and participation liability resulting from an analysis of the Company's third-party licenses and use of the film assets prior to the sale to RHI using information that became available during the third quarter of 2007. During the third quarter of 2008, the Company recorded \$1.1 million negative amortization of film assets related to a change in estimate of the Company's residual and participation liability using information that became available during the third quarter of 2008.

*Selling, general and administrative expense.* Our selling, general and administrative expense decreased 4% period over period. This decrease is primarily due to the \$1.8 million decrease and \$2.1 million decrease of our expense related to

the RSU liability and SAR liability, respectively. This decrease was partially offset by increases in salary, research, and communication expenses and an increase in settlement expense related to the potential NICC settlement described in Note 10 of Notes to Unaudited Condensed Consolidated Financial Statements in this Report.

*Marketing expense.* Our marketing expense increased 10% due to increased media costs and increased promotional activities in 2008 as compared to 2007. The Company had three marketing promotions in the first nine months of 2007: *Love is a Four Letter Word* in February 2007, *A Stranger's Heart* in May 2007, and *Avenging Angel* in July 2007. The Company also had three marketing promotions in 2008: *The Good Witch* in January 2008, *Bridal Fever* in February 2008, and *A Gunfighter's Pledge* in July 2008. *A Gunfighter's Pledge* had a larger national off-air campaign than the one executed in the third quarter of 2007 as discussed above.

Table of Contents

*Interest expense.* Interest expense for the nine months ended September 30, 2008, decreased \$7.2 million compared to the nine months ended September 30, 2007. The principal balance of our credit facility went from \$69.6 million at December 31, 2007, to \$35.2 million at September 30, 2008 (the balance decreased from \$87.6 million at December 31, 2006 to \$80.9 million at September 30, 2007) and a decrease in the bank credit facility interest rate from 5.88% at September 30, 2007, to 4.45% at September 30, 2008, offset in part by higher principal balances on four of the five notes payable to Hallmark Cards affiliates. Additionally, on April 14, 2008, the Tax Note was credited \$1.5 million, which represented the Company's share of an IRS interest refund that Hallmark Cards received. This refund of interest reduced the balance of the Tax Note. During the nine months ended September 30, 2007, the Company recorded \$7.9 million of interest expense related to the Tax Note.

**Liquidity and Capital Resources**

During the nine months ended September 30, 2008 our operating activities provided \$41.6 million of cash. During the comparable period in 2007, our operating activities consumed \$2.8 million of cash. The most significant contribution to this favorable change of \$44.3 million was the increase in operating cash receipts from \$178.3 million to \$220.0 million during the nine months ended September 30, 2007 and 2008, respectively. Additionally, the Company's net loss for the nine months ended September 30, 2008, decreased \$83.2 million to \$38.5 million from \$121.7 million for the nine months ended September 30, 2007.

Cash used in investing activities was \$4.0 million and \$4.4 million for the nine months ended September 30, 2007 and 2008, respectively. During the nine months ended September 30, 2007 and 2008, the Company purchased property and equipment of \$970,000 and \$1.8 million, respectively. During the nine months ended September 30, 2007, the Company paid \$3.0 million to the buyer of the international business. During the nine months ended September 30, 2008, the Company paid \$2.6 million to the buyer of the international business. In accordance with the terms of the sale of the international business, the Company is obligated to reimburse the buyer for payments on certain lease arrangements, which were assumed by the buyer, at or about the same time the buyer is obligated to pay the lessor.

Cash used in financing activities was \$7.2 million and \$34.9 million for the nine months ended September 30, 2007 and 2008, respectively. We borrowed \$7.1 million and \$18.8 million under our credit facility to supplement the cash requirements of our operating and investing activities during the nine months ended September 30, 2007 and 2008, respectively. We repaid principal of \$13.8 million and \$56.1 million under our credit facility during the nine months ended September 30, 2007 and 2008, respectively.

*Cash Flows*

*To October 1, 2009*

As of September 30, 2008, the Company had \$4.3 million in cash and cash equivalents on hand and \$14.8 million of current borrowing capacity under the bank credit facility. Day-to-day cash disbursement requirements have typically been satisfied with cash on hand and operating cash receipts supplemented with the borrowing capacity available under the bank credit facility and forbearance by Hallmark Cards and its affiliates.



Operating activities for the year ended December 31, 2007, yielded positive cash flow as have the nine months ended September 30, 2008. However, there can be no assurance that the Company's operating activities will continue to generate positive cash flow.

The Company's principal sources of funds are cash on hand, cash generated by operations and amounts available under the Company's revolving bank credit facility through May 31, 2009. Another significant aspect of the Company's liquidity is the deferral of payments on obligations owed to Hallmark Cards and its subsidiaries. In March 2008, the Company and Hallmark Cards entered into an Amended and Restated Waiver Agreement which changed the maturity date of three obligations and deferred payments under certain obligations. However, under the Waiver Agreement, interest on the 2001, 2005 and 2006 Notes that accrues from November 16, 2008, through December 31, 2008, is payable in cash in January 2009; subsequent quarterly accrued interest is payable in cash 5 days after each quarterly period. Under an amendment in October 2008, the deferred payments under these obligations were extended to October 1, 2009. See Note 6 Related Party Long-Term Obligations Waiver and Standby Purchase Agreement.

Table of Contents

In March 2008, the bank credit facility was extended to May 31, 2009, and the bank's lending commitment was reduced to \$90.0 million. By its terms, the Bank's lending commitment was reduced to \$60.0 million on June 30, 2008. This commitment decreased to \$50.0 million on September 30, 2008, at which time the Company owed \$35.2 million on the facility. The bank's commitment will decrease further to \$45.0 million on March 31, 2009. Such decreases were made in accordance with the March 2008 amendment to the bank credit facility. The Company plans to use cash flows from operations to reduce outstanding borrowings under the facility and expects this cash flow to be sufficient to maintain outstanding borrowings under the commitment levels throughout the term of the facility. Accordingly, the Company's ability to comply with the scheduled reduction in the Bank credit facility and to pay any amounts outstanding upon the maturity is highly dependent upon the Company's ability to generate sufficient cash flows from operations between September 30, 2008, and May 31, 2009. See Note 5 Credit Facility.

The Waiver Agreement requires that Excess Cash Flow as defined in the Waiver Agreement be used to make payments due under the bank credit facility or to pay obligations subject to the Waiver Agreement. The Company has budgeted and anticipates that it will have substantial Excess Cash Flow for the year ended December 31, 2008 and that this amount will be used to make a reduction in the bank credit facility during the first quarter of 2009. See Note 6. However, the existence and amounts of any Excess Cash Flow depend on the Company's results and cash flow for the remainder of 2008, with its attendant risks, and is not assured.

In prior years, the Company's Tax Sharing Agreement with Hallmark Cards has also been a source of cash from financing activities. More recently, benefits to the Company under the tax sharing agreement have been used to reduce amounts owed to Hallmark Cards and its affiliates under the Tax Note. The Company may incur a tax liability to Hallmark Cards in 2009 pursuant to the Tax Sharing Agreement in part because accrued unpaid interest on the Company's 10.25% Senior Secured Note with HC Crown Corp. is not deducted in determining tax benefits and tax liabilities under that Agreement. This could result in a cash amount being payable to Hallmark Cards in the second quarter of 2009 unless Hallmark Cards agrees to defer any such tax liability. See Note 7 Related Party Transactions Tax Sharing Agreement.

The Company's recurring net loss situation necessitates that we continue to monitor and control all areas of expenses, including programming, marketing and distribution. The Company anticipates that its principal uses of cash during the next twelve months will continue to include the payment of operating expenses, accounts payable and accrued expenses, license fees for programming, interest and repayment of principal under its bank credit facility including the use of Excess Cash Flow as required by the Waiver Agreement, interest under certain notes payable to Hallmark Cards affiliates and payments under the Tax Sharing Agreement with Hallmark Cards.

The Company will endeavor to extend or refinance the bank credit facility prior to or upon its maturity. Any such extension or refinancing could require the continuation of a letter of credit from Hallmark Cards in support of the bank credit facility or other steps by the Company and, thus, is not assured. Upon maturity of the credit facility on May 31, 2009, if the facility has not been paid in full, renewed or replaced (1) JP Morgan Chase Bank, N.A., would have the right to draw down on Hallmark Cards' irrevocable letter of credit or (2) Hallmark Cards could purchase the interest of the lending bank in the facility. In either case, Hallmark Cards would have all the obligations and rights of the lending bank under the bank credit facility and could demand payment of outstanding amounts at any time after October 1, 2009 under the terms of the Waiver Agreement. Upon maturity of the credit facility on May 31, 2009, if not paid in full, renewed or replaced, the lending bank could forego drawing down on Hallmark Cards' irrevocable letter of credit and, alternatively, foreclose on the Company's assets. Such foreclosure proceedings would adversely affect our ability to continue our operations. However, prior to any such possible foreclosure, if the Company had not secured a refinancing of the credit facility or alternative financing, the Company would require Hallmark Cards to exercise its option, pursuant to the terms of the Waiver Agreement, to purchase all of the outstanding indebtedness under the credit facility. The amount purchased would then be subject to terms of the Waiver Agreement.



Table of Contents

The Company believes that cash on hand, cash generated by operations, and borrowing availability under its bank credit facility through May 31, 2009, when combined with the deferral of any required payments on related-party debt and related interest described under the Waiver Agreement, and, if necessary, Hallmark Cards' purchase of any outstanding indebtedness under the bank credit facility in May 2009 as described above, will be sufficient to fund the Company's operations and enable the Company to meet its liquidity needs through October 1, 2009.

The sufficiency of the existing sources of liquidity to fund the Company's operations is dependent upon maintaining subscriber revenue at or above the amount of such revenue for the nine months ended September 30, 2008, and continuing growth in advertising revenue. A significant decline in the popularity of the Hallmark Channel, a significant economic decline in the advertising market, an increase in program acquisition costs, an increase in competition or other adverse changes in operating conditions could negatively impact the Company's liquidity and its ability to fund the current level of operations. During the second and third quarters of 2008 the Company experienced a softening of advertising rates in the direct response and scatter market. Despite the significant decline in economic conditions nationally, and within the advertising industry, these conditions did not materially impact the Company's ability to fund current and expected levels of cash needed for operations. The Company expects this softening to continue through at least the second quarter of 2009, but, similarly, does not currently expect these changing market conditions to materially impact the Company's ability to fund its operations.

*On or After October 1, 2009*

The Company's long-term obligations include notes payable to Hallmark Cards or affiliates of Hallmark Cards which are the subject of the Waiver Agreement. These obligations include Notes issued in 2001, 2005 and 2006 which mature on December 31, 2009. See Note 6. Amounts currently due under these notes at September 30, 2008, are \$107.4 million, \$168.3 million and \$61.3 million, respectively. The Tax Note in the current amount of \$5.9 million matures on July 27, 2009. Additionally, at September 30, 2008, non-interest bearing unpaid accrued service fees and unreimbursed expenses of \$14.8 million were included in payable to affiliates on the accompanying condensed consolidated balance sheet. Another long-term obligation concern is VISN's ownership of the \$25.0 million company obligated mandatorily redeemable preferred membership interest in Crown Media United States that is redeemable no later than December 31, 2010. See Note 8 Company Obligated Mandatory Redeemable Preferred Interest and NICC License Agreement.

Because of the Company's possible inability to meet its obligations when they come due on and after October 1, 2009 and through December 31, 2009, the Company anticipates that prior to October 1, 2009, 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. 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, or other strategic alternatives. If the current credit market conditions continue, a refinancing could be difficult.

Upon maturity of the bank credit facility on May 31, 2009, the Company will not have a comparable credit facility unless the bank credit facility is extended, renewed or replaced. In that case, the Company would be solely dependent upon day-to-day operating cash receipts to meet its cash requirements.

***Bank Credit Facility, Hallmark Notes, and Tax Sharing Agreement***

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For information regarding our Bank Credit Facility, Hallmark Notes and Tax Sharing Agreement, please see Bank Credit Facility, Hallmark Notes, and Tax Sharing Agreement of the Company's Annual Report on Form 10-K as filed with the SEC for the year ended December 31, 2007. Also, please see Notes 5, 6 and 7 of Notes to Unaudited Condensed Consolidated Financial Statements contained in Item 1 of this Report.

Table of Contents

**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, 2007. 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.

**Available Information**

**We will make available free of charge through our website, [www.hallmarkchannel.com](http://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 September 30, 2008, the decline of the fair value of the fixed income portfolio would not be material.

As of September 30, 2008, our cash, cash equivalents and short-term investments had a fair value of \$4.3 and 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. For the three and nine months ended September 30, 2008, the impact of interest rate fluctuations, changed business prospects and all other factors did not have a material impact on the fair value of this portfolio, or on our income derived from this portfolio.

We have not used derivative financial instruments for speculative purposes. As of September 30, 2008, 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

Table of Contents

have not and will not use derivatives for speculative purposes.

If we 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.

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

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

Our material interest bearing assets consisted of cash equivalents and short-term investments. The balance of our interest bearing assets was \$4.3 million, or less than 1% of total assets, as of September 30, 2008. Our material liabilities subject to interest rate risk consisted of our bank credit facility, our note and interest payable to HC Crown, and our notes and interest payable to Hallmark Cards affiliates. The balance of those liabilities was \$378.2 million, or 28% of total liabilities, as of September 30, 2008. Net interest expense for the three and nine months ended September 30, 2008, was \$25.5 million, 40%, of our total revenue and \$75.4 million, 37%, of our total revenue, respectively. 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 ( Eurodollar ) 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 September 30, 2008, our interest expense for the three and nine months would change correspondingly by \$961,000 and \$3.0 million, respectively.

**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*



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There was no change in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2008, 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**

The following is an additional risk factor concerning our business as a result of current economic conditions in the United States.

*Current difficult conditions in the financial services markets may materially and adversely impact our business.*

Table of Contents

Dramatic declines in the values of, among other things, various derivative instruments, credit default swaps and the housing market during the prior year, with falling home prices and increasing foreclosures and unemployment, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks. Many lenders and institutional investors have reduced, and in some cases, ceased to provide funding to borrowers, including other financial institutions. This market turmoil and tightening of credit have led to an increased level of commercial and consumer delinquencies, lack of consumer confidence, increased market volatility and possibly a reduction of business activity generally. A continuation of these conditions could have, among other things, the following potential negative effects: A reduction in spending by consumers and generally advertisers, which could reduce our number of subscribers, advertising rates and thereby also our revenues; an increase in bad debts or the reserve for bad debts; making more difficult or unlikely a refinancing or replacement of our outstanding indebtedness, whether the bank credit facility or any indebtedness owed to Hallmark Cards and its subsidiaries; and exposure to increased interest expense to the extent that any refinanced debt could be at a higher cost.

**Item 6. Exhibits****INDEX TO EXHIBITS**

<b>Exhibit Number</b>	<b>Exhibit Title</b>
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).
10.1	Amendment No. 2 to Amended and Restated Waiver and Standby Purchase Agreement dated October 30, 2008, by and between Hallmark Cards Incorporated and Crown Media Holdings, Inc.
10.2	Lease Agreement, dated September 8, 2008, by and between Paramount Group, Inc., 1325 Avenue of the Americas, L.P., and Crown Media United States, LLC.
10.3	Guaranty Commitment, dated as of September 2, 2008, by and between Hallmark Cards, Incorporated and Crown Media United States, LLC.
31.1	Rule 13a-14(a) Certification executed by the Company's 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.

Table of Contents

**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.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
By:            /s/ HENRY S. SCHLEIFF Henry S. Schleiff	Principal Executive Officer	November 6, 2008
By:            /s/ BRIAN C. STEWART Brian C. Stewart	Principal Financial and Accounting Officer	November 6, 2008