CROWN MEDIA HOLDINGS INC
Form 10-Q
November 01, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

or

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

For the transition period from to .

Commission File Number: 000-30700

Crown Media Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**84-1524410**
(State or other jurisdiction of incorporation or organization)	(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)

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 for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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.

Large accelerated filer o	Accelerated filer o
Non-accelerated filer x (do not check if a smaller reporting company)	Smaller reporting company o

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

As of October 28, 2013, the number of shares of Class A Common Stock, $.01 par value outstanding was 359,675,936.

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In this Quarterly Report on Form 10-Q the terms Crown Media Holdings or the Company, refer to Crown Media Holdings, Inc. and, unless the context requires otherwise, subsidiaries of Crown Media Holdings that operate or have operated our businesses, including Crown Media United States, LLC (Crown Media United States).

The name Hallmark and other product or service names are trademarks or registered trademarks of entities owned by Hallmark Cards, Incorporated (Hallmark Cards).

Certain Terms

The following is a list of certain terms used throughout this Quarterly Report on Form 10-Q:

2011 Refinancing	The July 14, 2011 transaction pursuant to which the Company used the proceeds from the Term Loan and the Notes to repay the Term A Loan and the Term B Loan and redeem all of the outstanding Preferred Stock.
Amendment No. 1	Amendment No. 1 to the Company s Credit Agreement dated as of July 14, 2011 with the lenders party thereto and JPMorgan Chase Bank, N.A., as Administrative Agent, as executed March 29, 2013.
ADUs	Audience Deficiency Units, or units of advertising inventory that are made available to advertisers as fulfillment for past advertisements purchased by the advertiser that did not deliver the guaranteed viewership ratings.
Common Stock	Our Class A common stock, unless the context requires otherwise. As part of the Recapitalization, each outstanding share of Class B common stock was reclassified as a share of Class A common stock and the Class B common stock was eliminated.
CPM	Cost per thousand or advertising rate per thousand viewers.
Federal Tax Deconsolidation	The effect of an agreement dated October 29, 2012, pursuant to which Hallmark Cards caused 40 million shares of the Company s Common Stock to be transferred from HCC to a German subsidiary of Hallmark Cards, which is not part of Hallmark Cards consolidated federal tax group, thus reducing HCC s ownership of the Company s common stock from 90.3% to 79.2%. As a result of such transfer, the Company is no longer part of the Hallmark Cards consolidated federal tax group for federal income tax purposes.
Hallmark Cards or Hallmark	Hallmark Cards, Incorporated, the Company s ultimate parent.
Hallmark Channel	A 24-hour cable television destination for family-friendly programming and a leader in the production of original movies.
Hallmark Movie Channel	A 24-hour cable television destination dedicated to offering viewers a collection of movies and long form programming appropriate for the entire family, including a mix of Hallmark Channel original movies, classic theatrical films, and Hallmark Hall of Fame presentations
HCC	H C Crown, LLC, formerly H C Crown Corp., a subsidiary of Hallmark Cards; the Company s immediate parent.
Network or Networks	Hallmark Channel or Hallmark Movie Channel, individually or collectively, as the context requires.

Nielsen	Nielsen Media Research or The Nielsen Company; an information and measurement company, that provides television ratings, media measurements and other marketing and consumer information.
Notes	The $300.0 million of the Company s 10.5% senior unsecured notes due in 2019 issued in connection with the 2011 Refinancing.
Preferred Stock	Shares of the Company s Series A preferred stock issued in connection with the Recapitalization and subsequently redeemed in connection with the 2011 Refinancing.
Recapitalization	The June 29, 2010 transaction pursuant to which the Company extinguished approximately $1.2 billion owed

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	to HCC and Hallmark Cards upon issuance of (i) the Term A Loan, the Term B Loan and Preferred Stock in the aggregate face amount of $500 million and (ii) Common Stock.
Scatter Market	The period after the close of the Upfront Season during which advertising is sold in close proximity to its air date.
Subscriber	A household that receives, on a full or part-time basis, a network as part of a program package or a program tier of a distributor.
Term A Loan	The $200.0 million term loan issued by the Company to HCC in connection with the Recapitalization.
Term B Loan	The $115.0 million term loan issued by the Company to HCC in connection with the Recapitalization.
Term Loan	The $210.0 million senior secured term loan issued July 14, 2011, as amended March 29, 2013.
Upfront Season	The period of time (usually during the month of May) when advertisers commit to a certain volume of advertising for the fourth quarter of the same year and the first three quarters of the following year.

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements (Unaudited)***

CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	As of December 31, 2012	As of September 30, 2013
ASSETS		
Cash and cash equivalents	$ 43,705	$ 40,965
Accounts receivable, less allowance for doubtful accounts of $245 and $1,037, respectively	92,062	76,927
Programming rights	85,946	74,544
Prepaid programming rights	13,820	34,633
Deferred tax assets, net	34,200	34,200
Prepaid and other assets	2,326	2,428
Total current assets	272,059	263,697
Programming rights	174,971	196,459
Prepaid programming rights	13,748	9,704
Property and equipment, net	10,455	10,158
Deferred tax assets, net	225,149	202,420
Debt issuance costs, net	10,421	10,438
Prepaid and other assets	3,826	3,688
Goodwill	314,033	314,033
Total assets	$ 1,024,662	$ 1,010,597

See accompanying notes to unaudited condensed consolidated financial statements.

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CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(continued)

	As of December 31, 2012	As of September 30, 2013
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES:		
Accounts payable and accrued liabilities	$ 25,801	$ 19,118
Audience deficiency reserve liability	5,679	6,804
Programming rights payable	112,503	88,105
Payables to Hallmark Cards affiliates	1,239	913
Interest payable	14,468	6,580
Current maturities of long-term debt	19,600	
Total current liabilities	179,290	121,520
Accrued liabilities	15,852	14,592
Programming rights payable	30,121	47,763
Long-term debt, net of current maturities	468,040	454,243
Total liabilities	693,303	638,118
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY:		
Class A common stock, $.01 par value; 500,000,000 shares authorized; 359,675,936 shares issued and outstanding as of both December 31, 2012 and September 30, 2013	3,597	3,597
Paid-in capital	2,062,751	2,062,818
Accumulated deficit	(1,734,989)	(1,693,936)
Total stockholders equity	331,359	372,479
Total liabilities and stockholders equity	$ 1,024,662	$ 1,010,597

See accompanying notes to unaudited condensed consolidated financial statements.

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CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2013	2012	2013
Revenue:				
Advertising	$ 57,739	$ 63,577	$ 186,207	$ 195,413
Advertising by Hallmark Cards			1,911	2,112
Subscriber fees	19,294	20,527	58,952	61,273
Other revenue (including $0 and $161 from Hallmark Cards for three and nine months ended September 30, 2012)	22	273	499	614
Total revenue, net	77,055	84,377	247,569	259,412
Cost of Services:				
Programming costs				
Non-affiliates	29,066	33,133	96,322	95,393
Hallmark Cards affiliates	651	688	2,068	2,449
Other costs of services	3,302	4,244	10,039	11,416
Total cost of services	33,019	38,065	108,429	109,258
Selling, general and administrative expense (exclusive of depreciation and amortization expense shown separately below)	13,718	15,193	42,342	45,331
Marketing expense	430	3,993	1,669	5,686
Depreciation and amortization expense	373	525	1,069	1,369
Income from operations before interest and income tax expense	29,515	26,601	94,060	97,768
Interest expense	(11,451)	(10,486)	(34,655)	(32,284)
Income from operations before income tax expense	18,064	16,115	59,405	65,484
Income tax expense	(6,566)	(6,111)	(22,164)	(24,431)
Net income attributable to common stockholders	$ 11,498	$ 10,004	$ 37,241	$ 41,053
Weighted average number of common shares outstanding, basic and diluted	359,676	359,676	359,676	359,676
Net income per common share, basic and diluted	$ 0.03	$ 0.03	$ 0.10	$ 0.11

See accompanying notes to unaudited condensed consolidated financial statements.

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CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Nine Months Ended September 30, 2012	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 37,241	$ 41,053
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on the disposal of property and equipment		2
Depreciation and amortization	95,621	102,209
Provision for allowance for doubtful accounts	56	794
Income tax expense	22,164	23,145
Stock-based compensation	198	210
Changes in operating assets and liabilities:		
Decrease in accounts receivable	14,056	14,340
Additions to programming rights	(69,525)	(107,927)
Increase in prepaid and other assets	(32,184)	(17,587)
Decrease in accounts payable, accrued and other liabilities	(1,585)	(6,616)
Decrease in interest payable	(10,644)	(7,889)
Decrease in programming rights payable	(23,287)	(5,390)
Decrease in payables to Hallmark Cards affiliates	(11,926)	(1,972)
Net cash provided by operating activities	20,185	34,372
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(981)	(1,405)
Disposal of property and equipment		3
Net cash used in investing activities	(981)	(1,402)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on the Term Loan	(19,075)	(33,210)
Capitalized debt issuance costs		(1,116)
Discount on issuance of debt		(430)
Principal payments on capital lease obligations	(874)	(954)
Net cash used in financing activities	(19,949)	(35,710)
Net decrease in cash and cash equivalents	(745)	(2,740)
Cash and cash equivalents, beginning of period	35,181	43,705
Cash and cash equivalents, end of period	$ 34,436	$ 40,965
Supplemental disclosure of cash and non-cash activities:		
Interest paid	$ 43,794	$ 38,582
Reduction of additional paid-in capital for tax transactions	$ 17,996	$
Assets acquired through capital lease obligation	$ 23	$

See accompanying notes to unaudited condensed consolidated financial statements.

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CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Three and Nine Months Ended September 30, 2012 and 2013

1. Business and Organization

Crown Media Holdings, Inc. (Crown Media Holdings or the Company), through its wholly-owned subsidiary Crown Media United States, LLC (Crown Media United States), owns and operates pay television networks dedicated to high quality entertainment programming for adults and families, in the United States. Significant investors in the Company are H C Crown, LLC (HCC), a subsidiary of Hallmark Cards, Incorporated (Hallmark Cards) and Hallmark Cards GmbH, a German subsidiary of Hallmark Cards.

The Company s operations are currently organized into one operating segment, the Networks.

2. Summary of Significant Accounting Policies and Estimates

Interim Financial Statements

In the opinion of management, the accompanying unaudited condensed consolidated balance sheets and related unaudited 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 unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes to those statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2012.

Basis of Presentation

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

The preparation of financial statements in accordance with generally accepted accounting principles requires the consideration of events or transactions that occur after the balance sheet date but before the financial statements are issued. Depending on the nature of the subsequent event, financial statement recognition or disclosure of the subsequent event may be required.

Use of Estimates

The preparation of the accompanying unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions about future events. These estimates and the underlying assumptions affect the amounts of assets and liabilities reported, disclosures about contingent assets and liabilities, and reported amounts of revenue and expenses. Such estimates include the collectibility of accounts receivable, the valuation of goodwill, intangible assets and other long-lived assets, the net realizable value of programming rights, legal contingencies, indemnifications, barter transactions, audience deficiency reserve obligations and assumptions used in the calculation of income taxes and the related valuation allowance, among others.

All of the estimates that are employed are based on management s best estimates and judgment. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances. Management adjusts such estimates and assumptions when facts and circumstances dictate. Illiquid credit markets, volatile equity markets, and declines in consumer spending have combined to increase the uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes, if any, in those estimates resulting from continuing changes in the economic environment will be reflected in the financial statements in future periods.

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Allowance for Doubtful Accounts

The allowance for doubtful accounts is based upon the Company s assessment of probable loss related to uncollectible accounts receivable. The Company uses a number of factors in determining the allowance, including, among other things, the financial condition of a customer and collection trends. The Company s bad debt expense was $29,000 and $504,000 for the three months ended September 30, 2012 and 2013, respectively. The Company s bad debt expense was $56,000 and $794,000 for the nine months ended September 30, 2012 and 2013, respectively.

Barter Transactions

The Company enters into transactions that involve the exchange of its on-air advertising spots, in part, for other products and services, such as programming rights. Programming rights and the related deferred advertising revenue that result from such transactions are recognized at the estimated fair value when the programming is available for telecast. Barter programming rights are amortized in the same manner as non-barter programming rights and advertising revenue is recognized when the on-air advertising spots are delivered. The Company recognized $0 and $224,000 in barter advertising revenue during the three months ended September 30, 2012 and 2013, respectively. The Company recognized $320,000 and $1.4 million in barter advertising revenue during the nine months ended September 30, 2012 and 2013, respectively.

Fair Value of Financial Instruments

Financial Accounting Standards Board (FASB) Accounting Standards Codification (the ASC) Topic 820, *Fair Value Measurements and Disclosures*, provides guidance which defines fair value, establishes a framework for measuring fair value and specifies disclosures about fair value measurements. We determine fair value as an exit price, representing the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

The Company does not have balance sheet items measured at fair value on a recurring basis. Significant balance sheet items which are subject to non-recurring fair value measurements consist of impairment valuations of goodwill, promotion and placement fees, property and equipment, and owned programming.

Net Income per Share

Basic net income per share for each period is computed by dividing net income attributable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net income per share for each period is computed by dividing net income attributable to common stockholders by the weighted average number of common shares plus potentially dilutive common shares outstanding except whenever any such effect would be antidilutive. Potentially dilutive common shares consist of incremental common shares issuable upon the exercise of stock options. Approximately 0 and 12,000 stock options for the three and nine months ended September 30, 2012, respectively, have been excluded from the determination of diluted net income per share because the individual effect in each instance was antidilutive. No stock options were outstanding or excluded during the three and nine months ended September 30, 2013.

Concentration of Risk

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 of our distributors individually accounted for more than 10% of our consolidated subscriber revenue and collectively accounted for 87% and 88% of our consolidated subscriber revenue during the three months ended September 30, 2012 and 2013, respectively. Two of our distributors individually accounted for approximately 15% or more of our consolidated subscribers and collectively accounted for 44% of our subscribers during both the three months ended September 30, 2012 and 2013, respectively. The loss of one of these distributors could have an adverse impact on the Company s operations.

Five of our distributors individually accounted for more than 10% of our consolidated subscriber revenue and collectively accounted for 85% and 88% of our consolidated subscriber revenue during the nine months ended September 30, 2012 and 2013, respectively. Two of our distributors individually accounted for approximately 15% or more of our consolidated subscribers and collectively accounted for 44% of our subscribers during both the nine months ended September 30, 2012 and 2013, respectively. The loss of one of these distributors could have an adverse impact on the Company s operations.

Four and three of our programming content providers individually accounted for more than 10% of our total license fees for programming and collectively accounted for 66% and 71% of the consolidated programming liability as of September 30, 2012 and 2013, respectively. The loss of any one of these programming content providers could have an adverse impact on the Company s operations.

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Taxes on Income

Income tax expense or benefit comprises (i) amounts estimated to be payable or receivable with respect to the Company s pre-tax income or loss for the period pursuant to the statutory provisions of the various federal, state and local jurisdictions to which the Company is subject and (ii) the reported changes in deferred tax assets and liabilities during the period.

The Company accounts for income taxes under the asset and liability method which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax bases of assets and liabilities, including related operating loss and tax credit carryforwards, using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

Net deferred tax assets are recognized to the extent that management believes these assets will more likely than not be realized. In making such determination, management considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies and recent financial operations. In the event management subsequently determines that the Company would likely be able to realize deferred income tax assets in the future in excess of their net recorded amount, an adjustment to the valuation allowance would be recorded with a corresponding reduction in the provision for income taxes.

Management periodically evaluates the sustainability of tax positions taken. Whenever management estimates the probability of sustaining a tax position is at least more likely than not (*i.e.*, greater than 50%), the tax position is deemed warranted and is recognized at the largest amount of benefit that is greater than 50% likely of being realized upon settlement. Interest and penalties related to uncertain tax positions are recognized as income tax expense.

Recently Issued Accounting Pronouncements

No new accounting pronouncement issued or becoming effective during the most recent fiscal year had, or is expected to have, a material impact on the financial statements.

3. Programming Rights

Programming rights are comprised of the following:

	As of December 31, 2012	**As of September 30, 2013**

	(In thousands)	
Programming rights non-affiliates		
Acquired programming		
Licensed for less than 12 years	$ 294,272	$ 286,769
Original programming		
Licensed for less than 12 years	169,176	172,017
Licensed for 12 years or longer	4,440	20,352
Owned	5,772	14,902
Programming rights Hallmark Cards affiliates		
Licensed for less than 12 years	22,549	25,054
Programming rights, at cost	496,209	519,094
Accumulated amortization	(235,292)	(248,091)
Programming rights, net	$ 260,917	$ 271,003

In the regular course of evaluating the remaining usefulness of its various program rights, the Company may determine that certain rights may be of little future program value to it. In such instances, the Company shortens the estimated remaining life of the asset to zero, thereby accelerating amortization of the remaining net book value. During the three and nine months ended September 30, 2012, such changes in estimates resulted in additional amortization of programming rights of $769,000 and $2.1 million, respectively. Additionally, the Company evaluated the remaining usefulness of its owned programming asset and recognized $1.3 million of impairment expense during the nine months ended September 30, 2012. This impairment is included as a component of non-affiliate programming costs in the accompanying unaudited condensed consolidated statement of operations. During the three and nine months ended September 30, 2013, such changes in estimates resulted in additional amortization of programming rights of $16,000 and $2.1 million, respectively.

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At December 31, 2012, and September 30, 2013, $27.6 million and $44.3 million, respectively, of programming rights were included in prepaid programming rights on the accompanying unaudited condensed consolidated balance sheets. The various license periods associated with such amounts had not commenced as of the respective balance sheet dates.

Programming rights payable are comprised of the following:

	As of December 31, 2012		As of September 30, 2013
	(In thousands)		
Programming rights payable non-affiliates			
Acquired programming	$ 102,367		$ 105,040
Original programming	25,085		15,249
Programming rights payable Hallmark Cards affiliates	15,172		15,579
Total programming rights payable	142,624		135,868
Less current maturities	(112,503)		(88,105)
Long-term programming rights payable	$ 30,121		$ 47,763

Under certain license agreements with Sonar Entertainment, Inc. (Sonar), the Company is obligated to pay $5.3 million through December 1, 2013. In connection with its reorganization in bankruptcy, Sonar assigned its right to receive these license payments to Hallmark Cards. During the nine months ended September 30, 2012, the Company reclassified $748,000 from programming rights payable (to non-affiliates) to payables to Hallmark Cards affiliates. During the same period the Company remitted payment of $1.3 million to Hallmark Cards. At December 31, 2012, the amount payable to Hallmark Cards affiliates included $620,000 related to this assignment. During the nine months ended September 30, 2013, the Company reclassified $1.4 million from programming rights payable (to non-affiliates) to payables to Hallmark Cards affiliates. During the same period the Company remitted payment of $1.9 million to Hallmark Cards. At September 30, 2013, the amount payable to Hallmark Cards affiliates includes $130,000 related to this assignment. Obligations relating to license periods that had not commenced as of December 31, 2012 and September 30, 2013, were $2.0 million and $559,000, respectively; accordingly, such amounts are not reflected in the accompanying unaudited condensed consolidated balance sheets.

4. Revolving Credit Facilities, Term Loan, and the Notes

Credit Facilities and Term Loan

On March 29, 2013, the Company and the lender syndicate amended the Company s credit agreement dated July 14, 2011. Among other things, the amendment served to (i) significantly reduce the nominal interest rates applicable to principal owed by the Company and (ii) extend the maturity of the $30.0 million revolving credit facility.

The amendment also served to modify the lender syndicate supporting the Term Loan. For financial reporting purposes, the Company treated the transaction as a modification, as the present value of the cash flows did not substantially change.

The Company incurred costs of approximately $1.8 million in connection with the amendment, of which (i) $430,000, representing a 0.25% discount paid to all members of the lender syndicate, and (ii) $1.1 million of debt issuance costs paid to creditors have been capitalized with respect to the Term Loan and will be amortized along with previously unamortized amounts related to syndicate members. Third-party debt issuance costs of $260,000 were expensed and are included in selling, general and administrative expense in the accompanying unaudited condensed consolidated statement of operations for the nine months ended September 30, 2013.

The amendment reduced the Company s minimum rate on LIBOR borrowings under the Term Loan from 5.75% to 4.00% (the latter comprising a LIBOR floor of 1.00% plus an applicable rate of 3.00%). The LIBOR floor was reduced by 25 basis points and the applicable rate was reduced by 150 basis points. The July 14, 2018 maturity date for the Term Loan remains unchanged.

Prior to March 29, 2013, the Company made principal payments of $525,000 at each quarter s end. Under the amended Term Loan, the Company made quarterly principal payments of $430,000 through September 2013. Subsequent to that date, the Company is no longer required to make these principal payments due to its voluntary payment. The Company continues to be subject to requirements to remit additional principal payments in amounts equal to (1) 50% of excess cash flow (as defined in the amended credit agreement) as determined annually, which percentage will be reduced to 25% if the consolidated leverage ratio (as defined in the amended credit agreement) is equal to or less than 4.25 to 1 but greater than 3.25 to 1, and 0% if the consolidated leverage ratio is equal to or less than 3.25 to 1, respectively; (2) 100% of net cash proceeds resulting from dispositions or casualty events if such

proceeds have not been reinvested within one year after the occurrence of the disposition or casualty event; and (3) 100% of net cash proceeds from issuance of debt or preferred stock not otherwise permitted by the amended credit agreement.

Under the amended revolving credit facility, the maturity date was extended from July 14, 2016, to January 14, 2018. The interest rate applicable to future borrowings, if any, was also reduced from 3.5% to 2.75%. At December 31, 2012 and September 30, 2013, the Company had no outstanding borrowings under the amended revolving credit facility.

The covenants in the amended credit agreement continue to limit the ability of Crown Media Holdings and certain of its subsidiaries to (1) incur indebtedness; (2) create or permit liens on assets; (3) make certain dividends, stock repurchases and redemptions and other restricted payments; (4) make certain investments; (5) prepay indebtedness; (6) enter into certain transactions with Crown Media Holdings affiliates; (7) dispose of substantially all of the assets of Crown Media Holdings; (8) merge or consolidate; (9) enter into new unrelated lines of businesses; and (10) enter into sale and leaseback transactions. The amended credit agreement also requires compliance with a maximum total leverage ratio test and a maximum total secured leverage ratio test, but permits, with certain limitations, certain equity contributions to be made to Crown Media Holdings to enhance its ability to comply with such ratio tests.

The amended credit agreement contains a number of affirmative and negative covenants. The Company was in compliance with these covenants as of September 30, 2013.

At December 31, 2012, and September 30, 2013, the outstanding balance under the Term Loan, net of unamortized discount, was $187.6 million and $154.2 million, respectively. The Company made principal payments of $525,000 and $15.4 million under the Term Loan during the three months ended September 30, 2012 and 2013, respectively. The Company made principal payments of $19.1 million and $33.2 million under the Term Loan during the nine months ended September 30, 2012 and 2013, respectively.

Interest expense under the Term Loan was $3.0 million and $2.0 million for the three months ended September 30, 2012 and 2013, respectively. The effective interest rate was approximately 6.3% and 4.87% during the three months ended September 30, 2012 and 2013, respectively. The weighted average nominal interest rate was approximately 5.75% and 4.00% during the three months ended September 30, 2012 and 2013, respectively.

Interest expense under the Term Loan was $9.2 million and $6.9 million for the nine months ended September 30, 2012 and 2013, respectively. The effective interest rate was approximately 6.3% and 5.39% during the nine months ended September 30, 2012 and 2013, respectively. The weighted average nominal interest rate was approximately 5.75% and 4.69% during the nine months ended September 30, 2012 and 2013, respectively.

Interest expense under the revolving credit facility for the three and nine months ended September 30, 2012 and 2013, was $0. One letter of credit was outstanding in the amount of $202,000 at both December 31, 2012, and September 30, 2013. Commitment fees on the revolving credit facility are payable on the unused revolving credit commitment at the rate of 0.50% per annum, payable quarterly. Commitment fee expense for each of the three months ended September 30, 2012 and 2013 was $38,000, respectively. Commitment fee expense for each of the nine months ended September 30, 2012 and 2013 was $114,000 and $113,000, respectively.

The Notes

On July 14, 2011, the Company issued the Notes in a private placement conducted pursuant to Rule 144A under the Securities Act of 1933, as amended (the Securities Act). The Notes are guaranteed on a senior basis by each of Crown Media Holdings subsidiaries (the Guarantors).

Commencing January 15, 2012, interest on the Notes became payable each January 15th and July 15th. The Company is not required to make mandatory sinking fund payments with respect to the Notes.

The covenants in the related indenture (the Indenture) limit the ability of the Company to, among other things (1) incur additional debt; (2) pay dividends or make other restricted payments; (3) purchase, redeem or retire capital stock or subordinated debt; (4) make asset sales, including by way of sale leaseback transactions; (5) provide subsidiary guarantees; (6) enter into certain transactions with affiliates; (7) incur liens; (8) make investments; and (9) merge or consolidate with any other person.

During any period in which the Notes have an investment grade rating from both Moody s and S&P (at least Baa3 by Moody s and BBB- by S&P), and no default has occurred and is continuing under the Indenture, Crown Media Holdings and its restricted subsidiaries will not be required to comply with the covenants in the Indenture that limit their ability to (1) incur additional debt; (2) pay dividends or make other restricted payments; (3) purchase, redeem or retire capital stock or subordinated debt; (4) make asset

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sales; (5) provide subsidiary guarantees; and (6) enter into certain transactions with affiliates. The Company was in compliance with these covenants as of September 30, 2013.

Interest expense under the Notes was $8.0 million and $8.1 million for the three months ended September 30, 2012 and 2013, respectively. After giving effect to the amortization of associated debt issuance costs, the effective interest rate of the Notes was approximately 11.0% during the three months ended September 30, 2012 and 2013.

Interest expense under the Notes was $24.1 million and $24.2 million for the nine months ended September 30, 2012 and 2013, respectively. After giving effect to the amortization of associated debt issuance costs, the effective interest rate of the Notes was approximately 11.0% during the nine months ended September 30, 2012 and 2013.

Maturities

The aggregate maturities of long-term debt including estimated future interest for each of the five years subsequent to September 30, 2013, and the period thereafter, are as follows:

Notes, due July 15, 2019	$ 489,000	$ 31,500	$ 31,500	$ 31,500	$ 31,500	$ 31,500	$ 331,500
Term Loan, due July 14, 2018	186,465	6,332	6,332	6,350	6,332	161,119	
	$ 675,465	$ 37,832	$ 37,832	$ 37,850	$ 37,832	$ 192,619	$ 331,500

Guarantees

Because Crown Media Holdings has no independent assets or operations, the guarantees by the subsidiary guarantors are full and unconditional, joint and several, and there are no subsidiaries of Crown Media Holdings that are not subsidiary guarantors. With certain exceptions described above, the Indenture and the Amended Credit Agreement impose restrictions on the payment of dividends by Crown Media Holdings and the subsidiary guarantors.

5. Related Party Transactions

Tax Sharing Agreements

Under a federal tax sharing agreement dated March 11, 2003, the Company was included in Hallmark Cards consolidated federal tax group. On October 31, 2012, the percentage of the Company s common stock collectively owned by members of Hallmark Cards consolidated federal tax group decreased to less than 80%, the minimum threshold required for inclusion in a consolidated federal income tax return. Therefore, effective November 1, 2012, the Company became a separate-company taxpayer for federal income tax reporting purposes and is no longer included in the Hallmark Card s federal consolidated tax return.

For each of the periods in which the Company was a member of Hallmark Cards consolidated federal tax group, the Company either (i) received from Hallmark Cards the incremental tax benefit related to the loss it contributed to the consolidated return or (ii) paid Hallmark Cards the incremental tax associated with the taxable income it contributed to the consolidated return. Payments received from Hallmark Cards or credited against amounts owed by the Company to any other member of Hallmark Cards consolidated federal tax group have been recorded as additions to paid-in capital. Amounts owed or payments made to Hallmark Cards or to any member of Hallmark Cards consolidated group in excess of current tax expense have been recorded as reductions of paid-in capital.

The amount owed and reimbursed to Hallmark Cards pursuant to the federal tax sharing agreement in connection with the Company s taxable income for the three months ended September 30, 2012 was $6.9 million, which was reimbursed in October 2012. The Company reimbursed Hallmark Cards $17.8 million under the federal tax sharing agreement for 2012, net of a prior year overpayment of $1.0 million, through October 2012. During the three months ended September 30, 2013, Hallmark Cards reimbursed the Company $67,000 for an overpayment under the federal tax sharing agreement for 2012.

The IRS is currently auditing the Hallmark consolidated federal tax returns for 2010-2011. It is possible that the result of that audit could be an increase to taxable income attributable to the Company resulting in a payment under the tax sharing agreement with Hallmark Cards.

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Since May 9, 2000, the Company has been included in certain combined state income tax returns of Hallmark Cards or Hallmark Entertainment Holdings (HEH). In connection therewith, HEH and the Company entered into a state tax sharing agreement. Under the state tax sharing agreement, Hallmark Cards (as successor to HEH) and the Company file consolidated, combined or unitary state tax returns in some states. The Company makes tax-sharing payments to (or receives payments from) Hallmark Cards equal to the taxes (or tax refunds) that the Company would pay (or receive) if it filed on a stand-alone basis. Such payments are computed based on the Company s taxable income (loss) and other tax items beginning the day following the May 9, 2000 reorganization.

Notwithstanding that the Company is no longer a member of the Hallmark federal tax group, the Company will continue to be included in Hallmark Cards consolidated or combined returns for certain states. During 2012, the Company reimbursed Hallmark Cards approximately $495,000 with respect to the state tax sharing agreement for the 2011 tax year. For the year ended December 31, 2012, the Company owed Hallmark Cards approximately $264,000 with respect to the state tax sharing agreement, which was paid during October 2013. For the nine months ended September 30, 2013, it is estimated that the Company will owe Hallmark Cards approximately $310,000 with respect to the state tax sharing agreement, which is payable two days prior to the due date of the state tax returns.

Services Agreement with Hallmark Cards

Hallmark Cards provides Crown Media Holdings with tax, risk management, health safety, environmental, insurance, legal, treasury, human resources, cash management, real estate consulting services and other services as requested by the Company. In exchange, the Company is obligated to pay Hallmark Cards a fee, plus out-of-pocket expenses and third party fees, in arrears on the last business day of each quarter. Fees for Hallmark Cards services were $457,000 for 2012 and are expected to be approximately $347,000 for 2013.

At December 31, 2012 and September 30, 2013, the Company s payables to Hallmark Cards affiliates on the accompanying unaudited condensed consolidated balance sheets were $1.2 million and $913,000, respectively. The December 31, 2012, balance was comprised of $188,000 of invoices paid on the Company s behalf, $431,000 of taxes and $620,000 of assigned license payments. The September 30, 2013 balance was comprised of $778,000 of taxes, $130,000 of assigned license payments and $5,000 of invoices paid on the Company s behalf.

Hallmark Hall of Fame Programming License Agreement

In 2008, Crown Media United States entered into an agreement with Hallmark Hall of Fame Productions, LLC for the exclusive television license of 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 Hallmark Channel and Hallmark Movie Channel. These titles are licensed for ten year windows, which commenced at various times between 2007 and 2010. The total license fee for these movies is $17.2 million and is payable in equal monthly installments over the various ten-year exhibition windows.

In 2011, Crown Media United States entered into an additional agreement with Hallmark Hall of Fame Productions, LLC for the exclusive television license of 16 Hallmark Hall of Fame movies produced from 2009 through 2014, for exhibition on Hallmark Channel and Hallmark Movie Channel. These titles are licensed for ten-year windows, with windows commencing at various times between 2011 and 2014, depending on availability. The total license fee for these movies is $10.0 million and is payable in equal monthly installments over the various ten-year exhibition windows.

On July 6, 2011, the Company and Hallmark Cards entered into an agreement whereby Hallmark Cards provided the Company one-week, limited play licenses for each of six new Hallmark Hall of Fame two-hour movies produced by Hallmark Cards over the two-year contract term. In addition to providing the program licenses, Hallmark Cards has paid the Company $3.4 million of cash ratably as the individual licenses open, all in exchange for approximately two-thirds of the advertising units otherwise available during each airing of the movies. The Company has estimated the fair value of the program licenses to be approximately $1.0 million. The Company recognized total advertising revenue of approximately $4.4 million as it fulfilled its advertising obligation to Hallmark Cards. As of September 30, 2013, all of such movies have aired on Hallmark Channel.

Trademark Agreement with Hallmark Cards

Crown Media United States has a trademark license agreement with Hallmark Licensing, LLC, an affiliate of Hallmark Cards, for use of the Hallmark mark for use on Hallmark Channel and for Hallmark Movie Channel. In connection with the 2011 Refinancing, Hallmark Licensing, LLC extended these existing trademark licenses for an additional period terminating the earlier of (i) July 14, 2019 and (ii) the later of (x) the expiration or termination of the Amended Credit Agreement and (y) the redemption of all of the Notes, subject to any earlier termination of such license agreements pursuant to the respective terms of such license agreements.

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The Company is not required to pay any royalty fees under the trademark license agreements. Accordingly, no amounts have been reflected in the unaudited condensed consolidated balance sheets or unaudited condensed consolidated statements of operations for these licenses.

Under the trademark license agreement, the Company would be in default if the Company (i) fails to make any payment due under any loan agreement within five days of its due date or (ii) receives an opinion from our auditors that expresses their doubt with respect to our ability to continue as a going concern.

6. Restricted Stock Units and Long Term Incentive Plan

Restricted Stock Units

The Company recorded $43,000 and $86,000 of compensation expense associated with restricted stock units (RSUs) during the three months ended September 30, 2012 and 2013, respectively, which has been included in selling, general and administrative expense on the accompanying unaudited condensed consolidated statements of operations. The Company recorded $198,000 and $210,000 of compensation expense associated with restricted stock units during the nine months ended September 30, 2012 and 2013, respectively, which have been included in selling, general and administrative expense on the accompanying unaudited condensed consolidated statements of operations.

The closing price of a share of the Company s Common Stock, which is used to calculate the period end RSU liability, was $1.85 and $3.08 on December 31, 2012, and September 30, 2013, respectively. As of December 31, 2012 and September 30, 2013, there was unrecognized compensation cost, related to non-vested RSUs granted to the Company s directors, in the amount of $99,000 and $48,000, respectively, using the aforementioned stock prices. Actual compensation costs recognized in future periods may vary based upon fluctuations in stock price and forfeitures.

The Company issued cash settlements related to the RSUs during the three and nine months ended September 30, 2012 and 2013, of $231,000 and $257,000, respectively.

Long Term Incentive Plan

In the first quarter of 2010, the Company entered into Long Term Incentive Compensation Agreements (LTI Agreements) granting incentive compensation ranging from $25,000 to $536,000 per employee. The 50% Employment Awards vested and were settled in cash on August 31, 2012, in the aggregate amount of $1.2 million. A portion of the Performance Awards vested on December 31, 2012, and were settled during the first quarter of 2013 in the aggregate amount of $640,000; the remainder did not vest.

In the second quarter of 2011, the Company entered into LTI Agreements granting incentive compensation ranging from $23,000 to $550,000 per employee. The 50% Employment Awards vested on August 31, 2013, and were settled in cash on September 6, 2013, in the aggregate amount of $1.5 million. Each of the 50% Performance Awards will vest on December 31, 2013, subject to the Company s achievement of financial performance criteria, and will be settled in cash by the later of January 30, 2014, or 15 days after the Company issues its audited financials for 2013, but no later than March 15, 2014. Each award is also subject to earlier pro rata settlement as provided in each LTI Agreement.

In the first quarter of 2012, the Company entered into LTI Agreements granting incentive compensation ranging from $22,000 to $652,000 per employee. Each of the 50% Employment Awards will vest on August 31, 2014, subject to continued employment, and will be settled in cash by September 30, 2014. Each of the 50% Performance Awards will vest on December 31, 2014, subject to the Company s achievement of financial performance criteria, and will be settled in cash by the later of January 30, 2015, or 15 days after the Company issues its audited financials for 2014, but no later than March 15, 2015. Each award is also subject to earlier pro rata settlement as provided in each LTI Agreement.

In the first quarter of 2013, the Company entered into LTI Agreements granting incentive compensation ranging from $20,000 to $680,000 per employee. Each of the 40% Employment Awards, subject to continued employment, and each of the 60% Performance Awards, subject to the Company s achievement of financial performance criteria, will vest on December 31, 2015, and be settled in cash the later of January 30, 2016, or 15 days after the Company issues its audited financials for 2015, but no later than March 15, 2016. Each award is also subject to earlier pro rata settlement as provided in each LTI Agreement.

During the third quarter of 2012, the Company entered into LTI Agreements granting $20,000 incentive compensation to each independent director, subject to continued membership on the board. The related financial performance criteria for 2012 were achieved. On December 31, 2012, the performance criteria were achieved and on August 16, 2013, the awards vested. On August 23, 2013, the awards were settled in cash in the aggregate amount of $132,000.

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Additionally, in August 2012, the Company entered into LTI Agreements granting $50,000 incentive compensation to each independent director, subject to continued membership on the board through December 31, 2014, the vesting date, and achievement of the financial performance criteria. Each of the awards will be settled in cash by the later of January 30, 2015, or 15 days after the Company issues its audited financials for 2014, but no later than March 15, 2015.

In March 2013, the Company entered into LTI agreements granting $50,000 incentive compensation to each independent director, subject to continued membership on the board through December 31, 2015, the vesting date, and achievement of the financial performance criteria. Each award will be settled in cash by the later of January 30, 2016, or 15 days after the Company issues its audited financials for 2015, but no later than March 15, 2016. Each award is also subject to earlier pro rata settlement as provided in each LTI Agreement.

During the third quarter of 2013, the Company entered into LTI Agreements granting $35,000 incentive compensation to each independent director, subject to continued membership on the board through August 15, 2014, the vesting date, and achievement of the financial performance criteria. As each independent director must continue to perform service through August 15, 2014, the vesting date, the Company has recognized, and will continue to recognize, expense over the service period. Each award is also subject to earlier pro rata settlement as provided in each LTI Agreement.

Vesting of the 2011, 2012 and 2013 LTI Performance Awards will be determined in accordance with the Company performance criteria concerning adjusted EBITDA and cash flow. Each award is subject to earlier pro rata settlement as provided in the related LTI Agreement.

In recognition of these LTI Agreements, the accompanying unaudited condensed consolidated statements of operations include $812,000 and $965,000 in selling, general and administrative expense for the three months ended September 30, 2012 and 2013, respectively. Likewise, the accompanying unaudited condensed consolidated statements of operations include $2.1 million and $2.7 million in selling, general and administrative expense for the nine months ended September 30, 2012 and 2013, respectively. Related liabilities of $3.6 million and $4.1 million at December 31, 2012, and September 30, 2013, respectively, are included in accounts payable and accrued liabilities in the accompanying unaudited condensed consolidated balance sheets.

7. Fair Value

The following table presents the carrying amounts and estimated fair values of the Company s financial instruments at December 31, 2012 and September 30, 2013.

	December 31, 2012		September 30, 2013	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In thousands)			
Term Loan and interest payable (Level 3)	$ 187,670	$ 188,046	$ 154,260	$ 150,767
Notes and interest payable (Level 2)	314,438	352,368	306,563	341,848

ASC Topic 820 *Fair Value Measurements and Disclosures* defines fair value of a liability as the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company estimated the fair value of the Notes using the trading prices obtained from Bloomberg on December 31, 2012, and September 30, 2013, a Level 2 input, due to the limited amount of trading activity. The Company estimated the fair value of its Term Loan using a yield-to-maturity rate obtained from a pricing service, a Level 3 input.

At December 31, 2012 and September 30, 2013, the fair values of the Level 3 financial instruments were $188.0 million and $150.8 million, respectively. No transfers between levels occurred during 2012 and 2013.

Carrying amounts for accounts payable and accrued liabilities and accounts receivable are reasonable estimates of their fair values because of the short-term nature of these instruments. Interest rates on borrowings under the bank credit facility are for relatively short periods and variable. Therefore, the fair value of this debt is not significantly affected by fluctuations in interest rates. The credit spread on the debt is fixed, but the market rate will fluctuate. Only a significant change in the creditworthiness of the Company would impact the credit spread. Since issuance, the credit spread on the Company s Notes has decreased.

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8. 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.

Legal Proceedings

From time to time, the Company and/or various officers and directors may be named as defendants in legal actions involving various claims incident to the conduct of its business. Whenever the Company concludes that an adverse outcome in any such action is probable and a loss amount can reasonably be estimated, the Company records such loss amount. Related legal costs, net of anticipated insurance reimbursements, are expensed as incurred.

9. Income Taxes

As a result of the Federal Tax Deconsolidation, the Company s taxable income for the tax period from January 1, 2012, through October 31, 2012, was included in the federal income tax return of Hallmark Cards consolidated federal tax group. The Company has filed a separate federal tax return for the short tax period from November 1, 2012, through December 31, 2012, and will do so for each of the calendar years thereafter.

Notwithstanding the periods during which the Company was a member of Hallmark Cards consolidated federal tax group, the Company has continuously accounted for income taxes as if it were a separate-company taxpayer. For financial reporting purposes, deferred tax benefits recognized in connection with losses incurred while the Company was included in the Hallmark consolidated return were offset, in whole or in part, by a valuation allowance. However, subsequent to its exit from Hallmark Cards consolidated federal tax group, the Company will file federal tax returns on separate company basis. As a result, that portion of the Company s net operating losses that had previously been utilized by Hallmark Cards consolidated federal tax group, is not available to the Company as a separate-company taxpayer. Accordingly, in the fourth quarter of 2012, deferred tax assets, specifically the component related to net operating losses and the related valuation allowance, were each reduced by $229.7 million.

As of December 31, 2012, management determined that it was more likely than not that the Company will realize an additional portion of the benefit of its deferred tax assets. Accordingly, during the fourth quarter of 2012, the Company released an additional $54.2 million of the previously established valuation allowance.

During 2012, the alternative minimum tax (AMT) expense recognized was $268,000. In March 2013, $270,000 was paid related to this amount. During the three months ended March 31, 2013, AMT expense recognized was $453,000 and in April 2013, $475,000 was paid. During the three months ended June 30, 2013, AMT expense of $540,000 was recognized, and in June 2013, $550,000 was paid. During the three months ended September 30, 2013, AMT expense of $336,000 was recognized, and in September 2013, $525,000 was paid. During the nine months ended September 30, 2013, AMT expense of $1.3 million was recognized and $1.6 million was paid relating to 2013.

Since the Company is no longer included in the Hallmark Cards federal tax group, there is no longer a limitation on the use of net operating losses (NOLs) incurred prior to being included in the Hallmark Cards federal tax group. Accordingly, the Company has a deferred tax asset of $237.5 million related to the cumulative separate return limitation year (SRLY) NOLs as of December 31, 2012. In September 2012, the Company obtained a private letter ruling from the Internal Revenue Service in support of its position that as a result of the Federal Tax Deconsolidation, it will no longer be part of Hallmark Cards consolidated federal tax group and the restrictions on its ability to utilize the NOLs will no longer apply.

As of December 31, 2012, the Company had a federal NOL carry forward of $678.6 million and various state NOL carry forwards. The determination of the state NOL carry forwards depends on apportionment percentages and state laws that can change from year to year and impact the amount of such carry forwards. If not utilized, the federal NOLs will expire between 2018 and 2021, and the state NOLs will expire between 2013 and 2032.

At both December 31, 2012 and September 30, 2013, the total amount of unrecognized tax benefits for uncertain tax positions was $0. The Company recognized no increase or decrease in the amount of unrecognized tax benefits for uncertain tax positions. Accordingly, at both December 31, 2012 and September 30, 2013, there is no accrued interest related to uncertain tax positions.

By virtue of its previous inclusion in Hallmark Cards consolidated federal tax group, the Company is subject to examination by the Internal Revenue Service for periods subsequent to March 10, 2003. Further, NOL carryforwards 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 as those NOLs are utilized in future tax returns.

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In 2012, the Company had separate company nexus in New York and Georgia and will be included in the combined state tax returns of the Hallmark Cards group for California, Colorado and Illinois. State NOLs are also subject to examination in the year in which they are utilized regardless of whether the tax year in which they were generated has been closed by statute. In recent years, changes enacted by various states have served to defer the effectiveness of the Company s NOL carryforwards. Colorado has suspended NOLs in excess of $250,000 for tax years 2011 through 2013 and Illinois has suspended the use of NOLs for tax years 2011 and for NOLs in excess of $100,000 for 2012 and 2013.

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 our unaudited condensed consolidated financial statements and related notes included in Part I, Item 1 in this Quarterly Report on Form 10-Q. The following analysis contains forward-looking statements about our future revenue, operating results and expectations. See Risk Factors and Forward Looking Statements below for a discussion of the risks, assumptions and uncertainties affecting these statements.

Description of Business and Overview

Current Business

We own and operate pay television Networks, each of which is dedicated to high-quality entertainment programming for families. Hallmark Channel features popular television series such as *Golden Girls* and *Frasier* as well as original series and movies with compelling stories and internationally recognized stars. It also offers a lifestyle programming block currently featuring *Home and Family*. Hallmark Movie Channel is a cable network dedicated to offering movies appropriate for the entire family, consisting primarily of original movies, classic theatrical films, and presentations from the award-winning Hallmark Hall of Fame collection as well as other long form television programming. Consistent with the Hallmark brand, both Networks are preeminent sources of holiday programming, with Hallmark Channel often ranking first among cable networks for movies during the Christmas holiday season.

Reaching nearly 87 million subscribers as of September 30, 2013, Hallmark Channel is one of the most widely distributed independent networks in the United States. Hallmark Movie Channel is one of the fastest-growing new cable networks, reaching more than 52 million subscribers as of September 30, 2013.

We believe that we have established these Networks as destinations for viewers seeking outstanding family entertainment and as attractive outlets for advertisers seeking to target these viewers.

Programming acquired from third parties is an important component of our Networks as we continually develop and refine our programming strategy. This programming includes original series and movies and lifestyle programming produced specifically for us by a variety of experienced television production companies and theatrical movies and off network television series licensed to us by major studios and distributors. Our agreements for original series and movies and lifestyle programming typically provide for exclusive rights in the United States in all media for periods ranging from eight years to perpetuity. Our license agreements for theatrical films and off-network programming

usually give us more limited rights to exhibit the programming on our Networks, over a period of five or more years. From time to time, we also exhibit excerpts on our website.

Our Networks offer a range of high-quality entertainment programming for adults and families including lifestyle programming and talk shows, popular television series, movies, miniseries, theatricals, romances, literary classics, and contemporary stories. Sources for programming on our Networks include programming (both movies and series) licensed from Buena Vista Television, CBS Television Distribution, Hallmark Hall of Fame, MGM, Paramount Pictures, Sonar Entertainment, Sony Pictures Television, Twentieth Television, Warner Bros. and others. In recent years, we licensed from Hallmark Cards animated programming appropriate for children, such as *hoops & yoyo* and *Jingle the Husky Pup*.

Hallmark Channel and Hallmark Movie Channel are currently distributed to approximately 83% and 50%, respectively, of all United States pay television subscribers. We currently distribute (a) Hallmark Channel through 5,500 cable, satellite and other pay television distribution systems and (b) Hallmark Movie Channel through 3,768 such systems.

Five of our multiple-system distributors each accounted for more than 10%, and together accounted for a total of 88% of our consolidated subscriber revenue for the three and nine months ended September 30, 2013, respectively. Two of our multiple-system distributors for Hallmark Channel each accounted for approximately 15% or more of our consolidated subscribers for the three and nine months ended September 30, 2013, and together accounted for 44% of our consolidated subscribers on that date. Three of our

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programming content providers each accounted for more than 10% of our total license fees payable for the nine months ended September 30 2013, and together accounted for a total of 71% of the consolidated programming liability at the end of the period. The loss of one of these pay television distributors or programming content providers could have an adverse impact on the Company s operations.

We view a subscriber as a household that receives, on a full or part-time basis, a Network as part of a program package or a program tier of a distributor. We determine our Hallmark Channel and Hallmark Movie Channel subscribers from subscriber numbers reported by Nielsen. Subscribers include both viewers who pay a monthly fee for the tier programming and so-called promotional subscribers who are given free access to the tier by the distributor for a limited time.

We license the trademark Hallmark for use on our Networks pursuant to certain trademark license agreements with a subsidiary of Hallmark Cards. We believe that the use of this trademark is extremely important for our Networks due to the substantial name recognition and favorable characteristics associated with the name in the United States.

The IRS is currently auditing the Hallmark consolidated federal tax returns for 2010-2011. It is possible that the result of that audit could be an increase to taxable income attributable to the Company resulting in a payment under the tax sharing agreement with Hallmark Cards.

Current Challenges

The Company faces numerous operating challenges. Among such challenges are increasing viewership ratings, maintaining and increasing advertising revenue, maintaining and expanding the distribution of the Networks, broadening viewership demographics to meet our target audience, and controlling costs and expenses.

Ratings

Ratings success plays a significant role in our ability to achieve our distribution and advertising goals. We believe our ratings are affected by our ability to (i) acquire and produce series and original movies that appeal to our target demographic and (ii) develop a programming schedule that attracts a high number of viewers. Original productions are our most high profile programs and generate Hallmark Channel s highest ratings. The Company has typically incurred additional marketing and promotional expenses to help drive higher ratings for original productions and certain acquired movies, such as for *Cedar Cove* in 2013. We plan to maintain or increase the number of our original productions and develop a programming schedule that attracts a greater number of viewers in our target demographic, all while controlling the costs and expenses relating to these actions.

Advertising Revenue

During the three months ended September 30, 2013, CPMs for commitments in the 2012/2013 Scatter Market for Hallmark Channel were 40% greater than the CPMs for commitments during the 2012/2013 Upfront Season but were generally 5% lower than achieved during the three months ended September 30, 2012, during the 2011/2012 Scatter Market. During the three months ended September 30, 2013, CPMs for commitments in the 2012/2013 Scatter Market for Hallmark Movie Channel were 31% greater than the CPMs for commitments during the 2012/2013 Upfront Season but were generally 4% lower than achieved during the three months ended September 30, 2012, during the 2011/2012 Scatter Market.

Our direct response rates for Hallmark Channel during the three months ended September 30, 2013, were 21% higher than those during the three months ended September 30, 2012. Our direct response rates for Hallmark Movie Channel during the three months ended September 30, 2013, were 37% higher than those during the three months ended September 30, 2012.

During the 2011/2012 and the 2012/2013 Upfront Seasons, we entered into agreements with major advertising firms covering approximately 43% and 39% of our advertising inventory, respectively, for Hallmark Channel. Advertising units committed during the 2012/2013Upfront Season for Hallmark Channel were at CPMs 4% higher than the CPMs for those committed during the 2011/2012 Upfront Season, reflecting, in part, increases in rates related to our lifestyle programming block. We sold the balance of our 2012/2013 broadcast season inventory in the Scatter Market.

During the 2011/2012 and the 2012/2013 Upfront Seasons, Hallmark Movie Channel entered into advertising commitments for approximately 32% and 28% of its advertising inventory, respectively. Advertising units committed during the 2012/2013Upfront Season for Hallmark Movie Channel were at CPMs flat to the CPMs for those committed during the 2011/2012 Upfront Season.

Each advertiser with an upfront contract has the option to terminate its contract, as well as an option to expand its commitment. During the three months ended September 30, 2012 and 2013, Hallmark Channel experienced cancellation rates of approximately 8%

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and 7%, respectively. During the three months ended September 30, 2012 and 2013, Hallmark Movie Channel experienced cancellation rates of approximately 2% and 11%, respectively.

Distribution Agreements

Distribution agreements with multiple systems operators 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. Our long-term distribution challenge will be obtaining favorable renewals of our major distribution agreements as they expire. Our major distribution agreements have terms which expire at various times from December 2015 through December 2032.

The universe of cable and satellite TV subscribers in the United States is approximately 104 million homes. The top 30 cable TV networks in the United States, measured by the number of subscribers, have 97 million or more subscribers. According to Nielsen, Hallmark Channel had nearly 87 million subscribers at September 30, 2013, and Hallmark Movie Channel was distributed to more than 52 million subscribers.

Demographics

Each pay television network attracts a different audience with different viewer demographics (*i.e.*, viewers categorized by characteristics such as age, gender and income). As a result, advertisers are able to target the specific groups of viewers who are most likely to purchase their products by advertising on networks which attract the desired viewer demographic.

We believe that the key demographics for Hallmark Channel and Hallmark Movie Channel are the viewers in the groups adults aged 25 to 54 and women aged 25 to 54. The average viewing age for Hallmark Channel was 56.9 and 58.5 for the quarters ended September 30, 2012 and 2013, respectively. The average viewing age for Hallmark Movie Channel was 63.5 and 64.4 for the quarters ended September 30, 2012 and 2013, respectively. In order to achieve our revenue goals, we need to draw in our target audience.

Revenue from Continuing Operations

Our revenue consists of advertising fees and subscriber fees.

Advertising

We earn advertising revenue in the form of spot or general rate advertising and direct response advertising. Spot advertisements and direct response advertisements are generally 30 seconds long and are aired during or between programs. Spot advertisements are priced at a rate per thousand viewers (*i.e.,* the CPM) and almost always include the Company s commitment to deliver a specified number of viewers. Our revenue from direct response advertising varies in proportion to the direct sales achieved by the advertiser in response to the advertising. It is sold without ratings or product sales commitments. Our advertising revenue is affected by the mix of these forms of advertising. Advertising rates also vary by time of year due to seasonal changes in television viewership.

Advertising revenue is recorded net of ADUs. Whenever spot advertising is aired in programs that do not achieve promised viewership ratings, we issue ADUs which provide the advertiser with additional spots at no additional cost to make up for the shortfall. We defer a pro rata amount of advertising revenue and recognize a like amount as a liability for programs that do not achieve promised viewership ratings. When the make-good spots are subsequently aired, revenue is recognized and the liability is reduced. The level of inventory that is utilized for ADUs varies over time and is influenced by prior fluctuations in our under-delivery, if any, of viewers against promised ratings as well as the rate at which we and our customers mutually agree to utilize the ADUs.

We typically commit approximately 40% of our Networks advertising in the Upfront Season. We hold back a small percentage of our inventory for ADUs and commit the remainder in the spot or Scatter Market and to advertisers that purchase up-front inventory on a calendar year basis.

The volume of advertising inventory that we have available for sale is determined by our chosen commercial load per hour and the number of broadcast hours in which we air licensed program content. Our Networks are broadcast 24 hours per day. Our need to reserve inventory for the use of ADUs reduces the amount of advertising inventory available for cash sales.

We have advertising sales offices in New York, Los Angeles, Chicago, and Atlanta. In addition, we have made significant investments in programming, research, marketing and promotions, all specifically designed to support the sale of advertising time on our Networks.

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Subscriber Fees

Subscriber fees are payable to us on a per subscriber basis by pay television distributors for the right to carry our Networks. The fees we receive per subscriber vary with changes in the following factors, among others:

• the degree of competition in the market;

• the relative position in the market of the distributor and the popularity of the Network;

• the packaging arrangements for the Network; and

• length of the contract term and other commercial terms.

We are in continuous negotiations with our existing distributors to have our Networks placed in packages with a greater number of subscribers, thereby increasing our subscriber base and enhancing our opportunities to generate advertising revenue. We have been subject to requests by major distributors to pay promotion and placement fees to help fund the distributors efforts to market our Networks. Fees that we pay to a distributor are capitalized and amortized over the term of the applicable distribution agreement as a reduction in subscriber fee revenue. At the time we sign a distribution agreement and periodically thereafter, we evaluate the recoverability of the costs we incur against the incremental revenue directly and indirectly associated with each agreement.

Our Networks are usually offered as one of a number of networks on either a basic tier or part of other program packages and are not generally offered on a stand-alone basis. Thus, while cable or satellite customers may subscribe and unsubscribe to the tiers and program packages in which one of our Networks is placed, these customers do not subscribe and unsubscribe to our Networks alone.

Each Network s subscriber count depends on the number of distributors carrying the Network, the size of such distributors, and the program tiers on which the Network is carried by these distributors. From time to time, we experience increases or decreases in the number of subscribers as promotional periods end, or as a distributor arrangement is amended or terminated by us or the distributor. Management analyzes the estimated effect each new or amended distribution agreement will have on revenue and costs.

Cost of Services

Our cost of services consists primarily of the amortization of programming rights, the cost of signal distribution and the cost of promotional segments that are aired between programs.

Critical Accounting Policies, Judgments and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of 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 Notes to Unaudited Condensed Consolidated Financial Statements Summary of Significant Accounting Policies and Estimates in Item 1 of this Quarterly Report on Form 10-Q 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, 2012.

Effects of Transactions with Related and Certain Other Parties

In 2013 and in prior years, we entered into a number of significant transactions with Hallmark Cards and certain of its subsidiaries. These transactions include, among other things, trademark licenses, program licenses, and an administrative services agreement. A summary of the terms and financial impact of these transactions is described in the Company s Annual Report on Form 10-K as filed with the SEC for the year ended December 31, 2012.

Selected Historical Consolidated Financial Data of Crown Media Holdings

In the table below, we provide selected historical unaudited condensed consolidated financial and other data of Crown Media Holdings and its subsidiaries. The following selected unaudited condensed consolidated statement of operations data for three and nine months ended September 30, 2012 and 2013, are derived from the unaudited financial statements of Crown Media Holdings and its subsidiaries. Ratings and subscriber information is also unaudited. This data should be read together with the unaudited condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q.

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	Three Months Ended September 30,		Nine Months Ended September 30,		Percentage Change	
	2012	2013	2012	2013	Three Months	Nine Months
	(in thousands)					
Revenue:						
Advertising	$ 57,739	$ 63,577	$ 188,118	$ 197,525	10%	5%
Subscriber fees	19,294	20,527	58,952	61,273	6%	4%
Other revenue	22	273	499	614	1141%	23%
Total revenue	77,055	84,377	247,569	259,412	10%	5%
Cost of Services:						
Programming costs	29,717	33,821	98,390	97,842	14%	-1%
Operating costs	3,302	4,244	10,039	11,416	29%	14%
Total cost of services	33,019	38,065	108,429	109,258	15%	1%
Selling, general and administrative expense	14,091	15,718	43,411	46,700	12%	8%
Marketing expense	430	3,993	1,669	5,686	829%	241%
Income before interest and income tax expense	29,515	26,601	94,060	97,768	-10%	4%
Interest expense	(11,451)	(10,486)	(34,655)	(32,284)	-8%	-7%
Income before income tax expense and gain from sale of discontinued operations	18,064	16,115	59,405	65,484	-11%	10%
Income tax provision	(6,566)	(6,111)	(22,164)	(24,431)	-7%	10%
Net income	$ 11,498	$ 10,004	$ 37,241	$ 41,053	-13%	10%
Cash Flow Data:						
Net cash provided by operating activities	$ 12,234	$ 12,830	$ 20,185	$ 34,372	5%	70%
Net cash used in investing activities	$ (653)	$ (546)	$ (981)	$ (1,402)	-16%	43%
Net cash used in financing activities	$ (823)	$ (15,751)	$ (19,949)	$ (35,710)	1814%	79%
Other Data (Unaudited):						
HC Total day household ratings (1)(3)(4)	0.4	0.5	0.4	0.4	3%	-3%
HC primetime household ratings (2)(3)(4)	0.5	0.7	0.6	0.6	29%	6%
HMC Total day household ratings (1)(3)(4)	0.3	0.3	0.3	0.3	20%	20%
HMC primetime household ratings (2)(3)(4)	0.3	0.4	0.3	0.4	18%	21%
HC Total day W25-54 ratings (1)(3)(4)	0.2	0.3	0.2	0.2	2%	2%
HC primetime W25-54 ratings (2)(3)(4)	0.3	0.3	0.3	0.3	8%	-5%
HMC Total day W25-54 ratings (1)(3)(4)	0.1	0.1	0.1	0.1	13%	15%
HMC primetime W25-54 ratings (2)(3)(4)	0.1	0.1	0.1	0.1	-25%	-4%
HC subscribers at period end (4)	86,679	86,985	86,679	86,985	0%	0%
HMC subscribers at period end (4)	47,864	52,475	47,864	52,475	10%	10%

(1) Total day means the time period that Nielsen measures each individual day, 6 a.m. to 6 a.m.

(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 29, 2013 as compared to June 25, 2012, through September 30, 2012, and December 31, 2012 through September 29, 2013 as compared to December 26, 2011 through September 30, 2012.

(4) HC represents Hallmark Channel and HMC represents Hallmark Movie Channel. Ratings and subscribers are reported by The Nielsen Company.

Results of Operations

Three Months Ended September 30, 2012 Compared to Three Months Ended September 30, 2013

Revenue. Revenue from continuing operations comprised primarily of advertising and subscriber fees, increased $7.3 million or 10% for the third quarter of 2013 as compared to the third quarter of 2012.

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The $5.8 million or 10% increase in advertising revenue is due to Hallmark Movie Channel distribution and audience growth. Hallmark Movie Channel subscribers grew from nearly 48 million subscribers at September 30, 2012, to more than 52 million subscribers at September 30, 2013. Advertising revenue from the Hallmark Movie Channel was $10.4 million and $13.4 million for the three months ended September 30, 2012 and 2013, respectively.

Subscriber fee revenue increased $1.2 million or 6% due to rate increases under certain distribution agreements. The amount of promotion and placement fees that was recorded as a reduction of subscriber fee revenue was approximately $243,000 and $263,000 for the three months ended September 30, 2012 and 2013, respectively.

Cost of services. Cost of services as a percent of revenue increased to 45% for the three months ended September 30, 2013, as compared to 43% for the three months ended September 30, 2012. This increase results primarily from the 14% increase in programming costs, discussed below.

Programming costs increased $4.1 million or 14% during the three months ended September 30, 2013, compared to the three months ended September 30, 2012, primarily due to the amortization of *Cedar Cove*. Other costs of services for the three months ended September 30, 2013 increased $942,000 from the three months ended September 30, 2012, due to the $475,000 increase in bad debt expense from $29,000 during the quarter ended September 30, 2012 to $504,000 during the quarter ended September 30, 2013, and the $526,000 increase salary, consulting and playback costs.

Selling, general and administrative expense. Selling, general and administrative expense for the three months ended September 30, 2013, increased $1.6 million from the three months ended September 30, 2012, primarily related to a $1.4 million increase in employee costs and a $152,000 increase in depreciation and amortization expense.

Marketing expense. Marketing expense increased from $430,000 to $4.0 million during third quarter of 2013 versus the third quarter of 2012 due to the marketing and promotion of *Cedar Cove*.

Interest expense. Interest expense decreased $965,000 for the three months ended September 30, 2013, as compared to the three months ended September 30, 2012, due to Amendment No. 1 that reduced the Company s minimum rate on LIBOR borrowings under the Term Loan from 5.75% to 4.00% and the $17.4 million principal payment made in March 2013. At September 30, 2012 and 2013, the outstanding balance under the Term Loan was $188.1 million and $154.2 million, respectively. Interest expense on the Term Loan was $3.0 million and $2.0 for the quarters ended September 30, 2012 and 2013, respectively. Interest expense on the Notes was $8.0 million and $8.1 million for the quarters ended September 30, 2012 and 2013, respectively.

Income tax provision. Provisions for income tax of $6.6 million and $6.1 million reflect effective tax rates of 36.3% and 37.9% for the three months ended September 30, 2012 and 2013, respectively. The provision for income taxes differs from the amount that would be provided by applying the statutory U.S. federal income tax rate to pre-tax income primarily because of state income taxes and estimated permanent differences.

Nine Months Ended September 30, 2012 Compared to Nine Months Ended September 30, 2013

Revenue. Revenue from continuing operations, comprised primarily of advertising and subscriber fees, increased $11.8 million, or 5%, for the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012. The $9.4 million or 5% increase in advertising revenue is due to Hallmark Movie Channel distribution and audience growth. Our subscriber fee revenue increased $2.3 million, or 4%, due to rate increases under certain distribution agreements. The amount of promotion and placement fees that was recorded as a reduction of subscriber fee revenue was approximately $894,000 and $788,000 for nine months ended September 30, 2012 and 2013, respectively.

Cost of services. Cost of services as a percent of revenue decreased to 42% during the nine months ended September 30, 2013, as compared to 44% for the nine months ended September 30, 2012. This decrease results primarily from the effects of the 5% increase in advertising revenue discussed above.

Programming costs decreased $548,000 or 1% during the nine months ended September 30, 2013, compared to the nine months ended September 30, 2012, due to the expiration of a number of programming license agreements and the end of *The Martha Stewart Show* agreement, offset, in part by the amortization of *Cedar Cove*. Other costs of services for the nine months ended September 30, 2013 increased $1.4 million compared to the nine months ended September 30, 2012 primarily due to a $738,000 increase in bad debt expense from $56,000, during the period ended September 30, 2012, to $794,000, during the period ended September 30, 2013, and an increase in employee, playback and consulting costs of $596,000 period over period.

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Selling, general and administrative expense. Selling, general and administrative expense increased $3.3 million from the nine months ended September 30, 2012, primarily related to a $2.1 million increase in employee costs, a $296,000 increase in rent, a $260,000 increase in third party costs directly expensed in conjunction with Amendment No. 1 and a $300,000 increase in depreciation and amortization expense.

Marketing expense. Marketing expense increased from $1.7 million to $5.7 million during the nine months ended September 30, 2013, versus the nine months ended September 30, 2012, due to the marketing and promotion of *Cedar Cove*.

Interest expense. Interest expense decreased $2.4 million for the nine months ended September 30, 2013, as compared to the nine months ended September 30, 2012, due to Amendment No. 1 that reduced the Company s minimum rate on LIBOR borrowings under the Term Loan from 5.75% to 4.00% and the $17.4 million principal payment made in March 2013. Interest expense on the Term Loan was $9.2 million and $6.9 for the nine months ended September 30, 2012 and 2013, respectively. Interest expense on the Notes was $24.1 million and $24.2 million for the nine months ended September 30, 2012 and 2013, respectively.

Income tax provision. Provisions for income tax of $22.2 million and $24.4 million reflect effective tax rates of 37.3% for each of the nine months ended September 30, 2012 and 2013. The provision for income taxes differs from the amount that would be provided by applying the statutory U.S. federal income tax rate to pre-tax income primarily because of state income taxes and estimated permanent differences.

Liquidity and Capital Resources

Cash Flow from Operating Activities. Cash provided by operating activities was $20.2 million and $34.4 million for the nine months ended September 30, 2012 and 2013, respectively. The Company had net income of $37.2 million for the nine months ended September 30, 2012, as compared to $41.1 million for the nine months ended September 30, 2013. Our depreciation and amortization expense for the nine months ended September 30, 2013 increased $6.6 million. The Company made interest payments of $11.2 million and $6.2 million, respectively, on the Term Loan during the nine months ended September 30, 2012 and 2013. The Company made programming payments of $120.3 million and $130.7 million during the nine months ended September 30, 2012 and 2013, respectively. Cash receipts during the nine months ended September 30, 2012 and 2013 were $258.0 million and $274.7 million, respectively.

Cash Flow from Investing Activities. Cash used in investing activities was $981,000 and $1.4 million during the nine months ended September 30, 2012 and 2013, respectively, as the Company purchased additional computer equipment during 2013.

Cash Flow from Financing Activities. Cash used in financing activities was $19.9 million and $35.7 million for the nine months ended September 30, 2012 and 2013, respectively. The Company made principal payments on its Term Loan of $19.1 million and $33.2 million during the nine months ended September 30, 2012 and 2013, respectively. In conjunction with Amendment No. 1, the Company paid $1.1 million of debt issuance costs and $430,000 of debt discount in March 2013.

Principal Uses of Cash. The Company s management anticipates that the principal uses of cash during the twelve month period ending September 30, 2014 will include the payment of operating expenses, accounts payable and accrued expenses, programming costs, and interest payments of approximately $37.8 million under the Term Loan and Notes. The Company believes that cash on hand, cash generated by operations, and borrowing available under its amended revolving credit facility, will be sufficient to fund the Company s operations and enable the Company to meet its liquidity needs through September 30, 2014.

Credit Facilities and Term Loan

On March 29, 2013, the Company and the lender syndicate amended the Company s credit agreement dated July 14, 2011. Among other things, the amendment served to (i) significantly reduce the nominal interest rates applicable to principal owed by the Company and (ii) extend the maturity of the $30.0 million revolving credit facility.

The amendment also served to modify the lender syndicate supporting the Term Loan. For financial reporting purposes, the Company treated the transaction as a modification, as the present value of the cash flows did not substantially change.

The Company incurred costs of approximately $1.8 million in connection with the amendment, of which (i) $430,000, representing a 0.25% discount paid to all members of the lender syndicate, and (ii) $1.1 million of debt issuance costs paid to creditors have been capitalized with respect to the Term Loan and will be amortized along with previously unamortized amounts related to syndicate members. Third-party debt issuance costs of $260,000 were expensed and are included in selling, general and administrative expense in the accompanying condensed consolidated statement of operations for the nine months ended September 30, 2013.

The amendment reduced the Company s minimum rate on LIBOR borrowings under the Term Loan from 5.75% to 4.00% (the latter comprising a LIBOR floor of 1.00% plus an applicable rate of 3.00%). The LIBOR floor was reduced by 25 basis points and the applicable rate was reduced by 150 basis points. The July 14, 2018 maturity date for the Term Loan remains unchanged.

Prior to March 29, 2013, the Company made principal payments of $525,000 at each quarter s end. Under the amended Term Loan, the Company made quarterly principal payments of $430,000 through September 2013. Subsequent to that date, the Company is no longer required to make these principal payments due to its voluntary payment. The Company continues to be subject to requirements to remit additional principal payments in amounts equal to (1) 50% of excess cash flow (as defined in the amended credit agreement) as determined annually, which percentage will be reduced to 25% if the consolidated leverage ratio (as defined in the amended credit agreement) is equal to or less than 4.25 to 1 but greater than 3.25 to 1, and 0% if the consolidated leverage ratio is equal to or less than 3.25 to 1, respectively; (2) 100% of net cash proceeds resulting from dispositions or casualty events if such proceeds have not been reinvested within one year after the occurrence of the disposition or casualty event; and (3) 100% of net cash proceeds from issuance of debt or preferred stock not otherwise permitted by the amended credit agreement.

Under the amended revolving credit facility, the maturity date was extended from July 14, 2016, to January 14, 2018. The interest rate applicable to future borrowings, if any, was also reduced from 3.5% to 2.75%. At December 31, 2012 and September 30, 2013, the Company had no outstanding borrowings under the amended revolving credit facility.

The covenants in the amended credit agreement continue to limit the ability of Crown Media Holdings and certain of its subsidiaries to (1) incur indebtedness; (2) create or permit liens on assets; (3) make certain dividends, stock repurchases and redemptions and other restricted payments; (4) make certain investments; (5) prepay indebtedness; (6) enter into certain transactions with Crown Media Holdings affiliates; (7) dispose of substantially all of the assets of Crown Media Holdings; (8) merge or consolidate; (9) enter into new unrelated lines of businesses; and (10) enter into sale and leaseback transactions. The amended credit agreement also requires compliance with a maximum total leverage ratio test and a maximum total secured leverage ratio test, but permits, with certain limitations, certain equity contributions to be made to Crown Media Holdings to enhance its ability to comply with such ratio tests.

The amended credit agreement contains a number of affirmative and negative covenants. The Company was in compliance with these covenants as of September 30, 2013.

At December 31, 2012, and September 30, 2013, the outstanding balance under the Term Loan, net of unamortized discount, was $187.6 million and $154.2 million, respectively. The Company made principal payments of $525,000 and $15.4 million under the Term Loan during the three months ended September 30, 2012 and 2013, respectively. The Company made principal payments of $19.1 million and $33.2 million under the Term Loan during the nine months ended September 30, 2012 and 2013, respectively.

Interest expense under the Term Loan was $3.0 million and $2.0 million for the three months ended September 30, 2012 and 2013, respectively. The effective interest rate was approximately 6.3% and 4.87% during the three months ended September 30, 2012 and 2013, respectively. The weighted average nominal interest rate was approximately 5.75% and 4.00% during the three months ended September 30, 2012 and 2013, respectively.

Interest expense under the Term Loan was $9.2 million and $6.9 million for the nine months ended September 30, 2012 and 2013, respectively. The effective interest rate was approximately 6.3% and 5.39% during the nine months ended September 30, 2012 and 2013, respectively. The weighted average nominal interest rate was approximately 5.75% and 4.69% during the nine months ended September 30, 2012 and 2013, respectively.

Interest expense under the revolving credit facility for the three and nine months ended September 30, 2012 and 2013, was $0. One letter of credit was outstanding in the amount of $202,000 at both December 31, 2012, and September 30, 2013. Commitment fees on the revolving credit facility are payable on the unused revolving credit commitment at the rate of 0.50% per annum, payable quarterly. Commitment fee expense for each of the three months ended September 30, 2012 and 2013 was $38,000, respectively. Commitment fee expense for each of the nine months ended September 30, 2012 and 2013 was $114,000 and $113,000, respectively.

The Notes

On July 14, 2011, the Company issued the Notes in a private placement conducted pursuant to Rule 144A under the Securities Act of 1933, as amended (the Securities Act). The Notes are guaranteed on a senior basis by each of Crown Media Holdings subsidiaries (the Guarantors).

Commencing January 15, 2012, interest on the Notes became payable each January 15th and July 15th. The Company is not required to make mandatory sinking fund payments with respect to the Notes.

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The covenants in the related indenture (the Indenture) limit the ability of the Company to, among other things (1) incur additional debt; (2) pay dividends or make other restricted payments; (3) purchase, redeem or retire capital stock or subordinated debt; (4) make asset sales, including by way of sale leaseback transactions; (5) provide subsidiary guarantees; (6) enter into certain transactions with affiliates; (7) incur liens; (8) make investments; and (9) merge or consolidate with any other person.

During any period in which the Notes have an investment grade rating from both Moody s and S&P (at least Baa3 by Moody s and BBB- by S&P), and no default has occurred and is continuing under the Indenture, Crown Media Holdings and its restricted subsidiaries will not be required to comply with the covenants in the Indenture that limit their ability to (1) incur additional debt; (2) pay dividends or make other restricted payments; (3) purchase, redeem or retire capital stock or subordinated debt; (4) make asset sales; (5) provide subsidiary guarantees; and (6) enter into certain transactions with affiliates. The Company was in compliance with these covenants as of September 30, 2013.

Interest expense under the Notes was $8.0 million and $8.1 million for the three months ended September 30, 2012 and 2013, respectively. After giving effect to the amortization of associated debt issuance costs, the effective interest rate of the Notes was approximately 11.0% during the three months ended September 30, 2012 and 2013.

Interest expense under the Notes was $24.1 million and $24.2 million for the nine months ended September 30, 2012 and 2013, respectively. After giving effect to the amortization of associated debt issuance costs, the effective interest rate of the Notes was approximately 11.0% during the nine months ended September 30, 2012 and 2013.

*Guarantee*s. Because Crown Media Holdings has no independent assets or operations, the guarantees by the subsidiary guarantors are full and unconditional, joint and several, and there are no subsidiaries of Crown Media Holdings that are not subsidiary guarantors. With certain exceptions described above, the Indenture and the Amended Credit Agreement impose restrictions on the payment of dividends by Crown Media Holdings and the subsidiary guarantors.

Risk Factors and Forward-Looking Statements

The discussion set forth in this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 concerning potential future events. Such forward-looking statements are based on assumptions by Crown Media Holdings management, as of the date of this Quarterly Report on 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, plans 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 differ materially from those anticipated by such forward-looking statements.

Among the factors that could cause actual results to differ materially are those discussed in the Company s filings with the Securities and Exchange Commission (the SEC), including the Risk Factors stated in the Company s Annual Report on Form 10-K for the year ended December 31, 2012 (the 2012 Annual Report), and subsequent Quarterly Reports on Form 10-Q. Such Risk Factors include, but are not limited to, the following: competition for distribution of networks, viewers, advertisers and the acquisition of programming; fluctuations in the availability of programming; fluctuations in demand for programming which we air on our Networks; our ability to address our liquidity needs;

and our substantial indebtedness affecting our financial condition and results. The forward-looking statements in this report speak as of the filing date of this report. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

Available Information

We will make available free of charge through our website, www.hallmarkchannel.com, the 2012 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 SEC.

The filings are also available through the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549 or by calling 1-800-SEC-0330. Also, these filings are available on the internet at *www.sec.gov*.

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. Our code is available through our website,

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or copies may be requested by contacting the Company s General Counsel at 12700 Ventura Boulevard, Studio City, California 91604.

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

As of September 30, 2013, our cash had a fair value of $41.0 million. In the past, the primary purpose of our investing activities has been to preserve principal until the cash is required to fund operations. Consequently, the size of this portfolio fluctuated significantly as cash was provided by and used in our business.

We have not used derivative financial instruments for speculative purposes. As of September 30, 2013, we are not hedged or otherwise protected against risks associated with any of our investing or financing activities.

We are exposed to market risk.

We are exposed to market risk, including changes to interest rates. To reduce the volatility relating to these exposures, we may enter into various derivative investment transactions in the near term pursuant to our investment and risk management policies and procedures in areas such as hedging and counterparty exposure practices. We have not used 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. The balance of our interest bearing assets was $41.0 million, or 4% of total assets as of September 30, 2013. Our material liability subject to interest rate risk consisted of our Term Loan. The balance of this liability was $154.3 million, or 24% of total liabilities, as of September 30, 2013. Net interest expense for the nine months ended September 30, 2013 was $32.3 million, 12%, of our total revenue. Our net interest expense for this liability is sensitive to changes in the general level of interest rates, primarily U.S. and LIBOR interest rates. In this regard, changes in U.S. and LIBOR interest rates affect the fair value of interest bearing liabilities.

Our variable rate Term Loan is subject to an interest rate floor of 1.0% and a margin of 3.0%. Accordingly, if the relevant market interest rate had been 1% greater or lower, the effect on the Term Loan s effective interest rate and resulting interest expense for the period would have been negligible.

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

a. Disclosure Controls and Procedures

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

b. Changes in Internal Control over Financial Reporting

There was no change in the Company s internal control over financial reporting that occurred during the quarter ended September 30, 2013, that materially affected, or was reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1A. Risk Factors

You should carefully consider the factors discussed in Part I, Item 1A, Risk Factors in our 2012 Annual Report, as such risk factors have been updated by the filing with the SEC of subsequent periodic and current reports from time to time, which factors could materially affect our business, financial condition, or future results. Such risks, however, are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, and/or reporting results.

Item 6. ***Exhibits***

INDEX TO EXHIBITS

Exhibit Number	Exhibit Title
3.1	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).
3.2	Second Amended and Restated Certificate of Incorporation of Crown Media Holdings, Inc. (previously filed as Exhibit 3.1 to our Current Report on Form 8-K filed on March 1, 2010 and incorporated herein by

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	reference).
3.3	Certificate of Designation, Powers, Preferences, Qualifications, Limitations, Restrictions and Relative Rights of Series A Convertible Preferred Stock of Crown Media Holdings, Inc. (previously filed as Exhibit 3.2 to our Current Report on Form 8-K filed on March 1, 2010 and incorporated herein by reference).
3.4	Third Amended and Restated Certificate of Incorporation of Crown Media Holdings, Inc. (previously filed as Exhibit 3.3 to our Current Report on Form 8-K filed on March 1, 2010 and incorporated herein by reference).
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 Certification.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	Taxonomy Extension Calculation Linkbase Document
101. DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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* Management contract or compensating plan or arrangement.

Furnished, not filed.

XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and is otherwise not subject to liability under these sections.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CROWN MEDIA HOLDINGS, INC.

	Signature	Title	Date
By:	/s/ WILLIAM J. ABBOTT William J. Abbott	Principal Executive Officer	November 1, 2013
By:	/s/ ANDREW ROOKE Andrew Rooke	Principal Financial and Accounting Officer	November 1, 2013

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INDEX TO EXHIBITS

Exhibit Number	Exhibit Title
3.1	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).
3.2	Second Amended and Restated Certificate of Incorporation of Crown Media Holdings, Inc. (previously filed as Exhibit 3.1 to our Current Report on Form 8-K filed on March 1, 2010 and incorporated herein by reference).
3.3	Certificate of Designation, Powers, Preferences, Qualifications, Limitations, Restrictions and Relative Rights of Series A Convertible Preferred Stock of Crown Media Holdings, Inc. (previously filed as Exhibit 3.2 to our Current Report on Form 8-K filed on March 1, 2010 and incorporated herein by reference).
3.4	Third Amended and Restated Certificate of Incorporation of Crown Media Holdings, Inc. (previously filed as Exhibit 3.3 to our Current Report on Form 8-K filed on March 1, 2010 and incorporated herein by reference).
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