

CROWN MEDIA HOLDINGS INC  
Form 10-Q  
November 09, 2010  
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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_ .

Commission File Number: 000-30700

**Crown Media Holdings, Inc.**

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(Exact Name of Registrant as Specified in Its Charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**84-1524410**  
(I.R.S. Employer Identification No.)

**12700 Ventura Boulevard,**

**Suite 200**

**Studio City, California 91604**

(Address of Principal Executive Offices and Zip Code)

**(818) 755-2400**

(Registrant's Telephone Number, Including Area Code)

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

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

Indicate by check mark whether the registrant 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  No

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

As of November 1, 2010, the number of shares of Class A Common Stock, \$.01 par value outstanding was 359,675,936.

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In this Form 10-Q the terms *Crown Media Holdings* and the *Company* refer to *Crown Media Holdings, Inc.* and, unless the context requires otherwise, subsidiaries of *Crown Media Holdings* that operate or have operated our businesses including *Crown Media United States, LLC* ( *Crown Media United States* ). The term *common stock* refers to our *Class A common stock* and *Class B common stock*, unless the context requires otherwise. As part of the recapitalization transactions described below, 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.

The name *Hallmark* and other product or service names are trademarks or registered trademarks of their owners.

**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)****CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

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

	As of December 31, 2009	As of September 30, 2010
<b>ASSETS</b>		
Cash and cash equivalents	\$ 10,456	\$ 36,150
Restricted cash		20,019
Accounts receivable, less allowance for doubtful accounts of \$476 and \$224, respectively	68,817	62,978
Program license fees	106,825	98,690
Prepaid program license fees	1,778	10,727
Prepaid and other assets	2,271	2,351
Total current assets	190,147	230,915
Program license fees	178,332	138,939
Property and equipment, net	13,176	12,522
Goodwill	314,033	314,033
Prepaid and other assets	2,373	891
Total assets	\$ 698,061	\$ 697,300

See accompanying notes to unaudited condensed consolidated financial statements.



Table of Contents**CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except par value and number of shares)****(continued)**

	<b>As of December 31, 2009</b>	<b>As of September 30, 2010</b>
<b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>		
<b>LIABILITIES:</b>		
Accounts payable and accrued liabilities	\$ 19,642	\$ 22,857
Audience deficiency reserve liability	17,872	31,144
License fees payable	99,494	94,047
Payables to Hallmark Cards affiliates	23,745	5,543
Credit facility and interest payable	1,002	
Notes and interest payable to HCC	345,314	45,350
Company obligated mandatorily redeemable preferred interest	22,902	24,619
Total current liabilities	529,971	223,560
Accrued liabilities	24,484	21,333
License fees payable	82,881	44,016
Notes and interest payable to HCC		387,658
Senior secured note to HCC, including accrued interest	758,755	
Total liabilities	1,396,091	676,567
<b>COMMITMENTS AND CONTINGENCIES</b>		
Redeemable preferred stock, \$.01 par value; \$1,000 liquidation preference; 10,000,000 and 1,000,000 shares authorized; 0 and 185,000 shares issued and outstanding as of December 31, 2009, and September 30, 2010, respectively		191,860
<b>STOCKHOLDERS DEFICIT:</b>		
Class A common stock, \$.01 par value; 200,000,000 and 500,000,000 shares authorized; 74,117,654 and 359,675,936 shares issued and outstanding as of December 31, 2009, and September 30, 2010, respectively	741	3,597
Class B common stock, \$.01 par value; 120,000,000 and 0 shares authorized; 30,670,422 and 0 shares issued and outstanding as of December 31, 2009, and September 30, 2010, respectively	307	
Paid-in capital	1,456,788	1,993,390
Accumulated deficit	(2,155,866)	(2,168,114)
Total stockholders deficit	(698,030)	(171,127)
Total liabilities and stockholders deficit	\$ 698,061	\$ 697,300

See accompanying notes to unaudited condensed consolidated financial statements.





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(In thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2010	2009	2010
<b>Revenue:</b>				
Subscriber fees	\$ 15,998	\$ 13,973	\$ 47,153	\$ 46,839
Advertising	46,296	48,499	153,177	149,427
Advertising by Hallmark Cards	191		525	208
Other revenue	334	48	1,098	133
Total revenue, net	62,819	62,520	201,953	196,607
<b>Cost of Services:</b>				
Programming costs				
Hallmark Cards affiliates	315	437	914	1,274
Non-affiliates	31,365	30,809	94,282	89,343
Contract termination				103
Other costs of services	3,405	3,092	11,905	8,399
Total cost of services	35,085	34,338	107,101	99,119
Selling, general and administrative expense (exclusive of depreciation and amortization expense shown separately below)				
	12,208	12,294	35,000	36,581
Marketing expense	339	7,114	5,956	8,551
Depreciation and amortization expense	495	347	1,462	1,113
Loss on sale of film assets				155
Income from operations before interest and income tax expense	14,692	8,427	52,434	51,088
Interest income	115		375	43
Interest expense	(24,999)	(2,509)	(75,774)	(53,622)
(Loss) income from operations before income tax expense	\$ (10,192)	\$ 5,918	\$ (22,965)	\$ (2,491)
Income tax expense (Note 6)				(2,897)
Net(loss) income and comprehensive (loss) income	\$ (10,192)	\$ 5,918	\$ (22,965)	\$ (5,388)
Imputed preferred stock dividends from amortization of discount on preferred stock		(6,860)		(6,860)
Net loss and comprehensive loss to common stockholders	\$ (10,192)	\$ (942)	\$ (22,965)	\$ (12,248)
Weighted average number of common shares outstanding, basic and diluted				
	104,788	359,676	104,788	192,552
Net (loss) income per common share, basic	\$ (0.10)	\$ 0.00	\$ (0.22)	\$ (0.06)
Net (loss) income per common share, diluted	\$ (0.10)	\$ 0.00	\$ (0.22)	\$ (0.06)

See accompanying notes to unaudited condensed consolidated financial statements.



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

	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2010</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (22,965)	\$ (5,388)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Loss on sale of film assets		155
Depreciation and amortization	99,319	93,186
Accretion on company obligated mandatorily redeemable preferred interest	1,560	1,717
Provision for allowance for doubtful accounts	1,128	44
Loss on sale of fixed asset		2
Debt issuance costs		1,049
Income tax expense		2,897
Stock-based (benefit) compensation	(550)	233
Changes in operating assets and liabilities:		
Decrease in accounts receivable	7,894	5,795
Additions to program license fees	(79,829)	(41,946)
Decrease (increase) in prepaid and other assets	4,964	(10,126)
(Decrease) increase in accounts payable, accrued and other liabilities	(5,538)	14,311
Increase in interest payable	49,481	33,820
Decrease in license fees payable	(22,375)	(44,312)
Increase in payables to affiliates	278	78
Net cash provided by operating activities	33,367	51,515
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(371)	(729)
Payments to buyer of international business	(691)	(686)
Net cash used in investing activities	(1,062)	(1,415)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Funding of restricted cash account		(20,019)
Borrowings under the credit facility	18,062	
Principal payments on the credit facility	(44,121)	(1,000)
Accretion of interest on notes payable to HCC		868
Payments for debt issuance costs under the troubled debt restructuring		(3,596)
Principal payments on capital lease obligations	(601)	(659)
Net cash used in financing activities	(26,660)	(24,406)
Net increase in cash and cash equivalents	5,645	25,694
Cash and cash equivalents, beginning of period	2,714	10,456
Cash and cash equivalents, end of period	\$ 8,359	\$ 36,150
<b>Supplemental disclosure of cash and non-cash activities:</b>		
Interest paid	\$ 22,022	\$ 15,079
Reduction of additional paid-in capital for obligation under tax sharing agreement	\$ 4,893	\$ 5,501
Asset acquired through capital lease obligation	\$	\$ 232
Additional paid-in capital from imputed dividends on preferred stock	\$	\$ 6,860
Increase in accumulated deficit from imputed dividends on preferred stock	\$	\$ (6,860)
<b>Non-cash activities related to the troubled debt restructuring:</b>		
Acceleration of prepaid and other assets	\$	\$ 475
Satisfaction of payable to Hallmark Cards affiliates		(23,798)
Issuance of new notes and interest payable to HCC		432,140

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Satisfaction of old notes and interest payable to HCC	(340,697)
Satisfaction of senior secured note to HCC, including accrued interest	(797,423)
Issuance of preferred stock	185,000
Issuance of common stock	2,856
Elimination of Class B common stock designation	(307)
Additional paid-in capital from preferred and common stock issuance	541,754

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, 2009 and 2010**

**1. Business and Organization**

*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 channels (collectively the *Channels* or the *channels* ) dedicated to high quality, entertainment programming for adults and families, in the United States. At June 29, 2010, following the recapitalization of the Company as described below, the significant investor in the Company was H C Crown Corp. ( *HCC* ), a subsidiary of Hallmark Cards, Incorporated ( *Hallmark Cards* ).

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

*Recapitalization of the Company*

On June 29, 2010 the Company consummated a series of recapitalization transactions (the *Recapitalization* ) pursuant to a Master Recapitalization Agreement dated February 26, 2010, by and among the Company, Hallmark Cards, HCC and related entities.

Among other things, the Recapitalization included the following:

- Exchange of approximately \$1.162 billion of debt (the *HCC Debt* ) for new debt, preferred stock and common stock;
- Mergers of two intermediate holding companies, Hallmark Entertainment Investments Co. ( *HEI* ) and Hallmark Entertainment Holdings, Inc. ( *HEH* ), with and into the Company (collectively, the *Mergers* );

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- Reclassification of shares of Class B common stock into shares of Class A common stock upon the filing of the Second Amended and Restated Certificate of Incorporation; and
- Approval and authorization for the future filing of the Third Amended and Restated Certificate of Incorporation, the principal effect of which would be a reverse split of shares of common stock at such time as authorized by the Company's Board of Directors.

The following were issued in exchange for HCC Debt:

- \$315.0 million principal amount of new debt issued pursuant to the terms of the credit agreement between the Company and HCC (the Credit Agreement) in two tranches: (i) the \$200.0 million Term A Loan bearing interest at 9.5% per annum through December 31, 2011, and 12% thereafter and (ii) the \$115.0 million Term B Loan bearing interest at 11.5% through December 31, 2011, and 14.0% thereafter (collectively, the New Debt) (see Note 5);
- 185,000 shares of the Company's Series A Convertible Preferred Stock (Preferred Stock), \$0.01 par value, with the terms summarized under Preferred Stock Terms in Item 2 *Management's Discussion and Analysis of Financial Condition and Results of Operations* below; and
- 254,887,860 shares of the Company's Class A common stock in exchange for the residual amount of HCC Debt converted at \$2.5969 per share.

Immediately after consummation of the Mergers and issuance of common stock in partial exchange for HCC Debt, HCC owned approximately 90.3% of the Company's Class A common stock and all of the outstanding

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Preferred Stock.

In addition, the transactions resulted in the following:

- The decrease of the authorized Preferred Stock to 1,000,000 shares; the increase of the authorized shares of Class A common stock to 500,000,000 shares; and the elimination of the Class B common stock;
- Amendment No. 2 to the Tax Sharing Agreement between the Company and Hallmark Cards, to among other things, (i) permit Hallmark Cards to defer any future tax benefit payable to the Company for application against future tax liabilities of the Company and (ii) allow the Company to deduct interest accrued on the 10.25% Senior Secured Note from January 1, 2010, through June 29, 2010; and (iii) provide for the treatment of the Recapitalization under the Tax Sharing Agreement (see Note 6 below);
- Execution of the registration rights agreement, by and among the Company, HCC and certain HEIC stockholders;
- Extension of the Company's \$30.0 million revolving line of credit to June 30, 2011, and Hallmark Card's agreement to guarantee up to \$30.0 million for such revolving line of credit (see Notes 4 and 5 below); and
- A Stockholders Agreement, by and among the Company, HCC and Hallmark Cards, pursuant to which, among other things, Hallmark Cards entities agreed not to acquire, through December 31, 2013, additional shares of Class A common stock, subject to certain exceptions, and agreed to certain restrictions on their ability to sell or transfer shares of Class A common stock until December 31, 2013 and, subject to lesser restrictions, until December 31, 2020.

See Recapitalization in Note 5 for the accounting treatment of the Recapitalization.

***Liquidity***

As of September 30, 2010, the Company had \$36.2 million in cash and cash equivalents on hand. Also available to the Company was the full \$30.0 million bank credit facility which expires June 30, 2011. Day-to-day cash disbursement requirements have typically been satisfied with cash on hand and operating cash receipts supplemented with the borrowing capacity available under the bank credit facility and, prior to the Recapitalization, forbearance by Hallmark Cards and its affiliates.

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The Company's management anticipates that the principal uses of cash during the twelve month period ending September 30, 2011, will include the payment of operating expenses, accounts payable and accrued expenses, programming costs, and nominal interest of approximately \$30.0 million to \$45.0 million due under the New Debt issued in the Recapitalization. Subject to the legal availability of funds and approval by the Company's board of directors, the Company may also pay approximately \$19.5 million for cash dividends on Preferred Stock during the nine months ending September 30, 2011; at the option of the Company's board of directors, such dividends, if any, may be paid in the form of additional shares of Preferred Stock.

At September 30, 2010, the Company also had an additional \$20.0 million of cash, the use of which is restricted to payment of the \$25.0 million company obligated, mandatorily redeemable preferred interest payable to VISN Management Corp. ( VISN, a wholly-owned subsidiary of National Interfaith Cable Coalition, Inc., NICC ) on December 31, 2010. The Company believes that it will be able to fund all, or substantially all, of the remaining \$5.0 million with cash provided by operating activities.

### **2. Summary of Significant Accounting Policies and Estimates**

#### *Interim Financial Statements*

In the opinion of management, the accompanying condensed consolidated balance sheets and related interim condensed consolidated statements of operations and cash flows include all adjustments, consisting of normal recurring items necessary for their fair presentation in conformity with accounting principles generally accepted in the United States. Interim results are not necessarily indicative of results for a full year. These condensed



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consolidated financial statements should be read in conjunction with the 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, 2009.

***Basis of Presentation***

The 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 is required. Subsequent events have been evaluated.

***Use of Estimates***

The preparation of the accompanying 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 revenues and expenses. Such estimates include the collectability of accounts receivable, the valuation of goodwill, intangible assets, and other long-lived assets, legal contingencies, indemnifications, and assumptions used in the calculation of income taxes, among others. A significant non-recurring use of estimates occurred in the course of recording the Company's June 2010 troubled debt restructuring which required that the Company estimate the fair values of preferred stock and common stock issued in the Recapitalization.

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, foreign currency, and energy 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 in those estimates resulting from continuing changes in the economic environment will be reflected in the financial statements in future periods.

***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, collection trends. The Company's bad debt expense was \$235,000 and \$12,000 for the three months ended September 30, 2009 and 2010, respectively. The Company's bad debt expense was \$1.1 million and \$44,000 for the nine months ended September 30, 2009 and 2010, 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. On January 1, 2008 we adopted that portion of the standard that relates to those financial assets and liabilities and nonfinancial assets and liabilities which are recognized or disclosed at fair value on a recurring basis (that is, at least annually). On January 1, 2009, subject to the FASB's delayed implementation, we adopted the remaining provisions of the standard. After adoption, we now 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.

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The Company does not have balance sheet items carried at fair value on a recurring basis as well as similar assets and liabilities. Significant balance sheet items which are subject to non-recurring fair value measurements consist of impairment valuations of goodwill and property and equipment. The standard has not had a significant impact on the determination of fair value related to non-financial assets and non-financial liabilities in 2010.

***Net Income (Loss) per Share***

Basic net income (loss) per share for each period is computed by dividing net income (loss) attributable to common stock by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share for each period is computed by dividing net income (loss) attributable to common stock by the weighted average number of common shares plus potentially dilutive common shares outstanding except whenever any such effect would be antidilutive. Potential common shares consist of incremental common shares issuable upon the exercise of stock options. Approximately 88,000 and 66,000 stock options for the three months and nine months ended September 30, 2009 and 2010, respectively, have been excluded from the determination of diluted net income or loss per share because the individual effect in each instance was antidilutive.

Holders of Preferred Stock are entitled to mandatory, cumulative quarterly dividends at the following annual rates: 0% during 2010, 14% during 2011 and 16%, (the perpetual rate) during 2012 and all periods thereafter. In addition to their rights to Preferred Stock dividends, holders of Preferred Stock are entitled to participate in common stock dividends, if any, on an as if converted basis. The potential conversion of Preferred Stock into approximately 71.2 million shares of common stock has been excluded from the diluted loss per share calculation because the effect would be antidilutive.

The Company has estimated that the absence of perpetual rate dividends during 2010 and 2011 resulted in an implicit discount of \$17.4 million in the estimated fair value of Preferred Stock upon issuance at June 29, 2010. Such discount is being amortized through December 31, 2011. Amortization is reflected in the accompanying condensed consolidated financial statements as an increase in accumulated deficit and redeemable preferred stock. During the three and nine months ended September 30, 2010, amortization amounted to \$6.9 million. During the three months ending December 31, 2010, an additional \$7.1 million will be amortized. The remaining \$3.4 million will be amortized during 2011. Such amortization is reflected as an adjustment to net income to derive net income attributable to common stockholders.

***Concentration of Credit 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 each accounted for more than 10% of our consolidated subscriber revenue for both the three months ended September 30, 2009 and 2010, and together accounted for a total of 76% and 78% of consolidated subscriber revenue during the three months ended September 30, 2009 and 2010, respectively. Three of our distributors each accounted for approximately 15% or more of our consolidated subscribers for the three months ended September 30, 2009 and 2010, respectively, and together accounted for 61% and 60% of our subscribers during the three months ended September 30, 2009 and 2010, respectively.

Five and six of our distributors each accounted for more than 10% of our consolidated subscriber revenue for the nine months ended September 30, 2009 and 2010, and together accounted for a total of 76% and 80% of consolidated subscriber revenue during the nine months ended September 30, 2009 and 2010, respectively. Three of our distributors each accounted for approximately 15% or more of our consolidated subscribers for the nine months ended September 30, 2009 and 2010, respectively, and together accounted for 61% and 60% of our subscribers during the nine months ended September 30, 2009 and 2010, respectively.

Four and five of our programming content providers accounted for more than 10% of our total license fees payable for the nine months ended September 30, 2009 and 2010, respectively, and together accounted for a total of

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83% and 92% of the consolidated programming liability, respectively.

***Recently Issued Accounting Pronouncements***

In October 2009, the FASB issued Accounting Standards Update, 2009-13, Revenue Recognition (*ASC Topic 605*): *Multiple Deliverable Revenue Arrangements – A Consensus of the FASB Emerging Issues Task Force*. This update provides application guidance on whether multiple deliverables exist, how the deliverables should be separated and how the consideration should be allocated to one or more units of accounting. This update establishes a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence, if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific or third-party evidence is available. The Company will be required to apply this guidance for fiscal years beginning on or after June 15, 2010, prospectively for revenue arrangements entered into or materially modified after January 1, 2011; however, earlier application is permitted. The Company has not determined the impact that this update may have on its financial statements.

In January 2010, the FASB issued guidance that requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. The guidance is effective for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures that are effective for annual periods beginning after December 15, 2010. The adoption of this guidance did not have a material impact on our consolidated financial statements.

***Health Care Reform***

During the first quarter of 2010, the U.S. Congress passed and the President signed into law the Patient Protection and Affordable Care Act as well as the Health Care and Education Reconciliation Act of 2010, which represent significant changes to the current U.S. health care system. The legislation is far-reaching and is intended to expand access to health insurance coverage over time by increasing the eligibility thresholds for most state Medicaid programs and providing certain other individuals and small businesses with tax incentives to subsidize a portion of the cost of health insurance coverage. The legislation includes requirements that most individuals obtain health insurance coverage and that most large employers offer coverage to their employees or pay financial penalties. Some of the more significant changes, including the requirement that individuals obtain coverage, do not become effective until 2014 or later. It is too early to fully understand the impacts of the legislation on our business.

**3. Program License Fees**

Program license fees are comprised of the following:

**As of December 31,  
2009**

**As of September 30,  
2010**

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		(In thousands)	
Program license fees	non-affiliates	\$ 597,206	\$ 584,597
Program license fees	Hallmark Cards affiliates	12,668	14,567
Program license fees, at cost		609,874	599,164
Accumulated amortization		(324,717)	(361,535)
Program license fees, net		\$ 285,157	\$ 237,629

At December 31, 2009, and September 30, 2010, \$1.8 million and \$10.7 million, respectively, of program license fees were included in prepaid and other assets on the accompanying condensed consolidated balance sheets because the related license periods had not commenced.

License fees payable are comprised of the following:

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	As of December 31, 2009	As of September 30, 2010
	(In thousands)	
License fees payable non-affiliates	\$ 171,966	\$ 126,764
License fees payable Hallmark Cards affiliates	10,409	11,299
Total license fees payable	182,375	138,063
Less current maturities	(99,494)	(94,047)
Long-term license fees payable	\$ 82,881	\$ 44,016

In the regular course of evaluating the remaining usefulness of its various program licenses, the Company may determine that certain licenses may be of little future program value to it. In such instances, the Company shortens the estimated remaining lives to zero, thereby accelerating amortization of the remaining net book value. During the three months ended March 31, 2010, such changes in estimates resulted in additional amortization of program license fees of \$227,000; the Company made no such changes in estimates during the three and nine months ended September 30, 2009, and the three months ended June 30 and September 30, 2010.

**4. Credit Facility**

In connection with the Recapitalization, the Company entered into Amendment No. 17 to the Company's amended credit agreement with JP Morgan Chase Bank, effective June 29, 2010. Amendment No. 17, among other things, extended the maturity date of the credit facility provided by the credit agreement to June 30, 2011, from August 31, 2010. Pursuant to Amendment No. 16 to the credit facility, entered into on March 2, 2010, the maximum amount that may be borrowed under the credit facility is \$30.0 million.

Amendment No. 17 terminated the Hallmark Cards Subordination and Support Agreement. The Hallmark Cards Facility Guarantee remains in place and an intercreditor agreement among HCC, JP Morgan Chase Bank and the Company was entered into, which among other things defines the lien priorities and allows for payments to HCC pursuant to the Recapitalization. The credit facility is guaranteed by Hallmark Cards and the Company's subsidiaries and is secured by all tangible and intangible assets of the Company and its subsidiaries. Interest under the credit facility is equal to the LIBOR Rate (as defined in Amendment No. 17) plus 2.25%, in the case of a Eurodollar Loan (as defined in Amendment No. 17), and the Alternate Base Rate (as defined in Amendment No. 17) plus 1.25%, in the case of an Alternate Base Rate Loan.

The credit facility, as amended, contains a number of affirmative and negative covenants. The affirmative and negative covenants and default provisions are described in the Company's Annual Report on Form 10-K. The Company was in compliance with these covenants as of September 30, 2010.

At December 31, 2009, and September 30, 2010, the Company had outstanding borrowings of \$1.0 million and \$0, respectively, under the credit facility and there were no letters of credit outstanding. At December 31, 2009, all of the outstanding balance bore interest at the Eurodollar rate (2.49% weighted average rate at December 31, 2009). Interest expense on borrowings under the credit facility for each of the three months ended September 30, 2009 and 2010, was \$53,000 and \$0, respectively. Interest expense on borrowings under the credit facility for each of the nine months ended September 30, 2009 and 2010, was \$342,000 and \$4,000, respectively.

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

***Recapitalization***

For financial reporting purposes, the Recapitalization has been accounted for as a troubled debt restructuring in accordance with the guidance of *ASC Topic 470-60 Debt Troubled Debt Restructurings*. Identification of the Recapitalization as a troubled debt restructuring involved both qualitative and quantitative aspects. Among the qualitative aspects considered were (i) the Company's expectations that it would have been unable to fulfill the debt service requirements associated with approximately \$342.2 million of principal and interest payable to HCC on May 1, 2010 upon the expiration of the waiver agreement (which was extended to August 31, 2010 pursuant to the master recapitalization agreement), along with an additional \$784.6 million of principal and interest that would become immediately due pursuant to cross-default provisions, and (ii) the going concern opinion rendered by the Company's independent registered public accounting firm in connection with the financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. Quantitatively, Hallmark



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Cards is deemed to have granted a concession within the meaning of ASC 470-60. Prior to consummation of the Recapitalization, the weighted average interest rate of HCC debt was approximately 8.3%. After consideration of (x) the estimated fair values of Preferred Stock and Common Stock issued in the Recapitalization and (y) the debt service requirements of New Debt, the overall effective interest rate on the New Debt resulting from the Recapitalization is less than 1%.

Pursuant to the guidance in the ASC, we (1) recorded the issuance of Preferred Stock and Common Stock at their respective estimated fair values as of June 29, 2010 and (2) recorded New Debt in an amount equal to the residual of (i) the carrying value of HCC Debt less (ii) the estimated fair values of such Preferred Stock and Common Stock. New Debt has been apportioned between the Term A and Term B Loans on the basis of their relative fair values. The amounts by which the apportioned Term Loans exceeded the respective stated amounts of principal are being amortized over the terms of the loans as reductions of the interest expense that otherwise would arise from the stated cash interest rates. The resulting effective interest rates are approximately 0.789% and 1.002%, for the Term A Loan and Term B Loan, respectively. If, and when, any of the available pay-in-kind options (where interest is added to principal) are exercised, the effects of such elections will be recognized prospectively.

The Mergers of HEI and HEH involved non-substantive subsidiaries of Hallmark Cards. The Mergers were recorded at carry-over basis pursuant to the guidance of ASC 805-50 *Business Combinations Related Issues*. HEIC and HEH did not have assets other than their investment in the Company.

During the third quarter of 2010 the Company determined that its preferred stock should have been classified in temporary equity due to Hallmark Cards' control of the Company's Board of Directors and its voting securities. Accordingly, the Company corrected the classification of its \$185 million preferred stock to present it as temporary equity. The redeemable preferred stock presented in the accompanying condensed consolidated balance sheet as of September 30, 2010 also includes the third quarter imputed dividend of approximately \$6.9 million.

The following table summarizes the accounting for the Recapitalization:

	<b>In thousands</b>	
<b>Pre-Recapitalization</b>		
HCC Debt	\$	1,161,918
Deferred debt issuance costs		(475)
Transaction costs		(3,596)
	\$	1,157,847
<b>Post-Recapitalization</b>		
New Debt	\$	432,140
Preferred stock, \$185,000 shares, \$0.01 par value, \$1,000 liquidation preference		185,000
Common stock, \$0.01 par value		2,549
Additional paid-in capital		
Fair values of new preferred stock and common stock, less liquidation preference and par value, respectively	\$	541,754
Transaction costs related to new preferred stock and common stock		(2,547)
Transaction costs related to the New Debt included in selling, general and administrative expense		(1,049)
	\$	1,157,847

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See Recapitalization of the Company in Note 1 for information regarding the debt obligations owed to HCC immediately prior to the Recapitalization. See Note 2 for information related to an imputed discount that arose with the issuance of Preferred Stock and the related effect on the determination of net income (loss) per share.

### *Related Party Long-Term Obligations*

The aggregate maturities of related party long-term debt and future interest (assuming no utilization of the payment-in-kind options) for each of the five years subsequent to September 30, 2010, are as follows:

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	Total	Less than 1 Year	Payments Due by Period			
			2 Years (In thousands)	3 Years	4 Years	5 Years
Term A note, due December 31, 2013, interest payable quarterly to HCC at 9.5% per annum through December 31, 2011 and 12% thereafter(1)	\$ 276,578	\$ 32,392	\$ 22,756	\$ 23,984	\$ 197,446	\$
Term B note, due December 31, 2013, interest payable quarterly to HCC at 11.5% per annum through December 31, 2011 and 14% thereafter	167,091	16,558	15,386	16,089	119,058	
	\$ 443,669	\$ 48,950	\$ 38,142	\$ 40,073	\$ 316,504	\$

(1) The Company anticipates making a principal payment on the Term A note of approximately \$8.6 million, which is the Company's estimated principal payment based on the excess cash flow provisions discussed under Note 5.

The Company paid principal and interest of \$88,000 in June 2010 and principal and interest of \$8.1 million in October 2010 on the Term A and Term B notes. The \$8.1 million of principal and interest was included in notes and interest payable to HCC on the accompanying consolidated balance sheet at September 30, 2010.

**Senior Secured Note**

In August 2003, the Company issued a senior note to HCC for \$400.0 million. Cash payments for interest were not required from inception through June 29, 2010. The principal amount of the senior secured note accreted at 10.25% per annum, compounding semi-annually, to June 29, 2010. At December 31, 2009, \$758.8 million of principal and interest were included in the senior note payable in the accompanying consolidated balance sheet. The Company's obligations under this note, including \$797.4 million of principal and accrued interest, were terminated in connection with the Recapitalization.

**Notes and Interest Payable to HCC**

On December 14, 2001, the Company executed a \$75.0 million promissory note with HCC. Interest was payable in cash, quarterly in arrears five days after the end of each calendar quarter. The rate of interest under this note was LIBOR plus 5% per annum (5.29% at December 31, 2009). At December 31, 2009, \$108.6 million is reported as note payable to Hallmark Cards affiliate and \$1.5 million is reported as interest payable to Hallmark Cards affiliate on the accompanying consolidated balance sheet. Interest of \$6.3 million was paid in 2009, interest of \$1.5 million was paid on January 5, 2010, interest of \$1.4 million was paid on April 2, 2010, and interest of \$1.4 million was paid on June 29, 2010. The Company's obligations under this note, including \$108.6 million of principal, were terminated in connection with the Recapitalization.

On October 1, 2005, the Company converted approximately \$132.8 million of its license fees payable to a Hallmark Cards affiliate to a promissory note subsequently transferred to HCC. The rate of interest under this note was LIBOR plus 5% per annum (5.29% at December 31,

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2009). At December 31, 2009, \$170.1 million is reported as note payable to HCC and \$2.3 million is reported as interest payable to HCC on the accompanying consolidated balance sheet. Interest of \$9.8 million was paid in 2009, interest of \$2.3 million was paid on January 5, 2010, interest of \$2.2 million was paid on April 2, 2010, and interest of \$2.3 million was paid on June 29, 2010. The Company's obligations under this note, including \$170.1 of principal, were terminated in connection with the Recapitalization.

On March 21, 2006, the Company converted approximately \$70.4 million of its payable to a Hallmark Cards affiliate to a promissory note subsequently transferred to HCC. The rate of interest under this note was LIBOR plus 5% per annum (5.29% at December 31, 2009). At December 31, 2009, \$62.0 million is reported as note payable to HCC and \$838,000 is reported as interest payable to HCC on the accompanying consolidated balance sheet. Interest of \$3.6 million was paid in 2009, interest of \$838,000 was paid on January 5, 2010, interest of \$814,000 was paid on

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April 2, 2010, and interest of \$820,000 was paid on June 29, 2010. The Company's obligations under this note, including \$62.0 million of principal, were terminated in connection with the Recapitalization.

***Hallmark Guarantee; Interest and Fee Reductions***

Hallmark Cards has provided to JPMorgan Chase Bank under the credit facility the Hallmark Cards facility guarantee. The guarantee is unconditional for obligations of the Company under the bank credit facility. If any payment is made on the guarantee, it will be treated as a purchase of the lending bank's interest in the credit facility. Prior to April 2009, Hallmark Cards' credit support for the Company's bank credit facility consisted of supplying a letter of credit.

The above mentioned credit support provided by Hallmark Cards resulted in reductions in the interest rate and commitment fees under the credit facility; however, the Company agreed to pay and has paid an amount equal to the reductions in the interest rate and commitment fees to Hallmark Cards. On April 1, 2009, the interest rate and commitment fees under the renewed credit facility increased and the Company began paying Hallmark Cards a smaller reduction amount of the interest rate and commitment fees equal to 0.75% and 0.125%. Interest expense paid to HCC in connection with the JPMorgan Chase Bank credit facility was \$15,000 and \$0 for the three months ended September 30, 2009, and 2010, respectively. Interest expense paid to HCC in connection with the credit facility was \$1.0 million and \$2,000 for the nine months ended September 30, 2009, and 2010, respectively. Commitment fee expense for the three months ended September 30, 2009 and 2010, was \$9,000 and \$10,000, respectively. Commitment fee expense for the nine months ended September 30, 2009 and 2010, was \$36,000 and \$32,000, respectively.

***Other Agreements with Hallmark Cards and Affiliates***

See Item 2 *Management's Discussion and Analysis of Financial Condition and Results of Operations* below for discussion regarding other agreements with Hallmark Cards and its affiliates.

**6. Related Party Transactions**

***Tax Sharing Agreement***

*Overview*

On March 11, 2003, Crown Media Holdings became a member of Hallmark Cards consolidated federal tax group and entered into a federal tax sharing agreement with Hallmark Cards (the "tax sharing agreement"). Hallmark Cards includes Crown Media Holdings in its consolidated federal income tax return. Accordingly, Hallmark Cards has benefited from subsequent tax losses and may benefit from future federal tax losses, which

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may be generated by Crown Media Holdings. Based on the tax sharing agreement, Hallmark Cards has agreed to pay Crown Media Holdings all of the benefits realized by Hallmark Cards as a result of including Crown Media Holdings in its consolidated income tax return. Through December 31, 2009, these benefits have been paid 75% in cash on a quarterly basis with the balance applied as an offset against other amounts owed by Crown Media Holdings to any member of the Hallmark Cards consolidated group under any loan, line of credit or other payable, subject to limitations under any loan indentures or contracts restricting such offsets. As a result of the Recapitalization, the tax agreement has been amended to provide that 100% of any such benefit will be deferred for application against future tax liabilities of the Company. Pursuant to the amendment to the tax sharing agreement in August 2003, the benefit that would otherwise result from interest accrued on the 10.25% senior secured note will not be available to the Company until such interest is paid in cash. As a result of the Recapitalization, such interest accrued from January 1, 2010, through June 29, 2010, will be treated as a deduction under the amended tax sharing agreement.

At December 31, 2009, the Company owed Hallmark Cards \$8.5 million under the tax sharing agreement for 2009. The liability was satisfied on June 29, 2010, in connection with the Recapitalization. The Company owed \$5.5 million under the amended tax sharing agreement for the nine months ended September 30, 2010.

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Any payments received from Hallmark Cards or credited against amounts owed by Crown Media Holdings to any member of the Hallmark Cards consolidated group under the tax sharing agreements have been recorded as additions to paid-in capital in the accompanying consolidated statements of stockholders' (deficit) equity. Any amounts owed or payments made to Hallmark Cards or to any member of the Hallmark Cards consolidated group under the tax sharing agreement have been recorded as reductions to paid-in capital.

The first payment by the Company pursuant to the amended tax sharing agreement will occur after the first full quarter following the closing of the Recapitalization Transactions and will be made in respect of the period commencing from January 1, 2010, through the last day of the first full quarter following the closing. The Company expects to make its first cash payment through the fourth quarter of 2010 prior to December 31, 2010, for tax liabilities incurred under the tax sharing agreement as amended.

Historically, the Company has accounted for income taxes as if it were a separate taxpayer not included in the consolidated tax return of Hallmark Cards. For tax purposes, the Recapitalization generated cancellation of debt income which is currently estimated at approximately \$200.0 million. Accordingly, the Company is expected to generate federal and state taxable income in 2010 for both regular tax and alternative minimum tax (AMT) purposes. For regular tax purposes, this income will be fully offset by net operating loss carryforwards. However, for federal AMT purposes, loss carryforwards can be used against AMT income but are limited to 90% of AMT income. As a result, the Company has recorded an income tax expense of approximately \$2.9 million for the estimated AMT in its consolidated statements of operations. The Company is not able to recognize an offsetting deferred tax benefit from the AMT credit carryforward because of its full valuation allowance on deferred tax assets.

However, as a result of being included in the consolidated tax return of Hallmark Cards, this AMT expense is not required to be paid to the Internal Revenue Service nor to Hallmark Cards under the tax sharing agreement. Accordingly, the Company has reduced the liability for the aforementioned AMT and credited paid-in capital. The net result for AMT calculated as if the Company is a separate taxpayer is a charge to the consolidated statements of operations and a corresponding credit to paid-in capital.

***Services Agreement with Hallmark Cards***

Hallmark Cards provides Crown Media Holdings with tax, risk management, health safety, environmental, insurance, legal, treasury, human resources, and cash management services and real estate consulting services. 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 \$455,000 for 2009 and are scheduled to be \$387,000 for 2010. Intercompany service fee expense for the three months ended September 30, 2009 and 2010, was \$114,000 and \$97,000, respectively. Intercompany service fee expense for the nine months ended September 30, 2009 and 2010, was \$341,000 and \$290,000, respectively.

At December 31, 2009, and September 30, 2010, non-interest bearing unpaid accrued service fees and unreimbursed expenses of \$15.2 million and \$42,000, respectively, were included in payable to affiliates on the accompanying consolidated balance sheets. The \$15.2 million outstanding at December 31, 2009, was satisfied on June 29, 2010, in connection with the Recapitalization. For the year ended December 31, 2009, and the nine months ended September 30, 2010, out-of-pocket expenses and amounts paid to third parties on the Company's behalf by Hallmark Cards were \$420,000 and \$78,000, respectively.

*Guarantees with Hallmark Cards*

On February 24, 2010, the Company executed a letter of credit/guaranty commitment with respect to a certain lease agreement with 12700 Investments, Ltd. for the office space at 12700 Ventura Boulevard, Studio City, California. The landlord required that Crown Media United States, the entity which executed the lease, provide a letter of credit of \$1.6 million securing certain obligations of Crown Media United States. Consequently, Hallmark Cards has agreed to guarantee the issuer of such letter of credit against any loss thereon pursuant to the guaranty. As an inducement for Hallmark Cards to issue the guaranty, Crown Media United States has agreed to pay Hallmark Cards a fee which equals 0.75% per annum of the outstanding letter of credit obligation. Additionally, in the event



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that Hallmark Cards is required to pay any amount under the guaranty, Crown Media United States must reimburse Hallmark Cards for any such amount plus any fees and charges associated with making such payment, any interest applicable to such amount and any costs and expenses of Hallmark Cards in connection with protecting its rights under the guaranty.

On September 2, 2008, Hallmark Cards issued a guaranty for the benefit of Crown Media United States, which guaranty pertains to a lease agreement with Paramount Group, Inc. for the office space at 1325 Avenue of the Americas, New York, New York. As a condition to executing the lease agreement, the landlord required Hallmark Cards to guaranty all obligations of Crown Media United States under the lease agreement. As an inducement for Hallmark Cards to issue the guaranty, Crown Media United States has paid Hallmark Cards a fee which equals 0.28% per annum of the outstanding obligation under the lease agreement. Additionally, in the event that Hallmark Cards is required to pay any amount under the guaranty, Crown Media United States must reimburse Hallmark Cards for any such amount plus any fees and charges associated with making such payment, any interest applicable to such amount and any costs and expenses of Hallmark Cards in connection with protecting its rights under the guaranty.

From time to time, in the normal course of business, Hallmark Cards has guaranteed the Company's performance on certain of the Company's other obligations. If Hallmark Cards has to perform under these obligations, the Company then typically repays Hallmark Cards.

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

VISN owns a \$25.0 million company obligated mandatorily redeemable preferred interest in Crown Media United States (the preferred interest). On November 13, 1998, the Company, VISN, Vision Group Incorporated and Henson Cable Networks, Inc. signed an amended and restated company agreement governing the operation of Crown Media United States (the company agreement), which agreement was further amended on February 22, 2001, January 1, 2002, March 5, 2003, January 1, 2004, November 15, 2004 and December 1, 2005 (the December 2005 NICC Settlement Agreement).

Crown Media United States may voluntarily redeem the \$25.0 million preferred interest at any time; however, it is obligated to do so no later than December 31, 2010. The terms of the Recapitalization required the Company to set aside in its own name an unspecified amount, not to exceed \$25.0 million, for the sole purpose of redeeming the preferred interest. The \$20.0 million set aside as of September 30, 2010, is reflected as restricted cash in the accompanying condensed, consolidated balance sheet. Due to the mandatory redemption provision of the preferred interest, on July 1, 2003, the preferred interest was remeasured at fair value and the difference is being accreted and recorded as interest expense.

On January 2, 2008, the Company and NICC resolved a number of disputes with the execution of an agreement (the Modification Agreement) which, among other things, immediately extinguished NICC's conditional right to require the Company to repurchase all of the shares of the Company's Class A common stock then owned by NICC (Put Right). In addition, the Modification Agreement also settled the dispute with respect to whether the termination payment provision expired with, or survived, the December 31, 2007 expiration of the December 2005 NICC Settlement Agreement. The Company agreed to pay NICC \$3.8 million in three equal installments payable each January 20 of 2008, 2009 and 2010. The Company also agreed to provide NICC a two-hour broadcast period granted each Sunday morning during the two year period ending December 31, 2009. The Company is also obligated to pay NICC an estimated \$3.7 million in yearly installments at the rate of 6% of the outstanding liquidation preference of the preferred interest.

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During the three months ended September 30, 2009 and 2010, Crown Media United States paid NICC \$40,000 and \$0, respectively, related to the company agreement as amended. During the nine months ended September 30, 2009 and 2010, Crown Media United States paid NICC \$4.6 million and \$2.8 million, respectively, related to the company agreement as amended.

### **8. Share-Based Compensation**

Approximately 200,000 stock options expired, without being exercised, in August 2009 following the resignation of one of the Company's executives in May 2009. Such options were fully vested at the time of resignation.

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The Company recorded \$134,000 and \$124,000 of compensation expense associated with the employment and performance restricted stock units (RSUs) during the three months ended September 30, 2009 and 2010, respectively, which have been included in selling, general and administrative expense on the accompanying condensed consolidated statements of operations. The Company recorded \$303,000 of compensation benefit and \$233,000 of compensation expense associated with the employment and performance restricted stock units (RSUs) during the nine months ended September 30, 2009 and 2010, respectively, which have been included in selling, general and administrative expense on the accompanying condensed consolidated statements of operations.

As of December 31, 2009, and September 30, 2010, there was no unrecognized compensation cost, related to non-vested stock options granted to the Company's employees. The closing price of a share of the Company's common stock was \$1.45 on December 31, 2009, and \$2.39 on September 30, 2010, which is used to calculate the RSU liability. As of December 31, 2009, and September 30, 2010, there was unrecognized compensation cost, related to non-vested RSUs granted to the Company's employees, in the amount of \$190,000 and \$416,000, 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 of \$1.5 million during the year ended December 31, 2009, and \$163,000 during both the three and nine months ended September 30, 2010.

In May 2009, the then CEO terminated his employment and his share appreciation rights (SARs) were forfeited at that time. The Company recorded \$0 and \$247,000 in compensation benefit related to SARs for the three and nine months ended September 30, 2009, on the Company's condensed consolidated statement of operations as a component of selling, general and administrative expense. The SARs were recorded as a liability until termination.

## **9. Long Term Incentive Plan**

In the second quarter of 2009, the Company granted Long Term Incentive Compensation Agreements (LTI Agreements) to each vice president, senior vice president and executive vice president of the Company. The target award under each LTI Agreements is a percentage of the employee's base salary and range from \$26,000 to \$469,000. Of each award, 50% is an Employment Award and 50% is a Performance Award. The Employment Award will vest and be settled in cash on August 31, 2011, subject to earlier pro rata settlement as provided in the LTI Agreement. The Performance Award will vest and be settled in cash 50% on December 31, 2010, and 50% on December 31, 2011, in accordance with the Company performance criteria concerning adjusted EBITDA and cash flow and subject to earlier pro rata settlement as provided in the LTI Agreement. Early settlement is provided in the case of involuntary termination of employment without cause on or after January 1, 2010, death or disability. Potential payouts under the Performance Awards depend on achieving 90% or higher of a target threshold and range from 0% to 150% of the target award. The Company's Compensation Committee has the ability to increase or decrease the payout based on an assessment of demographics achieved, relative market conditions and management of expenses.

In the first quarter of 2010, the Company granted LTI Agreements to each vice president, senior vice president and executive vice president of the Company. The target award under each LTI Agreements is a percentage of the employee's base salary and range from \$25,000 to \$536,000. Of each award, 50% is an Employment Award and 50% is a Performance Award. The Employment Award will vest on August 31, 2012, and be settled in cash within 30 days thereafter, subject to earlier pro rata settlement as provided in the LTI Agreement. The Performance Award will vest on December 31, 2012, and be settled in cash the later of 30 days thereafter or 15 days after the Company issues its audited financials for 2012, but by no later than March 15, 2013. Vesting of the Performance Award will be determined in accordance with the Company performance criteria concerning adjusted EBITDA and cash flow and subject to earlier pro rata settlement as provided in the LTI Agreement. Early settlement

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is provided in the case of involuntary termination of employment without cause on or after January 1, 2011, death or disability. Potential payouts under the Performance Awards depend on achieving 90% or higher of a target threshold and range from 0% to 150% of the target award. The Company's Compensation Committee has the ability to increase or decrease the payout based on an assessment of demographics achieved, relative market conditions and management of expenses.

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The Company recorded \$104,000 and \$309,000 of expense included in selling, general and administrative expense in the accompanying consolidated statement of operations for the three months ended September 30, 2009 and 2010, related to these agreements. The Company recorded \$398,000 and \$1.0 million of expense included in selling, general and administrative expense in the accompanying consolidated statement of operations for the nine months ended September 30, 2009 and 2010, related to these agreements. Additionally, the \$540,000 and \$1.6 million liability for these agreements was included in accounts payable and accrued liabilities in the accompanying consolidated balance sheets at December 31, 2009, and September 30, 2010.

**10. Fair Value**

The following table presents the carrying amounts and estimated fair values of certain of the Company's financial instruments at December 31, 2009, and September 30, 2010.

	December 31, 2009		September 30, 2010	
	Carrying Amount	Significant Unobservable Inputs (Level 3) Fair Value	Carrying Amount	Significant Unobservable Inputs (Level 3) Fair Value
(In thousands)				
Senior secured note to HCC, including accrued interest	\$ 758,755	\$ 641,635	\$	\$
Note and interest payable to HCC	110,062	93,074		
Note and interest payable to HCC	62,845	53,144		
Note and interest payable to HCC	172,407	145,795		
Term A note and interest payable to HCC			270,482	199,056
Term B note and interest payable to HCC			162,526	119,600
Company obligated mandatorily redeemable preferred interest	22,902	19,800	24,619	24,125

ASC Topic 820 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. When determining fair value, the Company considers the principal or most advantageous market in which the Company would transact and the market-based risk measurements or assumptions that market participants would use in pricing the liability, such as inherent risk, transfer restrictions, and credit risk. Level 3 is defined as inputs that are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the liability.

The carrying amounts shown in the table are included on the accompanying consolidated balance sheets under the indicated captions. The valuation of the Company obligated mandatorily redeemable preferred interest is based on the preferred liquidation preference being payable in full on December 31, 2010.

The Company estimates the fair value of its debt to HCC on a quarterly basis.

Accounts payable and receivable are carried at 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 credit spread will fluctuate.

Estimates of the fair value of certain of the Company's financial instruments are presented in the tables above. As a result of recent market conditions, the Company's debt obligations with HCC and the mandatorily redeemable

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preferred interest have limited or no observable market data available. Fair value measurements for these instruments are included in Level 3 of the fair value hierarchy of *ASC Topic 820*. These fair value measurements are based primarily upon the Company's own estimates and are often based on its current pricing policy, the current economic and competitive environment, the characteristics of the instrument, credit and interest rate risks, and other such factors. Therefore, the results cannot be determined with precision, cannot be substantiated by comparison to quoted prices in active markets, and may not be realized in an immediate settlement of the liability. Additionally, there are inherent uncertainties in any fair value measurement technique, and changes in the underlying assumptions used, including discount rates, liquidity risks, and estimates of future cash flows, could significantly affect the fair value measurement amounts.

The majority of the Company's debt has been transacted with HCC.

## **11. Commitments and Contingencies**

On July 13, 2009, a lawsuit was brought in the Delaware Court of Chancery against each member of the Board of Directors of the Company, Hallmark Cards and its affiliates, as well as the Company as a nominal defendant, by a minority stockholder of the Company regarding the then proposed Recapitalization. The plaintiff is S. Muoio & Co. LLC which owned beneficially approximately 5.8% of the Company's Class A common stock at the time of the complaint, according to the complaint and filings with the SEC. The lawsuit claims to be a derivative action and a class action on behalf of the plaintiff and other minority stockholders of the Company. The lawsuit alleges, among other things, that the defendants have breached fiduciary duties owed to the Company and minority stockholders in connection with the Recapitalization transactions. The lawsuit includes allegations that the consummation of the Recapitalization transactions would result in an unfair amount of equity issued to the majority stockholders, thereby reducing the minority stockholders' equity and voting interests in the Company, and that the majority stockholders would be able to eliminate the minority stockholders through a short-form merger. The complaint requested the court enjoin the defendants from consummating the Recapitalization transactions and award plaintiff fees and expenses incurred in bringing the lawsuit.

On July 22, 2009, a Stipulation Providing for Notice of Transaction (the "Stipulation") was filed with the Delaware Court of Chancery. The Stipulation provided that the Company could not consummate the transaction contemplated in the Recapitalization transactions until not less than seven weeks after providing the plaintiff with a notice of the terms of the proposed transaction, including copies of the final transaction agreements. If the plaintiff moved for preliminary injunctive relief with respect to any such transaction, the parties would establish a schedule with the Court of Chancery to resolve such motion during the seven week period. In addition, following the decision of the Court of Chancery, the Company would not consummate any transaction for a period of at least one week, during which time any party may seek an expedited appeal. The Stipulation further provided that the plaintiff would withdraw its motion for preliminary injunction filed on July 13, 2009 and that the action would be stayed until the earlier of providing the notice of a transaction or an announcement by the Company that it was no longer considering a transaction.

By a letter of February 28, 2010, the plaintiff in this lawsuit informed the Special Committee of the Board of Directors, which considered and negotiated the Recapitalization, that the plaintiff objected to the proposed recapitalization on the terms set forth in the term sheet dated February 9, 2010. The plaintiff asserted, among other things, that the transactions contemplated by the term sheet would unfairly dilute the economic and voting interests of the Company's minority stockholders, that the transactions should be subject to a vote of the majority of the minority stockholders and that the proposed transactions remain inadequate. The plaintiff indicated that if the Company executed definitive documents for the Recapitalization, the plaintiff would pursue the litigation. The February 26, 2010 agreements executed by the Company for the Recapitalization materially followed the provisions in the earlier term sheet.

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Notice of the terms of the proposed Recapitalization, including copies of the executed definitive documents for the Recapitalization, was provided to the plaintiff on March 1, 2010. On March 11, 2010, the plaintiff filed an amended complaint raising similar allegations of breach of fiduciary duty against Hallmark Cards and the director defendants and seeking rescission of the Recapitalization rather than a preliminary injunction enjoining the consummation of the Recapitalization, or alternatively, an award of rescissory damages. If the Company is forced to



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rescind the Recapitalization, short-term debt would increase to approximately \$1.2 billion, plus accrued interest. A trial took place in September 2010 and the parties are currently preparing post trial briefs to be submitted to the court. A decision of the court is expected to be issued in the first quarter of 2011.

From time to time, the Company, together with, in some instances, certain of its directors and officers is a defendant or codefendant in legal actions involving various claims incident to the conduct of its business. It is not currently possible to predict the outcome of the proceeding discussed above. Legal fees incurred to defend the proceeding will be expensed as incurred. Approximately \$4.0 million has been recorded in accounts receivable and accounts payable and accrued liabilities on the accompanying balance sheet at September 30, 2010, related to amounts to be reimbursed by the insurance company.

**12. Third Party Indemnity**

In December 2006, the Company sold its film library consisting of domestic rights and certain international ancillary rights to approximately 620 television movies, mini-series and series (the Crown Library) to RHI Entertainment LLC (RHI). As a condition of the sale, the Company agreed to pay up to \$22.5 million for residuals and profit participations related to RHI's domestic exploitation of the Crown Library for a ten-year period ending December 14, 2016. The Company estimated the fair value of this obligation to be approximately \$10.6 million at December 15, 2006, assuming the maximum payout. Any revisions to this estimated liability will be reflected as gain (loss) from sale of film assets in future periods. In 2006, the Company recorded an \$8.2 million gain related to the sale of these film assets.

In December 2009 the Company concluded that payments for residuals and participations under its liability to RHI would occur generally later than originally estimated in December 2006. Accordingly, the Company reduced the carrying amount of the liability by \$682,000 and recognized a corresponding gain from sale of film assets in the accompanying statement of operations. In July 2010, the Company received notification of pending requests for payments of approximately \$8.0 million related to exploitation of the Crown Library through mid-2010. Accordingly, the Company increased the carrying amount of the liability by \$155,000 and recognized a corresponding loss from sale of film assets in the accompanying statement of operations.

Carrying amounts of this liability of \$13.9 million and \$14.6 million as of December 31, 2009, and September 30, 2010, respectively, are included in accrued liabilities on the accompanying consolidated balance sheets. The aggregate amount of payments that the Company will make under this obligation is dependent upon the relative success RHI achieves in exploiting these film assets. However, in no event will the aggregate cash payments under this obligation exceed \$22.5 million. At September 30, 2010, the maximum future payout remaining under this agreement is \$19.9 million. The timing of such payments is dependent upon not only the timing of RHI's exploitation of these film assets but RHI's administrative processes by which it will request payments from the Company. Accordingly, it is likely that, during the remaining term of this liability, the carrying amount will be adjusted as additional information becomes available to the Company.

**13. Martha Stewart Agreement**

In January 2010, the Company entered into a multi-year agreement with Martha Stewart Living Omnimedia, Inc. (Martha Stewart Living) to exclusively televise original episodes of the daytime home and lifestyle series *The Martha Stewart Show* on Hallmark Channel beginning September 2010. As part of the agreement, Martha Stewart Living will also develop a range of new and original series and prime time specials

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that will complement Hallmark Channel's schedule. The portion of the agreement that relates to *The Martha Stewart Show* represents a collaborative arrangement.

The Company has and will continue to act as principal in the transactions related to the (i) the sale of most of advertising units aired during *The Martha Stewart Show*, (ii) collection of accounts receivable related to most sales of advertising units and product integrations, and (iii) the broadcast of *The Martha Stewart Show* and associated advertising units. Accordingly, the Company is reporting revenue related to these transactions on a gross basis. The Company recognized advertising revenue of \$1.1 million related to this transaction for the three and nine months

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ended September 30, 2010.

The aggregate amount payable to Martha Stewart Living each season represents programming expense. The Company has and will continue to recognize programming expense using the percent-of-revenue method. Non-affiliate programming expense related to Martha Stewart Living was \$1.1 million for the three and nine months ended September 30, 2010.

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

The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

**Description of Business and Overview**

*Current Business*

We own and operate the Channels. With 90.2 million subscribers (as provided by Nielsen Research) in the United States at September 30, 2010, the Hallmark Channel is the 38th most widely distributed advertising-supported cable channel in the United States. At December 31, 2009, the Hallmark Channel was the 38th most widely distributed advertising-supported cable channel in the United States with 88.3 million subscribers (as provided by Nielsen Research). For the third quarter of 2010, the Hallmark Channel finished the quarter as the 24th highest rated advertising-supported cable channel for total day household ratings and the 25th highest rated advertising-supported cable channel in prime time as measured by Nielsen Research. At October 31, 2010, the number of subscribers declined to 87.3 million due to lack of a contract with AT&T u-Verse ( AT&T ).

We launched our second 24-hour linear channel, the Hallmark Movie Channel, during the first quarter of 2005. Programming on the Hallmark Movie Channel consists primarily of movies and mini-series. The Hallmark Movie Channel has generated subscriber fees and advertising revenue since 2005. As distribution continues to expand, the financial contribution of the Hallmark Movie Channel may grow, including increases in advertising and subscription revenue. The Hallmark Movie Channel is operated through Crown Media Holdings' existing infrastructure at a small incremental cost. In April 2008, we began distributing the Hallmark Movie Channel HD in high definition format, resulting in additional costs; however, we expect that this additional format will continue to contribute to subscriber growth for the Hallmark Movie Channel. See below for information regarding a high definition version of the Hallmark Channel.

At September 30, 2010, the Hallmark Movie Channel was distributed to over 38.2 million subscribers, an increase of nearly 9.1 million subscribers from 29.1 million at December 31, 2009. The overall increase in distribution, particularly in certain key markets, and a greater number of advertising spots has contributed to improved Hallmark Movie Channel revenue in 2010 and should continue to do so through the remainder of the year. In the second quarter of 2010, we began selling Hallmark Movie Channel inventory to advertisers based on audience guarantees, which has increased and will continue to increase our ability to grow revenues from that channel. At October 31, 2010, the number of subscribers declined to 36.7 million due to lack of a contract with AT&T.

*Current Challenges*

The Company faces numerous operating challenges. Among them are increasing viewership ratings, maintaining and increasing advertising revenue, maintaining and expanding the distribution of the Channels, 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. Our ratings declined from 15th in total day viewership and 12th for prime time in 2009 to 26th in total day viewership and 23rd for prime time in 2010. We believe our ratings are affected by our ability to (i) acquire and produce series and 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 the Hallmark Channel's highest ratings. In the past, the Company has typically incurred additional marketing and promotional expenses surrounding original productions and certain acquired movies to drive higher ratings. Certain acquired series delivered historically strong ratings, but recently they have been part of the decline experienced in viewer ratings. In order to reverse the recent decline in ratings, we plan to continue or increase the number of our original productions and

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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.

Our recent agreements with Martha Stewart Living Omnimedia, including the acquisition of exclusive rights to the live daytime lifestyle program *The Martha Stewart Show* and rights to the extensive library of Martha Stewart branded lifestyle programming, represent a key part of our strategy to attract viewers that appeal to relatively higher CPM (*i.e.*, advertising rates per thousand viewers) advertisers. We introduced this lifestyle programming in various dayparts in the second quarter of 2010, leading to the September 2010 premier of *The Martha Stewart Show* on the Hallmark Channel. Additionally in September, Hallmark Channel premiered several other original lifestyle shows for the daytime lifestyle block. These program changes have resulted and may result at least initially in reductions in the ratings delivery of the Channel, but our plan is that, over time, these changes will increase our revenue through the delivery of a more targeted demographic and attraction of higher CPM advertisers.

Prior to the second quarter of 2010, the Hallmark Movie Channel had not been the subject of ratings measurement by Nielsen Media Research. Since then, however, the Hallmark Movie Channel has had Nielsen ratings and we have been selling advertising inventory for the Hallmark Movie Channel based on a price per unit of audience measurement.

*Advertising Revenue*

The overall improvement in the economy during the first nine months of 2010 had a favorable impact on cable advertising rates, including the rates for our inventory. Our third quarter scatter market inventory was sold at rates 43% above rates in the third quarter 2009 scatter market and 110% above the rates for third quarter 2010 inventory sold in the upfront. Additionally, direct response rates were down by 27% compared to that inventory sold in the same period of 2009. Although our CPMs in the third quarter of 2010 were higher than the same period of 2009, our delivery of our key demographic, women 25-54, was substantially lower than prior periods. Our demographic delivery in the third quarter of 2010 was lower than the previous quarter and lower than the same period of 2009. This lower demographic delivery more than offset gains in our CPMs resulting in lower advertising revenue in the third quarter of 2010 compared to the third quarter of 2009.

In the 2010/2011 upfront process representing the sale of our inventory for the last quarter of 2010 and the first three quarters of 2011, we entered into agreements with major advertising firms representing approximately 41% of our advertising inventory. In the prior year 2009/2010 upfront we sold approximately 40% of our inventory. The 2010/2011 inventory was sold at CPMs over 25% higher than the inventory sold in the 2009/2010 upfront, including significant increases in rates related to our new lifestyle programming block. The Company will sell the balance of the general rate inventory for the 2010/2011 broadcast season to advertisers that purchase upfront inventory on a calendar year basis, rather than an advertising year basis, and in the scatter marketplace. Additionally, we sold approximately 39% of the Hallmark Movie Channel's available inventory in the 2010/2011 upfront.

Following the upfront period, sales of our general rate, direct response and paid-programming inventory are made closer to the timing of the actual advertisement. As compared to the upfront sales for the same periods, scatter rates in the third quarter of 2010 were 110% higher.

Advertisers with upfront contracts have an option to terminate their contracts, as well as an option to expand the amount of inventory purchased under the contracts. In prior years, cancellations of upfront contracts were unusual. During the twelve months period ended September 2009

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comprising the 2008/2009 broadcast season, advertisers canceled approximately 13% of the inventory covered by such contracts. The Company sold the balance of the 2008/2009 general rate inventory, including that resulting from the cancellations, in the scatter market. Advertisers cancelled a total of 11% of the inventory covered by upfront contracts during the third quarter of 2010 as compared to 14% during the third quarter of 2009.

The Company was able to sell the Martha Stewart programming time block at rates 117% higher than prior year's rates during that same time block.

### *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 September 30, 2010, through December 2023, inclusive of renewal options.

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Agreements representing an additional 5% of subscribers to the Hallmark Channel will expire prior to December 31, 2010.

Our agreement with National Cable Television Cooperative ( NCTC ), representing approximately 12% of our total Hallmark Channel subscriber base, expired in December 2009. Since then, we entered into a series of extensions with NCTC, the last of which expired May 7, 2010. The Company is currently in negotiations with NCTC and anticipates that an agreement will be completed in the fourth quarter of 2010. In the mean time, we continue to distribute the Channels to NCTC member operators, generally in accordance with the provisions of the most recently expired agreement. Due to lack of an agreement from May 8, 2010, through September 30, 2010, the Company recognized revenue on a cash basis; thus, causing a decrease in advertising revenue during that period.

The Company's agreement with AT&T expired on August 31, 2010. On September 1, 2010, the Hallmark Channel and the Hallmark Movie Channel were dropped from AT&T's platform because the parties had not agreed to the terms of a new distribution agreement. As a result, we expect the overall subscriber numbers for the Hallmark Channel and the Hallmark Movie Channel to decrease by approximately 2.5 million and 1.0 million, respectively. The Company accounted for subscriber revenue earned through August 31, 2010, on an accrual basis.

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 90 million or more subscribers. Our goal is for the Hallmark Channel to reach 91 million subscribers and the Hallmark Movie Channel to reach 40 million subscribers by the end of 2010.

*Demographics*

As pay television channels draw audience share, audience demographics (i.e., viewers categorized by characteristics such as age, gender and income) become fragmented. As a result, advertisers are able to target the specific groups of viewers who are most likely to purchase their products by advertising on channels which attract the desired viewer demographic.

We believe that the key demographics for the Hallmark Channel are the viewers in the groups Adults aged 25 to 54 and Women aged 25 to 54. However, the average median age of a viewer of the Hallmark Channel was 59.5 in 2009. In order to achieve our revenue goals, we need to draw in our target audience. Broadcasts of *The Martha Stewart Show* and other Martha Stewart Living productions on the Hallmark Channel, which commenced in September 2010, are key parts of our efforts to attract our target audience over time.

*Launch of High Definition*

We launched a high definition version of the Hallmark Channel in February 2010. The costs for this launch were approximately \$5.0 million, of which a non-cash charge of \$4.4 million was recognized in December 2009 in connection with the terminations of two existing channel delivery agreements. The Company may also incur additional costs including the cost of converting certain television series to high definition. The



launch of a high definition version furthers the Company's efforts to maintain competitiveness.

### **Revenue from Continuing Operations**

Our revenue consists of subscriber fees and advertising fees.

#### *Subscriber Fees*

Subscriber fees are generally payable to us on a per subscriber basis by pay television distributors for the right to carry our Channels. Rates 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 channel;

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- the packaging arrangements for the channel; and
- length of the contract term and other commercial terms.

We are in continuous negotiations with our existing distributors to increase our subscriber base in order to enhance our advertising revenue. We have been subject to past requests by major distributors to pay subscriber acquisition fees for additional subscribers or to waive or accept lower subscriber fees if certain numbers of additional subscribers are provided. We also may help fund the distributors' efforts to market our Channels or we may permit distributors to offer limited promotional periods without payment of subscriber fees.

In the past, we have generally paid certain television distributors up-front subscriber acquisition fees to obtain initial carriage on domestic pay distributor systems. Subscriber acquisition fees that we paid in the past were capitalized and amortized over the contractual term of the applicable distribution agreement as a reduction in subscriber fee revenue. If the amortization expense exceeds the revenue recognized on a per distributor basis, the excess amortization is included as a component of cost of services. At the time we sign a distribution agreement and periodically thereafter, we evaluate the recoverability of the costs we incur against the incremental revenue directly and indirectly associated with each agreement.

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

Our subscriber count depends on the number of distributors carrying one of our Channels and the size of such distributors as well as the program tiers on which our Channel is carried by these distributors. From time to time, we experience decreases in the number of subscribers as promotional periods end, or as a distributor arrangement is amended or terminated by us or the distributor. The level of subscribers could also be affected by a distributor repositioning our Channels from one tier to another tier. Management analyzes the estimated effect each new or amended distribution agreement will have on revenue and costs. Based upon these analyses, if subscriber acquisition fees are needed, management endeavors to achieve a fair combination of subscriber commitments and subscriber acquisition fees.

*Advertising*

Historically, revenue from advertising aired on our channels has contributed more than 75% of our total annual revenue. We earn advertising revenue in the form of spot or general rate advertising, direct response advertising and paid-programming (i.e., infomercials). Spot advertisements and direct response advertisements are generally 30 seconds long and are aired during or between licensed program content. Spot advertisements are priced at a rate per thousand viewers and almost always bear 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. It is sold without ratings or product sales commitments. Paid-programming is sold at fixed rates for 30 minute blocks of time, typically airing in the early morning hours. It requires no licensed program content. Our advertising revenue is affected by the mix of these forms of advertising.

Our rates for spot advertisements are generally calculated on the basis of an agreed upon price per unit of audience measurement in return for a guaranteed commitment by the advertiser. We commit to provide advertisers certain rating levels in connection with their advertising. Advertising rates also vary by time of year due to seasonal changes in television viewership. Revenue is recorded net of estimated delivery shortfalls ( audience deficiency units or ADUs ), which are usually settled by providing the advertiser additional advertising time. The remainder of the revenue is recognized as the make-good advertising time is delivered in satisfaction of ADUs. Revenue from direct response advertising depends largely upon actions of viewers.

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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. 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.

Our channels are broadcast 24 hours per day. Our advertising inventory comprises the commercial load or advertising capacity of the program hours in which we intend to broadcast licensed program content. The volume of inventory that we have available for sale is determined by the number of our channels (*i.e.*, two), our chosen commercial load per hour and the number of broadcast hours in which we air licensed program content. Sales of advertising inventory for cash are decreased by our need to reserve inventory for the use of ADUs.

**Cost of Services**

Our cost of services consists primarily of the amortization of program license fees; 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 Crown Media Holdings to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of 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 contained in Item 1 of this Report and Critical Accounting Policies, Judgments and Estimates in Item 7 of the Company's Annual Report on Form 10-K as filed with the SEC for the year ended December 31, 2009.

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

In 2010 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, an administrative services agreement, a tax sharing agreement and the Recapitalization, including the loans under the Credit Agreement, a registration rights agreement and a stockholders agreement. For information regarding such transactions and transactions with other related parties, please see Effects of Transactions with Related and Certain Other Parties in Item 7 of the Company's Annual Report on Form 10-K as filed with the SEC for the year ended December 31, 2009, and The Recapitalization in the Company's Schedule 14C Information Statement filed with the SEC on May 21, 2010. Also, please see Notes 1, 5 and 6 of Notes to Unaudited Condensed Consolidated Financial Statements contained in Item 1 of this Report.

*Credit Agreement*

Pursuant to the Recapitalization, the Company and HCC entered into a Credit Agreement providing for the restructuring of approximately \$315.0 million principal amount of the HCC Debt into new debt instruments on terms including the following:

- *Maturity:* The maturity of the New Debt is December 31, 2013.

- *Tranches:* The New Debt includes two tranches:

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- Term A Loan of \$200.0 million bears interest payable in cash at the rate of 9.5% per annum through December 31, 2011, and 12% thereafter.
- Term B Loan of \$115.0 million bears interest payable in cash at the rate of 11.5% through December 31, 2011, and 14% thereafter. At the Company's option, it may pay-in-kind ( PIK ) interest payable for quarters in 2010. Through September 30, 2010, the Company has paid interest in cash.

The Company has the option to PIK up to three additional quarterly cash payments in the aggregate for the Term A Loan and the Term B Loan. Exercise of the 2010 PIK option under the Term B Loan will not reduce the number of additional PIK payments available to the Company. If the Company opts to PIK both the Term A Loan and the Term B Loan cash payments in a single quarter, that will count as two of the Company's three additional PIK options.

*Default Interest:* The Company will be required to pay interest on its obligations to HCC at an interest rate equal to the original interest rate applicable to such obligations plus 2% if: (i) any amount of principal of the New Debt is not paid when due; (ii) any amount payable under any Fundamental Document (as defined in the Credit Agreement) is not paid when due; or (iii) an Event of Default (as described below) exists.

*Prepayment:* The New Debt is prepayable at any time at par plus accrued interest.

*Mandatory Prepayments:* The following amounts must be used to prepay the New Debt. All net cash proceeds from asset sales or other dispositions, except to the extent such net cash proceeds are reinvested in productive assets of a kind then used or usable in the business of the Company or its subsidiaries within 180 days of the sale or other disposition; 100% of net cash proceeds from equity issuances; 100% of net cash proceeds from debt issuances (exclusive of the bank credit facility); 75% of Excess Cash Flow (as defined in the Credit Agreement); and upon the sale of assets in advance of a condemnation proceeding, or following the occurrence of a casualty or condemnation for which the Company or its subsidiaries have received proceeds, any such proceeds in excess of the amount used to replace the subject assets. Prepayments must be applied in the following order (i) first to PIK interest on the Term A Loan (ii) then to principal on the Term A Loan (iii) then to PIK interest on the Term B Loan, and (iv) finally to principal on the Term B Loan.

*Acceleration:* The principal and interest on the New Debt will become immediately due and payable upon a change in control arising from (i) a Premium Transaction (as described below under "Stockholders Agreement") or (ii) a transaction approved by the Company's Board of Directors. Upon an Event of Default, HCC may declare the principal and interest on the New Debt due and payable, without presentment, demand, protest or other notice.

*Collateral:* The obligations under the Credit Agreement are secured by substantially all of the Company's assets. This security interest is subordinate to the lender's security interest under the bank credit facility.

*Affirmative Covenants:* Under the Credit Agreement, the Company and its subsidiary guarantors will, among other things:

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- (i) Provide annual and quarterly financial statements and compliance certificates to HCC.
  
- (ii) Maintain their corporate existence and material rights, licenses and permits and comply in all material respects with applicable law.
  
- (iii) Keep their tangible properties that are material to the business in good repair and working condition and their assets of an insurable character.
  
- (iv) Provide prompt notice to HCC of material events including any Event of Default, any material adverse change in the party's condition or operations or any event which could reasonably be expected to materially and adversely affect performance of such party's obligations to HCC, result in a Material Adverse Effect (as defined in the Credit Agreement) or otherwise cause the loss of more than 7.5 million subscribers.

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(v) Provide prompt notice to HCC of the institution of any action or investigation by any governmental authority or material development in any action or investigation, which might, if adversely determined, reasonably be expected to have a material adverse effect or otherwise cause the loss of more than 7.5 million subscribers.

(vi) Upon HCC's request, take all actions necessary to register copyrights or trademarks.

(vii) Defend the collateral against liens other than permitted encumbrances.

(viii) Notify HCC of any potential violation of, non-compliance with or potential liability under, any environmental laws which could reasonably be expected to have a material adverse effect.

(ix) Upon HCC's request, obtain credit ratings issued by Moody's or S&P.

*Negative Covenants:* The Credit Agreement includes restrictions on the ability of the Company and its subsidiary guarantors (the Credit Parties) to, among other things:

(i) Incur additional indebtedness, subject to certain exceptions including, but not limited to, indebtedness in respect of secured purchase money financings not to exceed \$30.0 million at any time, ordinary trade payables, indebtedness to another Credit Party and the \$30.0 million revolving credit facility.

(ii) Incur liens on any collateral, subject to certain exceptions including, but not limited to, subordinated liens in favor of guilds as required by collective bargaining agreements and liens incurred in the ordinary course of business.

(iii) Incur guaranties, subject to certain exceptions including, but not limited to, certain guaranties that would constitute investments.

(iv) Make investments or payments, subject to certain exceptions including investments of less than \$5 million in the aggregate to entities that are not wholly-owned subsidiaries, intercompany advances, payments to other Credit Parties and to Hallmark Cards pursuant to the terms of a service agreement.



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(v) Sell, lease, transfer, license, or otherwise dispose of (A) movies or television programs other than in the ordinary course of business (provided that the Company will not be entitled to sell, transfer or alienate its entire interest items of such products with an aggregate value in excess of \$5 million), (B) channels owned or operated by the Credit Parties or (C) other property except de minimis dispositions made in the ordinary course of business.

(vi) Sell, discount or otherwise dispose of notes, accounts receivable, or other obligations owing to HCC except in the ordinary course of business.

(vii) Make or incur obligations to make capital expenditures in excess of \$10.0 million for fiscal year 2010, \$5.0 million for fiscal year 2011, \$5.0 million for fiscal year 2012, and \$5.0 million for fiscal year 2013.

(viii) Amend any material agreement in a manner materially disadvantageous to HCC.

(ix) Enter into any agreement prohibiting the creation or assumption of liens upon the properties or assets of the Credit Parties or requiring an obligation to be secured if some other obligation is secured.

(x) Enter into any interest rate protection agreement or currency agreement other than for bona fide hedging purposes.

(xi) Permit the Cash Interest Coverage ratio (as defined in the Credit Agreement) of the Company and its consolidated subsidiaries, as at the end of each fiscal quarter, to be less than 2.0:1.0.

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*Events of Default:* The Credit Agreement defines Events of Default to include the following:

- (i) Any representation or warranty made by any Credit Party in the Credit Agreement, other Fundamental Document or in any document furnished to HCC pursuant to the Credit Agreement or other Fundamental Document, is proven to have been false or misleading in any material respect.
- (ii) Default in the payment of any principal of or interest on the New Debt (subject to a five day grace period) or other fees payable by the Company under the Credit Agreement.
- (iii) Default by any Credit Party in the performance of the covenant requiring notice of material events, any other negative covenant or the requirement to establish the NICC reserve account.
- (iv) Default by any Credit Party in the performance of any other covenant or agreement contained in the Credit Agreement or any Fundamental Document, continuing unremedied for thirty days after the defaulting party obtains knowledge thereof or receives written notice from HCC.
- (v) Default with respect to any indebtedness of any Credit Party in excess of \$1.0 million when due or the performance of any obligation relating to such indebtedness, if the effect is to accelerate or permit the acceleration of the maturity of such indebtedness.
- (vi) Any Credit Party does not pay its debts as they become due or admits in writing its inability to pay its debts, makes a general assignment for the benefit of creditors or is subject of a voluntary or involuntary bankruptcy or similar proceeding.
- (vii) Final judgments for payments in excess of \$1.0 million are rendered in the aggregate against any Credit Party that is not discharged or stayed pending appeal within thirty days from the entry of the judgment.
- (viii) The Credit Agreement or other Fundamental Document ceases to be in full force and effect.
- (ix) The Credit Parties fail to maintain employee benefit plans in accordance with ERISA.
- (x) The Company defaults on the NICC Preferred Interest and such default is not remedied, cured, waived or consented to within the grace period with respect thereto.

- (xi) Any demand for payment is made pursuant to Hallmark Cards' guaranty with respect to the bank credit facility.

***Stockholders Agreement***

Pursuant to the Recapitalization, the Company, Hallmark Cards and HCC entered into the Stockholders Agreement which provides for, among other things, the following.

*Standstill Provisions:* Hallmark Cards will not, and will cause its controlled affiliates not to, acquire any additional shares of Common Stock (including pursuant to a short form merger) until December 31, 2013 except:

- (i) acquisitions that are effected with the prior approval of a special committee of the Board of Directors comprised solely of independent, disinterested directors;

- (ii) acquisitions in connection with the conversion of Preferred Stock;

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(iii) in the event that the Company issues additional shares of capital stock, such additional shares as are necessary to ensure that Hallmark Cards continues to hold at least the same percentage of the shares of all classes of the Company's capital stock as Hallmark Cards owned immediately prior to such issuance; and

(iv) acquisitions effected between January 1, 2012 and December 31, 2013 and either (x) in connection with certain Premium Transactions (as defined below) or (y) pursuant to a tender offer by Hallmark Cards or its affiliates for all of the outstanding shares of Common Stock, provided the holders of Common Stock not affiliated with Hallmark Cards tender, in the aggregate, at least a majority of the shares of Common Stock held by all such stockholders at such time.

Premium Transaction means a transaction involving the sale or transfer by HCC of its shares of Common Stock to a third party (by merger or otherwise) in which all stockholders unaffiliated with Hallmark Cards are entitled to participate and are entitled to receive both (i) consideration equivalent in value to the highest consideration per share of Common Stock received by HCC in connection with such transaction, and (ii) a premium of \$0.50 per share of Common Stock (subject to adjustment for any stock splits, combinations, reclassifications, adjustments, sale of Common Stock by the Company, or sale of Common Stock by HCC pursuant to a public offering or block trade as described above, or any similar transaction). For the avoidance of doubt, the aggregate premium shall not exceed \$17,400,880, which is the product of the number of outstanding shares owned by minority stockholders as of the date of the Master Recapitalization Agreement multiplied by \$0.50. Also, for the avoidance of doubt, HCC may effectuate a Premium Transaction pursuant to a short-form merger (or other merger) between the Company and HCC or any purchaser of its shares, so long as the holders of Class A Common Stock not affiliated with HCC receive the consideration provided for in this paragraph in connection with such merger.

*Co-sale Provisions:* Until December 31, 2013, HCC will not sell or transfer its Common Stock to a third party except:

(i) to an affiliate of Hallmark Cards or pursuant to a bona fide pledge of the shares to a lender that is not an affiliate of Hallmark Cards (collectively, a Permitted Transfer );

(ii) with the prior approval of a special committee of the Board of Directors comprised solely of independent disinterested directors; or

(iii) after January 1, 2012 until December 31, 2013 (x) in a Premium Transaction or (y) pursuant to a public offering or block trade in which to the knowledge of HCC, no purchaser (together with its affiliates and associates) acquires beneficial ownership of a block of shares of the Company in such transaction in excess of 5% (in the case of a public offering) or 2% (in the case of any block trade) of the outstanding Common Stock.

From and after January 1, 2014 until the earlier of December 31, 2020 and such time as Hallmark Cards and its controlled affiliates no longer beneficially own a majority of the Common Stock, HCC will not sell or transfer, in one or a series of related transactions, a majority of the outstanding shares of Common Stock to a third party, unless (x) in a Permitted Transfer, (y) with the prior approval of a special committee of the Board of Directors or (z) all stockholders unaffiliated with Hallmark Cards will at Hallmark Cards' option be entitled to either participate in such transaction on the same terms as HCC or receive cash consideration equivalent in value to the highest consideration per share of Common Stock received by HCC in connection with such transaction.

*Subscription Rights:* Except as otherwise set forth below, any time the Company proposes to issue equity securities of any kind, including any warrants, options or other rights to acquire equity securities and debt securities convertible into equity securities ( Proposed Securities ), the Company will:

(i) give written notice setting forth in reasonable detail (w) the designation and all of the terms and provisions of the Proposed Securities, including the voting powers, preferences and relative participating, optional or other special rights, and the qualification, limitations or restrictions thereof and interest rate and maturity, (x) the price and other terms of the proposed sale of such securities, (y) the amount of such securities

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proposed to be issued, and (z) such other information as HCC reasonably requests in order to evaluate the proposed issuance; and

(ii) offer to issue to HCC or its affiliate a portion of the Proposed Securities equal to a percentage (the Fully Diluted Ownership Percentage ) determined by dividing (x) the number of shares owned by HCC and its affiliates immediately prior to the issuance of the Proposed Securities by (y) the total number of shares of Common Stock then outstanding, including for purposes of this calculation all shares outstanding on a fully diluted basis.

If the Proposed Securities are to be issued to employees of the Company or its affiliates as compensation with the approval of the Board of Directors (the Employee Proposed Securities ), the Company must comply with the following:

(i) If the Employee Proposed Securities are shares of capital stock, subject to vesting or other similar conditions ( Restricted Stock ), then HCC and, if applicable, its affiliates have the right to purchase capital stock of the same class as the Restricted Stock but which is not subject to vesting or other similar conditions. HCC or its affiliates may purchase up to the number of shares of capital stock equal to the number of shares of Restricted Stock to be issued multiplied by a fraction, the numerator of which is the Fully Diluted Ownership Percentage and the denominator of which is 100% minus the Fully Diluted Ownership Percentage. The purchase price for such securities will be the fair market value of the Restricted Stock on the date of issuance.

(ii) If the Employee Proposed Securities are options to acquire capital stock of the Company, then the issuance of the Proposed Securities will be deemed to occur upon the exercise of the options and not upon the issuance of the options, and HCC and, if applicable, its affiliates, will have the right to purchase, prior to the expiration of ten (10) business days after receipt of notice of such exercise from the Company, capital stock of the same class as the underlying security. HCC or its affiliates may purchase up to the number of shares of capital stock equal to the number of shares of the underlying security to be issued upon the exercise of such Employee Proposed Securities multiplied by a fraction, the numerator of which is the Fully Diluted Ownership Percentage and the denominator of which is the quantity 100% minus the Fully Diluted Ownership Percentage. The issuance price will be deemed to be the fair market value of the underlying security on the date of exercise and not the exercise price of the option or right.

If the Proposed Securities are options or rights to acquire capital stock of the Company but are not Employee Proposed Securities, then the issuance of the Proposed Securities will be deemed to occur upon the exercise of the options or rights and not upon the issuance of the options or rights, and HCC and, if applicable, its affiliates have the right to purchase capital stock of the same class as the underlying security. HCC or its affiliates may purchase up to the number of shares of capital stock equal to the number of shares of the underlying security to be issued upon the exercise of such Proposed Securities multiplied by a fraction, the numerator of which is the Fully Diluted Ownership Percentage and the denominator of which is the quantity 100% minus the Fully Diluted Ownership Percentage. The issuance price will be deemed to be the sum of the purchase price for such options or rights, plus any additional consideration paid upon exercise of such options or rights.

HCC and, if applicable, its affiliates, must exercise their purchase rights within ten (10) business days after receipt of such notice from the Company. Upon the expiration of the offering period, the Company will be free to sell such Proposed Securities that HCC and its affiliates have not elected to purchase during the ninety (90) days following such expiration on terms and conditions no more favorable to the purchasers thereof than those offered HCC and its affiliates.

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The majority of the obligations of Hallmark Cards set forth in the Stockholders Agreement will terminate upon a payment default on the New Debt, subject to a 60-day cure period. The Stockholders Agreement also terminates on the earliest of (i) such time as Hallmark Cards and its controlled affiliates cease to hold a majority of the Common Stock, (ii) such time as Hallmark Cards and its affiliates own all of the outstanding Common Stock and (iii) December 31, 2020.

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*Inapplicability of Prior Stockholders Agreement:* As a result of the Mergers and the terms of the Stockholders Agreement, Hallmark Cards will no longer be subject to the prior stockholders agreement with the Company. The prior stockholders agreement among the Company and its largest stockholders set forth certain corporate governance rights, and limitations on the Company's ability, directly or indirectly, to enter into any material contracts or transactions with any affiliate of certain stockholders, including a wholly-owned subsidiary of Hallmark Cards, unless certain conditions were met.

***Registration Rights Agreement***

In connection with the Recapitalization, the Company, HCC and any prior stockholders of HEIC that execute a joinder are parties to a Registration Rights Agreement (the "Registration Rights Agreement") relating to the shares of Common Stock (i) issued to HCC or any joined party in connection with the Mergers, (ii) issuable to HCC upon conversion of the HCC Debt and upon conversion of the Preferred Stock, (iii) acquired by HCC pursuant to its subscription rights as set forth in the Stockholders Agreement and (iv) issued as a dividend or other distribution with respect to, or in exchange for or in replacement of the shares of Common Stock referred to in clauses (i) (iii) (the shares described in clauses (i) (iv) collectively, the "Registrable Securities"). The Registration Rights Agreement grants (i) three (3) demand registration rights exercisable by the holders of a majority of the Registrable Securities, (ii) three (3) resale shelf demand rights exercisable by holders of a majority of the Registrable Securities and (iii) unlimited piggyback rights. The expenses of any of these registrations will be borne by the Company.

***Preferred Stock Terms***

In connection with the Recapitalization, the Company issued to HCC 185,000 shares of Preferred Stock. The terms of the Preferred Stock include the following:

*Dividends:* No dividends will accrue or be payable from the date of issue of the Preferred Stock through December 31, 2010. Cumulative dividends will accrue from and after January 1, 2011 through December 31, 2011 at the rate of 14% per annum of the Original Issue Price. The Original Issue Price is \$1,000 per share subject to adjustment in the event of any stock dividends, stock splits, stock distributions or combinations and other corporate actions having a similar effect with respect to the Preferred Stock. Cumulative dividends will accrue from and after January 1, 2012 at the rate of 16% per annum of the Original Issue Price. Until December 31, 2014, dividends are payable in cash or in additional shares of Preferred Stock, at the option of the Company. After December 31, 2014, dividends on the Preferred Stock are payable in cash only. The Preferred Stock will participate with the Common Stock as to any declared dividends on an as converted basis.

*Optional Conversion:* Each share of Preferred Stock will become and remain convertible at the earlier of December 31, 2013, or upon a payment or refinancing of the New Debt (a "Refinancing") at the option of the holder into a share of Common Stock at the rate equal to the Original Issue Price plus accrued and unpaid cash dividends with respect to such shares of Preferred Stock divided by the Preferred Conversion Price. Preferred Conversion Price was \$2.5969 as of the closing of the Recapitalization, which price is subject to adjustments for stock splits, combinations, dividends, mergers, recapitalizations and other corporate actions having a similar effect with respect to the Preferred Stock and other adjustments as provided below under "Anti-Dilution Protection."



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*Anti-Dilution Protection:* The Preferred Conversion Price will be subject to adjustment for stock splits, combinations, dividends, mergers, recapitalizations and other corporate actions having a similar effect with respect to the Preferred Stock. The Preferred Conversion Price will also be subject to adjustment on a full-ratchet basis in the event that the Company issues additional shares (other Board approved employee options or shares in an acquisition, merger or joint venture) at a purchase price less than the prevailing Preferred Conversion Price. Full-ratchet basis means an adjustment of the Preferred Conversion Price to the lowest consideration paid per share for the additional shares. Shares subject to options, other rights to acquire and convertible securities are deemed issued at their then exercise or conversion price.

*Mandatory Redemption:* The Company must provide written notice (the Excess Proceeds Notice ) to holders of Preferred Stock, when and as the Company receives, upon a refinancing of the New Debt, net proceeds from such refinancing in excess of the aggregate outstanding principal and interest amounts of New Debt (the Excess

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Refinancing Proceeds ). Upon receipt of such notice, the holders of Preferred Stock may elect to apply such Excess Refinancing Proceeds to redeem (to the extent of funds legally available for such redemption) at the Redemption Price a number of the outstanding shares of Preferred Stock. The Redemption Price means a price per share equal to the Original Issue Price, plus an amount equal to any accrued but unpaid cash dividends with respect to such share, together with any other dividends declared but unpaid. If the Company receives any such requests, it must redeem on the twentieth day after delivery of the Excess Proceeds Notice, the number of outstanding shares of Preferred Stock set forth in all such notices received by the Company within fifteen days after delivery of the Excess Proceeds Notice. If the Excess Refinancing Proceeds are not sufficient to redeem all shares of Preferred Stock to be redeemed, the Company will redeem a pro rata portion of redeemable shares based on the holders' respective redemption requests.

*Optional Redemption:* The Company will be able to redeem the Preferred Stock at any time, upon 10-days written notice, at the Redemption Price.

*Voting Rights:* The Preferred Stock will vote together with the Common Stock as a single class, with the Preferred Stock voting on an as converted basis.

*Protective Provisions:* The consent of holders of more than 50% of the Preferred Stock, voting as a separate class, will be required to approve certain actions, including without limitation:

- (i) Any authorization, offer, sale or issuance of any equity securities pari passu or senior in right of liquidation, dividends or otherwise to the Preferred Stock or any additional shares of Preferred Stock.
- (ii) Repurchase or redemption of equity securities (other than from an employee following termination), or declaration or payment of any dividend on the Common Stock.
- (iii) Any sale, merger, liquidation or dissolution of the Company.
- (iv) Any significant acquisitions involving the payment, contribution or assignment by or to the Company or its subsidiaries of money or assets greater than \$5,000,000.
- (v) Any action that adversely alters or changes the rights, preferences or privileges of the Preferred Stock.
- (vi) The issuance of any additional shares of Common Stock (other than pursuant to options outstanding on the Closing Date) or options or rights to acquire Common Stock.

(vii) Except for certain indebtedness, liens and guaranties permitted by the Credit Agreement, authorization or issuance of any debt security unless the debt security has received the prior approval of the Board of Directors, or amendment of the terms of any agreement regarding material indebtedness of the Company, unless the amendment has been approved by the Board of Directors.

*Liquidation Preference:* In the event of any liquidation or winding up of the Company, the holders of the Preferred Stock will be entitled to receive, in preference to the holders of the Common Stock, an amount equal to the greater of (x) the Original Issue Price per share plus accrued but unpaid cash dividends thereon, or (y) that amount that would be received by such holders on an as converted basis had all Preferred Stock been converted into Common Stock immediately prior to such liquidation or winding up. A consolidation, merger or other form of acquisition of the Company or a sale of all or substantially all of its assets will be deemed to be a liquidation or winding up for purposes of the liquidation preference.

*Tax Sharing Agreement*

On March 11, 2003, the Company became a member of Hallmark Cards consolidated federal tax group and entered into a tax sharing agreement with Hallmark Cards. Hallmark Cards includes the Company in its consolidated federal income tax return. Accordingly, Hallmark Cards has benefited from past tax losses and may benefit from future tax losses, which may be generated by the Company. Based on the tax sharing agreement,

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Hallmark Cards pays the Company all of the benefits realized by Hallmark Cards as a result of consolidation, 75% in cash on a quarterly basis and the balance when the Company becomes a taxpayer. Under the tax sharing agreement, at Hallmark Cards' option, this 25% balance may also be applied as an offset against any amounts owed by the Company to any member of the Hallmark Cards consolidated group under any loan, line of credit or other payable, subject to any limitations under any loan indentures or contracts restricting such offsets.

The Company received \$21.3 million under the tax sharing agreement during 2008, which was offset against the tax note. The Company incurred liability under the tax sharing agreement to Hallmark Cards in the amount of \$8.5 million during 2009.

In connection with the Recapitalization, the tax sharing agreement was amended, effective as of January 1, 2010. The amendment provides, among other things, that:

- Hallmark Cards will not pay any Crown Tax Benefits (defined in the tax sharing agreement) in cash and instead will carry forward any such amounts to offset future Crown Tax Liability (defined in the tax sharing agreement);
- the Company is allowed to deduct both cash-pay and pay-in-kind, or PIK, interest due to Hallmark Cards in calculating tax-sharing payments;
- the conversion of the HCC Debt pursuant to the Recapitalization is not deemed the payment of interest expense to Hallmark Cards;
- cancellation of indebtedness income resulting from the Recapitalization will be excluded from the calculation of tax sharing payments for the 2010 tax year; and
- any amounts related to taxes owed to Hallmark Cards prior to December 31, 2009, was included in the HCC Debt.

The first payment by the Company pursuant to the amended tax sharing agreement is expected to occur on December 15, 2010.

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

In 2008, Crown Media United States entered into an agreement with Hallmark Cards to license 58 Hallmark Hall of Fame movies, consisting of 16 contemporary Hallmark Hall of Fame titles (i.e., produced from 2003 to 2008) and 42 older titles, for exhibition on the Hallmark Channel and Hallmark Movie Channel. These titles are licensed for ten year windows, with windows commencing at various times between 2007 and 2010,

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depending on availability. This agreement makes the Hallmark Channel and Hallmark Movie Channel the exclusive home for these movies. The total license fee for these movies is \$17.2 million and is payable in equal monthly installments over 10 year exhibition windows.

### *Hallmark Advertising*

Hallmark Cards purchased \$429,000 and \$775,000 of advertising on the Hallmark Channel in the United States at negotiated market rates, respectively, during the years ended December 31, 2008 and 2009.

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During November and December of 2009 and February of 2010, Hoops & Yoyo, popular animation characters created and owned by Hallmark Cards, hosted certain of our original movies airing on Hallmark Channel. The characters appeared intermittently during the airing of the movies to provide commentaries and narratives pertinent to the movies. Hallmark Cards provided the content and no license fee was paid by the Company to Hallmark Cards for such content.

***Intercompany Services Agreement***

The Company has an intercompany services agreement with Hallmark Cards, which was entered into in 2003 for a term of three years and then extended for additional years through December 31, 2010. Under the agreement, Hallmark Cards provides us with the following services: tax services; risk management, health, safety and environmental services and insurance; legal services; treasury and cash management services; real estate consulting services; human resources services; and other services mutually agreed by the parties.

We have agreed to pay Hallmark Cards \$541,000 in 2008 and \$455,000 in 2009 per year for these services, plus out-of-pocket expenses and third party fees, payable in arrears on the last business day of each quarter. The balance of the payable for services, expenses and fees under this and the previous services agreement as of both December 31, 2008 and 2009, was approximately \$5.5 million. We believe that the services being provided under the agreement have a value at least equal to the annual fee. For the last three months of 2008, the Company paid the monthly amount due under the intercompany service agreement in the amount of approximately \$135,000. The Company made timely payments in 2009.

***Hallmark Trademark License Agreements***

Crown Media United States operates under the benefit of a limited trademark license agreement with Hallmark Licensing, Inc., dated March 27, 2001, which has been extended through September 1, 2011. The amended and restated Crown Media United States trademark agreement permits Crown Media United States to name its network service as the Hallmark Channel. The agreement contains usage standards, which limit certain types of programming and programming content aired on Crown Media United States network. Crown Media United States also has a similar trademark license agreement with Hallmark Licensing, Inc., which is effective January 1, 2004, and as extended expires September 1, 2011, to permit the use of the Hallmark trademark in the name of the Hallmark Movie Channel.

Under the agreement, if Hallmark Cards notifies us in writing that it has determined that we have failed to comply with the usage standards set forth in the agreement or have otherwise breached our obligations under the agreement, we are required to stop any non-complying activity within 10 days of that notice or we may be in default of the agreement. We also may be in default if Hallmark Cards delivers such a written notice to us with respect to its standards three or more times in any 12-month period. In addition, there may be a default under the agreement if we fail to cure any breach of the program agreement with RHI Entertainment Distribution, if we fail to make any payments due under loan agreements within five days of the due date, or if we receive an opinion from our auditors that shows that we no longer are a going concern. The Company obtained a waiver for the trademark license agreement dated March 3, 2010, from Hallmark Cards related to its going concern opinion over its 2009 financial statements.

The license agreements can be terminated immediately and without notice if we transfer in any way our rights under the license agreements, if we have an event of default under the agreement or in events of bankruptcy, insolvency or similar proceedings.

*Lease Guarantees with Hallmark Cards*

On February 24, 2010, the Company executed a letter of credit/guaranty commitment with respect to a certain lease agreement with 12700 Investments, Ltd. for the office space at 12700 Ventura Boulevard, Studio City, California. The landlord required that Crown Media United States, the entity which executed the lease, provide a letter of credit of \$1.6 million securing certain obligations of Crown Media United States. Consequently, Hallmark Cards has agreed to guarantee the issuer of such letter of credit against any loss thereon pursuant to the guaranty. As

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an inducement for Hallmark Cards to issue the guaranty, Crown Media United States has agreed to pay Hallmark Cards a fee which equals 0.75% per annum of the outstanding letter of credit obligation. Additionally, in the event that Hallmark Cards is required to pay any amount under the guaranty, Crown Media United States must reimburse Hallmark Cards for any such amount plus any fees and charges associated with making such payment, any interest applicable to such amount and any costs and expenses of Hallmark Cards in connection with protecting its rights under the guaranty.

On September 2, 2008, Hallmark Cards issued a guaranty for the benefit of Crown Media United States, which guaranty pertains to a lease agreement with Paramount Group, Inc. for the office space at 1325 Avenue of the Americas, New York, New York. As a condition to executing the lease agreement, the landlord required Hallmark Cards to guaranty all obligations of Crown Media United States under the lease agreement. As an inducement for Hallmark Cards to issue the guaranty, Crown Media United States has paid Hallmark Cards a fee which equals 0.28% per annum of the outstanding obligation under the lease agreement. Additionally, in the event that Hallmark Cards is required to pay any amount under the guaranty, Crown Media United States must reimburse Hallmark Cards for any such amount plus any fees and charges associated with making such payment, any interest applicable to such amount and any costs and expenses of Hallmark Cards in connection with protecting its rights under the guaranty.

***VISN Preferred Interest***

VISN, a subsidiary of the National Interfaith Cable Coalition, Inc. ( NICC ), owns a \$25.0 million preferred interest in Crown Media United States. Under the Crown Media United States Amended and Restated Company Agreement, originally dated November 13, 1998, the members agreed that if during any year ending after January 1, 2005 and prior to December 31, 2009, Crown Media United States has federal taxable income (with possible adjustments) in excess of \$10.0 million, and the preferred interest has not been redeemed, Crown Media United States would redeem the preferred interest in an amount equal to the lesser of:

- such excess;
- \$5.0 million; or
- the amount equal to the preferred liquidation preference on the date of redemption.

Crown Media United States did not have such taxable income in 2009. Crown Media United States may voluntarily redeem the preferred interest at any time, however, it is obligated to do so on the date of redemption (December 31, 2010). The preferred interest has a liquidation preference of \$25.0 million. See information below on a January 2, 2008, agreement under which VISN may request the preferred interest be replaced with promissory notes of Crown Media Holdings.

***Crown Media United States Programming Agreement with NICC***

On January 2, 2008, Crown Media Holdings entered into an agreement with NICC regarding termination of any right of NICC under the agreement covering the operation of Crown Media United States (the Company Agreement ) to compel Crown Media Holdings to buy all of the



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outstanding shares of Class A Common Stock owned by NICC and NICC's subsidiary VISN Management Corp. ( VMC ) at the then current market value. The January 2008 agreement also covers other aspects of Crown Media Holdings' relationship with NICC.

The January 2008 agreement provided for the following:

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- The put agreement was terminated, and the purported exercise of the put was waived.
- Throughout 2008 and 2009, Crown will provide to NICC the use of a two-hour time period each Sunday morning for programming by NICC and NICC shall retain any advertising revenue from such time period. Neither NICC nor Crown is obligated to make any payment regarding this time period or the programming.
- NICC voluntarily relinquished its right to designate one director on Crown Media Holdings Board of Directors, effective with the resignation of its designee on December 19, 2007.
- In settlement of a claim of NICC for \$15,000,000 in the event of a change of control, Crown will pay NICC the total amount of \$3,750,000 in three installments of \$1,250,000 each on January 20, 2008, January 20, 2009 and January 20, 2010. If there would have been a change of control prior to January 20, 2010, Crown would have paid the remaining unpaid installments at that time. The Company has paid the January 20, 2008, 2009 and 2010, installments.
- For so long as the preferred interest remains outstanding, Crown will remit to NICC payments equivalent to 6.0% per annum of outstanding balance of the preferred interest. The 2008 and 2009 payments have been made.
- At the request of VMC, Crown will replace the preferred interest in Crown Media United States held by NICC/VMC with a promissory note of Crown and, at VMC's option, a second note payable to an independent not-for-profit corporation designated by VMC. Such notes with an aggregate face amount equal to the outstanding preferred interest at the conversion date would bear interest at 6.0% and a maturity date of December 31, 2010. If the preferred interest is not exchanged for notes, Crown will redeem the preferred interest as set forth in the Company Agreement of Crown Media United States.
- To the extent required by the Stockholders Agreement of HEIC, Crown will consent, and obtain the consent of HEIC, for VMC to assign its ownership of HEIC shares to a non-profit corporation designated by VMC or to NICC. The shares will continue to be subject to the HEIC Stockholders Agreement. As a result of the Recapitalization, the HEIC Stockholders Agreement is no longer effective.
- Except as provided or referenced in the January 2008 Agreement, the term and conditions of the following prior agreements between or among the parties to the January 2008 agreements were superseded: The Company Agreement and the December 2005 agreement. The Stockholders Agreement is modified to the extent provided in the January 2008 Agreement. In addition, the parties provided mutual releases.

During the years ended December 31, 2008 and 2009, Crown Media United States paid NICC \$6.4 million and \$4.6 million, respectively, related to the Company Agreement, the December 2005 Agreement and the January 2008 Agreement.

***DIRECTV Affiliation Agreement***

On August 20, 2001, Crown Media United States entered into an Affiliation Agreement with DIRECTV, Inc., a wholly owned subsidiary of DIRECTV Enterprises, Inc. Pursuant to the Affiliation Agreement, DIRECTV distributes the Hallmark Channel on the TOTAL CHOICE® tier of its DBS distribution system in the United States and pays us license fees for such distribution. At the same time we entered into a Stock Purchase Agreement with DIRECTV Enterprises whereby we issued 5,360,202 shares of our Class A Common Stock, which shares were subsequently transferred to its parent company, The DIRECTV Group, Inc. In March 2008, we renewed this distribution agreement for a multi-year term and additionally provided DIRECTV with the right to distribute the Standard Definition and High Definition versions of the Hallmark Movie Channel. As of December 31, 2009, DIRECTV accounted for 17.7 million of our subscribers. Upon completion of the Recapitalization, The DIRECTV Group, Inc.'s ownership percentage of our Class A Common Stock was reduced from approximately 7.2% to approximately 1.5%.

*Bank Credit Facility*

In 2001, the Company entered into a credit agreement (which agreement has been amended subsequently, with

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the most recent amendment dated June 29, 2010) with a syndicate of banks, led by JP Morgan Chase Bank, N.A. as Administrative Agent and Issuing Bank. In March 2008, JP Morgan Chase Bank became the sole lender under the bank credit facility by acquiring the interests of all other lending banks. The facility is guaranteed by the Company's subsidiaries, is secured by all tangible and intangible property of the Company and its subsidiaries, and is guaranteed by Hallmark Cards. Interest on the credit facility is the Eurodollar rate plus 2.25% or the alternate base rate plus 1.25%.

As a result of the most recent amendment executed in June 2010 (Amendment No. 17), the bank credit facility is a revolving line of credit in the amount of \$30.0 million due on June 30, 2011. Simultaneously with executing Amendment No. 17, Hallmark Cards Subordination and Support Agreement was terminated and an intercreditor agreement among HCC, JP Morgan Chase Bank and the Company was entered into, which among other things defines the lien priorities and allows for payments to HCC pursuant to the Recapitalization.

Each loan under the bank credit facility bears interest at a Eurodollar rate or an alternate base rate as we may request at the time of borrowing. The Eurodollar rate is based on the London interbank market for Eurodollars, and remains in effect for the time period of the loan ranging from one, two, three, six or twelve months. The alternate rate is based upon the prime rate of JP Morgan Chase Bank, a certificate of deposit rate or the Federal Funds effective rate, which is adjusted whenever the rates change. We were required to pay a commitment fee of 0.15% per annum of the committed, but not outstanding, amounts under the revolving credit facility, payable in quarterly installments. Pursuant to Amendment No. 15, the commitment fee of 0.15% per annum was increased to 0.375% per annum, which results in no increase to us because the difference was previously paid by us to Hallmark Cards.

The credit agreement, as amended, contains a number of affirmative and negative covenants. Affirmative covenants include, without limitation, the following: (1) (a) within 90 days after the end of each fiscal year, submit to the banks audited consolidated financial statements of the Company required to be submitted to the S.E.C., and (b) within 45 days after the end of each of the first three fiscal quarters, submit to the banks unaudited consolidated financial statements of the Company required to be submitted to the S.E.C.; (2) cause the Company's corporate existence to be effective; (3) keep tangible properties material to the Company's business in good condition; (4) provide notice of the following material events: (a) any event of default, (b) material adverse change in the condition or operations of any credit party, (c) any action which could affect the performance of the credit parties' obligations under the Credit Agreement, (d) any other event which could result in a material adverse effect, (e) opening or change of any executive office, (f) change in the name of the credit parties, (g) any event which affects the collectibility of receivables or decrease the value of the collateral, (h) proposed material amendment to any material agreement that are part of the collateral and (i) any notice which a credit party received with respect to a claimed default; (5) (a) insure its assets adequately, (b) insure against other hazards and risks, (c) maintain distributor's errors and omissions insurance, (d) maintain broadcaster's errors and omissions insurance, (e) cause all insurance to provide to the Lender a written notice of any termination or material change of coverage and (f) upon request, provide to the Lender a statement of insurance coverage; (6) maintain true and complete books and records of financial operations and provide the Agent access to such books and records; (7) observe and perform all material agreements with respect to the distribution/exploitation of the Products (as defined in the Credit Agreement); (8) pay all taxes and other governmental charges and indebtedness in the ordinary course of business of the credit parties; (9) defend the collateral against all liens, other than permitted encumbrances; (10) upon receipt of any (a) payment from any obligor which should be remitted to the Agent or (b) the proceeds of any sale of Product, remit such payment or proceeds to the Agent; (11) comply with all applicable environmental laws, notify the Agent of any material violation of any applicable environmental laws and indemnify the Agent and the Issuing Bank against any environmental law-related claims; and, (12) (a) upon request, execute and deliver all necessary documents to perfect the liens on the collateral and to carry out the purpose of the Credit Agreement and its ancillary documents and (b) clarify, if necessary, the chain of title for any item of the Products.

Negative covenants include limitations on (1) indebtedness, (2) liens, (3) guaranties, (4) investments, (5) making Restricted Payments, (Restricted Payments include any distribution on our equity, any redemption or other acquisition of our equity including redemption of the company obligated mandatorily redeemable preferred interest, any payment on debt of the Company which is subordinated to the bank loans, and any other payment to Hallmark Cards or any of its affiliates). The credit agreement, however, permits the Company to make payments to Hallmark Cards or an affiliate in payment of a valid outstanding obligation with respect to certain payments related



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to the Recapitalization or any commercially reasonable fees in consideration for Hallmark Cards having extended its guarantee for the bank credit facility under Amendment No. 15, (6) sale of assets, (7) sale of receivables, (8) entering into any sale and leaseback transactions, (9) entering into transactions with affiliates, (10) amending any material agreement with a credit party, (11) creating negative pledge, (12) mergers or acquisitions, (13) production of any item of Product in any fiscal year having an aggregate budgeted negative cost in excess of \$5.0 million, (14) changing our business activities, (15) entering into certain transactions that are prohibited under ERISA, (16) entering into any interest rate protection agreement or currency agreement, (17) acquiring or creating any new subsidiary, (18) using or storing hazardous materials on our premises, (19) creating any first tier subsidiary other than CM Intermediary or have any asset related to the Channel at a level above CM Intermediary and (20) creating any new liens.

Events of default under the amended credit agreement include, among other things, (1) the failure to pay principal or interest, with the default continuing unremedied for five days after receipt of a remittance advice, (2) a failure to observe covenants, (3) a change in control, (4) the Hallmark Cards guarantee of the credit facility shall have expired or otherwise terminated or Hallmark Cards shall have disavowed its obligations under the guarantee or default shall otherwise have occurred in accordance with the terms of the guarantee, (5) a termination by Hallmark Cards or any of its affiliates of the right of the Company or its subsidiaries to use the names Hallmark or Crown in their television services or any Channels owned or operated by them. For purposes of the credit facility, a change in control means that (a) HCC ceases to have sufficient voting power to elect a majority of the Company's board of directors or beneficial ownership of over a majority of the outstanding equity interest of the Company having voting power, (b) the majority of the Board is not comprised of individuals who were either in office or who were nominated by a two-third's vote of individuals in office or so nominated as at December 17, 2001, or (c) the consummation by the Company of a Rule 13e-3 transaction (or a going-private transaction) as defined in the Securities Exchange Act.

***Certain Business Relationships and Conflicts of Interest***

HCC holds approximately 90.3% of our outstanding shares of Class A Common Stock and 100% of Preferred Stock. HCC's control could discourage others from initiating potential merger, takeover or other change of control transactions that may otherwise be beneficial to our businesses or holders of Class A Common Stock. As a result, the market price of our Class A Common Stock or our business could suffer.

HCC's control relationship with us also could give rise to conflicts of interest, including:

- conflicts between HCC, as our controlling stockholder, and our other stockholders, whose interests may differ with respect to, among other things, our strategic direction or significant corporate transactions;
- conflicts related to corporate opportunities that could be pursued by us, on the one hand, or by HCC or its other affiliates, on the other hand; or
- conflicts related to existing or new contractual relationships between us, on the one hand, and HCC and its affiliates, on the other hand.

In addition, our directors, who may also be officers or directors of HCC or its affiliates, will have fiduciary duties, including duties of loyalty, to both companies and may have conflicts of interest with respect to matters potentially involving or affecting us.

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Our certificate of incorporation provides that Hallmark Cards will have no duty to refrain from engaging in activities or lines of business that are the same as or similar to the activities or lines of business in which we engage, and neither Hallmark Cards nor any officer or director of Hallmark Cards, except as provided below, will be liable to us or to our stockholders for breach of any fiduciary duty by reason of any such activities of Hallmark Cards. In the event that Hallmark Cards acquires knowledge of a potential transaction or matter which may be a corporate opportunity for both Hallmark Cards and us, Hallmark Cards will have no duty to communicate or offer that corporate opportunity to us and will not be liable to us or our stockholders for breach of any fiduciary duty as a stockholder by reason of the fact that Hallmark Cards pursues or acquires that corporate opportunity for itself, directs that corporate opportunity to another person, or does not communicate information regarding that corporate

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opportunity to us.

In the event that one of our directors or officers who is also a director or officer of Hallmark Cards acquires knowledge of a potential transaction or matter which may be a corporate opportunity for both us and Hallmark Cards, that director or officer will have fully satisfied his or her fiduciary duty to us and our stockholders with respect to that corporate opportunity if that director or officer acts in a manner consistent with the following policy:

- a business opportunity offered to any person who is one of our officers, and who is also a director but not an officer of Hallmark Cards, will belong to us;
- a business opportunity offered to any person who is one of our directors but not one of our officers, and who is also a director or officer of Hallmark Cards, will belong to us if that opportunity is expressly offered to that person in his or her capacity as one of our directors, and otherwise will belong to Hallmark Cards;
- a business opportunity offered to any person who is one of our officers and an officer of Hallmark Cards will belong to us if that opportunity is expressly offered to that person in his or her capacity as one of our officers, and otherwise will belong to Hallmark Cards; and
- a corporate transaction opportunity will belong to Hallmark cards and any person who is an officer or director of us and an officer or director of Hallmark Cards shall have no duty to communicate such corporate transaction opportunity to us.

For purposes of the policy:

- a business opportunity is any corporate opportunity relating to the operation of a multichannel video programming provider, other than a corporate transaction opportunity;
- a corporate transaction opportunity is any corporate opportunity relating to the acquisition by a third party unaffiliated with Hallmark Cards of the Company or of all or a material portion of its equity, debt, assets or voting power;
- a director who is our Chairman of the Board or Chairman of a committee of the Board will not be deemed to be one of our officers by reason of holding that position, unless that person is one of our full-time employees;
- references to us shall mean us and all corporations, partnerships, joint ventures, associations and other entities in which we beneficially own, directly or indirectly, 50% or more of the outstanding voting stock, voting power, partnership interests or similar voting interests; and
- the term Hallmark Cards means Hallmark Cards and all corporations, partnerships, joint ventures, associations and other entities, other than us, as we are defined in this paragraph, in which Hallmark Cards beneficially owns, directly or indirectly, 50% or more of the outstanding voting stock, voting power, partnership interests or similar voting interests.

The foregoing provisions of our certificate of incorporation will expire on the date that Hallmark Cards ceases to own beneficially common stock representing at least 20% of the total voting power of all of our classes of outstanding capital stock and no person who is one of our directors or officers is also a director or officer of Hallmark Cards or any of its subsidiaries.



We expect conflicts to be resolved on a case-by-case basis, and in a manner consistent with applicable law.

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In the table below, we provide selected historical condensed consolidated financial and other data of Crown Media Holdings and its subsidiaries. The following selected condensed consolidated statement of operations data and selected cash flow information for three and nine months ended September 30, 2009 and 2010, are derived from the unaudited financial statements of Crown Media Holdings and its subsidiaries. This data should be read together with the condensed consolidated financial statements and related notes included elsewhere in this Form 10-Q. Ratings and subscriber information also are unaudited but are not derived from such financial statements and notes thereto.

	Three Months Ended			Percent Change	Nine Months Ended					
	September 30,		2010		September 30,		2010	Percent Change		
	2009	2009		2010	2009	2009			2010	Change
<b>Revenues:</b>										
Subscriber fees	\$	15,998	\$	13,973	-13%	\$	47,153	\$	46,839	-1%
Advertising		46,487		48,499	4%		153,702		149,635	-3%
Sublicense fees and other revenue		334		48	-86%		1,098		133	-88%
Total revenues		62,819		62,520	0%		201,953		196,607	-3%
<b>Cost of Services:</b>										
Programming costs		31,680		31,246	-1%		95,196		90,617	-5%
Operating costs		3,405		3,092	-9%		11,905		8,502	-29%
Total cost of services		35,085		34,338	-2%		107,101		99,119	-7%
Selling, general and administrative expense		12,703		12,641	0%		36,462		37,694	3%
Marketing expense		339		7,114	1999%		5,956		8,551	44%
Loss from sale of film assets					0%				155	100%
Income before interest and income tax expense		14,692		8,427	-43%		52,434		51,088	-3%
Interest expense		(24,884)		(2,509)	-90%		(75,399)		(53,579)	-29%
Income tax expense					0%				(2,897)	100%
Net (loss) income	\$	(10,192)	\$	5,918	-158%	\$	(22,965)	\$	(5,388)	-77%
<b>Other Data:</b>										
Net cash provided by operating activities	\$	1,998	\$	22,727	1037%	\$	33,367	\$	51,515	54%
Net cash used in investing activities	\$	(414)	\$	(303)	-27%	\$	(1,062)	\$	(1,415)	33%
Net cash used in financing activities	\$	(18,016)	\$	(4,466)	-75%	\$	(26,660)	\$	(24,406)	-8%
Total domestic day household ratings (1)(3)		0.537		0.409	-24%		0.571		0.433	-24%
Total domestic primetime household ratings (2)(3)		0.899		0.657	-27%		0.976		0.711	-27%
Subscribers at period end		87,717		90,218	3%		87,717		90,218	3%

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

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

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

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***Results of Operations***

*Three Months Ended September 30, 2009, Compared to Three Months Ended September 30, 2010*

**Revenue.** Our revenue, comprised primarily of subscriber and advertising fees, decreased \$299,000 or less than 1% in 2010 over 2009. Our subscriber fee revenue remained constant. The amount of subscriber acquisition fees that was recorded as a reduction of subscriber fee revenue was approximately \$651,000 and \$485,000 for 2009 and 2010, respectively. The increase in subscriber revenue due to small contractual rate increases and significant growth in Hallmark Movie Channel subscribers was offset by the accounting treatment of subscriber revenue for one multiple systems operator and the lack of a month of revenue for another multiple systems operator.

Due to the lack of distribution agreements with two multiple system operators, the Company's subscriber revenue has and will continue to decline until new agreements are executed.

Advertising revenue increased \$2.0 million or 4% in 2010 over 2009 due to higher CPM rates offset by declines in viewer ratings across demographic categories for 2010 compared to 2009. The ratings decline reduced the revenue from all inventory, including inventory used to satisfy deficiencies in audience delivery. Audience deficiency unit revenue decreased \$1.2 million from contra-revenue of \$894,000 for 2009, to contra-revenue of \$2.1 million for the same period in 2010 as a result of such ratings declines, leading to a corresponding decrease in revenue recognized by the Company. CPM rates in the third quarter of 2010 increased by approximately 11% over the same period of 2009, thereby increasing revenues. However, the increase in CPM rates was more than offset by the decline in ratings which reduced the value of the Company's inventory.

We believe that changes to our program schedule in 2009 and through the third quarter of 2010, along with increased competition (including the availability of high definition distribution by competitors), contributed to a decline in ratings on the Hallmark Channel. From 2005 until early 2009, our programming schedule did not change significantly. Beginning in 2008, a number of programs that had previously received strong ratings began to experience ratings declines, and we placed television series in certain timeslots instead of movies or original productions. Also, a number of programs in the schedule provided strong household ratings performance but less effective delivery of our key demographic, women age 25-54. In 2009, we began to introduce new content into the schedule with the objective of increasing the delivery of women 25-54. The schedule changes likely resulted in some viewer confusion, resulting in lower ratings. We will continue to focus on program acquisitions, original program production and schedule changes that are intended to improve both the viewer ratings and the demographic delivery of the Hallmark Channel.

The fact that Hallmark Channel was not broadcast in high definition may have had a negative impact on ratings in 2009. Of the top 44 advertising supported cable networks with a 0.4 household rating or higher in prime time, only six of those networks (including Hallmark Channel) were not offered in high definition. Of those six networks, three experienced double-digit ratings decreases in 2009 compared to 2008 and three experienced single digit increases. In 2009, 33% of viewers with access to high definition programming services tuned to those high definition services first. The growth in popularity of high definition programming is expected to continue in 2010 and beyond, and these high definition trends were part of our decision to launch Hallmark Channel in high definition in February 2010.

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In 2009, competition within the cable television industry increased significantly. The number of cable networks investing in original programming increased 74% in 2009 compared to 2008, and, for the full year 2009, acquired (non-original) programming represented only 33% of prime time cable programming. The increase in cable networks' investment in original programming continues in 2010, and we believe it continues to negatively impact our ratings. Although Hallmark Channel continues to invest in original programming, our increase in investment for original content did not match the growth of the market or many of our competitors. The impact of the programming competition is heightened by the continued growth of time-shifting digital video recording devices, or DVRs. With the proliferation of these devices, viewers are able to increase their access to the new, compelling content.

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For the three months ended September 30, 2010, Nielsen ranked the Hallmark Channel 24th in total day viewership with a 0.409 household rating and 25th in primetime with a 0.657 household rating among the 78 cable channels in the United States market.

Advertising revenue from the Hallmark Movie Channel increased from \$2.4 million for the three months ended September 30, 2009, to \$4.6 million for the three months ended September 30, 2010. This is due to the increase in the number of subscribers as the Company continues to expand distribution of this channel.

*Cost of services.* Cost of services as a percent of revenue decreased to 55% in 2010 as compared to 56% in 2009. This decrease results primarily from the effects of the 9% decrease in operating costs, discussed below, offset in part by the 4% decrease in advertising revenue discussed above.

Programming costs decreased \$434,000 or 1% from 2009. During 2009 and through the third quarter of 2010, except for Martha Stewart programming, we did not enter into any significant new third party license agreements. As a result, expiring program rights and the related amortization were not replaced in full with assets and amortization from newer license agreements. At this time, we do not expect significant program acquisitions for the rest of 2010, other than the potential additional costs to obtain high definition version of certain of our programming.

Operating costs for 2010 decreased \$313,000 over 2009. The Company's bad debt expense was \$235,000 for 2009, as compared to \$12,000 for 2010. The decrease in bad debt expense is primarily due to certain advertising customers experiencing cash flow problems under generally poor economic conditions during 2009 and being unable to make timely payments. Customer cash flow problems declined in 2010 and, therefore, payments were received on a timelier basis.

*Selling, general and administrative expense.* Our selling, general and administrative expense for 2010 remained constant.

*Marketing expense.* Our marketing expense increased \$6.8 million or approximately 2,000% in the third quarter of 2010 versus the third quarter of 2009. The Company allocated significant marketing resources towards the third quarter launch of the Martha Stewart programming in 2010.

*Interest expense.* Interest expense decreased \$22.4 million due to the Recapitalization.

*Nine Months Ended September 30, 2009, Compared to Nine Months Ended September 30, 2010*

*Revenue.* Our revenue, comprised primarily of subscriber and advertising fees, decreased \$5.3 million or 3% in 2010 over 2009. Our subscriber fee revenue decreased \$314,000 or 1% due to on-going negotiations with two distributors. The amount of subscriber acquisition fees that was

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recorded as a reduction of subscriber fee revenue was approximately \$2.0 million and \$1.5 million for 2009 and 2010, respectively.

Due to the lack of distribution agreements with two multiple system operators, the Company's subscriber revenue has and will continue to decline until new agreements are executed.

The \$4.1 million or 3% decrease in advertising revenue is primarily due to declines in viewer ratings across demographic categories for 2010 compared to 2009. For the nine months ended September 30, 2010, Nielsen ranked the Hallmark Channel 26th in total day viewership with a 0.433 household rating and 23rd in primetime with a 0.711 household rating among the 78 cable channels in the United States market. The ratings decline reduced the revenue from all inventory, including inventory used to satisfy deficiencies in audience delivery. Audience deficiency unit revenue decreased \$7.5 million from contra-revenue of \$5.8 million for 2009, to contra-revenue of \$13.3 million for the same period in 2010 as a result of such ratings declines, leading to a corresponding decrease in revenue recognized by the Company.

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Advertising revenue from the Hallmark Movie Channel increased from \$7.5 million for the nine months ended September 30, 2009, to \$12.6 million for the nine months ended September 30, 2010. This is due to the increase in the number of subscribers as the Company continues to expand distribution of this channel.

*Cost of services.* Cost of services as a percent of revenue decreased to 50% in 2010 as compared to 53% in 2009. This decrease results primarily from the effects of the \$4.6 million or 5% decrease in programming costs, discussed below, offset in part by the 3% decrease in advertising revenue discussed above. We may, however, incur additional programming related costs in the future to obtain high definition versions of certain of our programming.

Operating costs for 2010 decreased \$3.4 million over 2009 due in part to the \$1.1 million decrease in bad debt expense. The Company's bad debt expense was \$1.1 million for 2009, as compared to \$44,000 for 2010. The decrease in bad debt expense is primarily due to certain advertising customers experiencing cash flow problems under generally poor economic conditions during 2009 and being unable to make timely payments. Customer cash flow problems declined in 2010 and, therefore, payments were received on a timelier basis. Additionally, salary and termination expense decreased \$1.4 million and playback and transponder expense decreased \$1.0 million due to terminations of employment during second quarter of 2009 and standard definition provider contracts in the fourth quarter of 2009.

*Selling, general and administrative expense.* Our selling, general and administrative expense for 2010 increased \$1.6 million over 2009. Salary and severance expense decreased \$5.2 million primarily due to terminations of employment in 2009. Additionally, commission expense increased \$785,000 due to meeting quarterly advertising revenue expectations. Research expense increased \$1.3 million due to the receipt of ratings for the Hallmark Movie Channel. Benefits and bonus expense increased \$3.3 million due to an increase in bonus expense based upon assumptions that certain performance metrics will be met and an increase in insurance premiums. Additionally, the Company recorded \$1.0 million of debt issuance costs in conjunction with the Recapitalization.

*Marketing expense.* Our marketing expense increased \$2.6 million or 44% in 2010 versus 2009. The Company allocated significant marketing resources towards the third quarter launch of the Martha Stewart programming in 2010. During 2009, the Company had one significant marketing promotion in January 2009 centered on the original movie, *Taking a Chance on Love*. The Company did not have a significant marketing promotion in the first quarter of 2010.

*Loss from sale of film assets.* In June 2010, the Company concluded that payments for residuals and participations, which are liabilities from the Company's December 2006 sale of its film assets, would occur generally sooner than originally estimated in December 2006 and December 2009 based upon a request for payment received in July 2010. Accordingly, in the second quarter of 2010, the Company increased the carrying amount of the liability by \$155,000 and recognized a corresponding loss from sale of film assets in the accompanying statement of operations.

*Interest expense.* Interest expense decreased \$21.8 million due to the Recapitalization.

*Income tax expense.* For tax purposes, the Recapitalization generated cancellation of debt income which is currently estimated at approximately \$200.0 million, which was offset by net operating losses. Accordingly, the Company is expected to generate federal and state taxable income for both regular tax and alternative minimum tax (AMT) purposes. For regular tax purposes, this income will be fully offset by net operating loss carryforwards. However, for federal AMT purposes, loss carryforwards can be used against AMT income but are limited to 90% of AMT

income. As a result, the Company has recorded an income tax expense of \$2.9 million for the estimated AMT in its consolidated statements of operations as it is not likely that any benefit of this AMT as a credit carryforward will be realized.

**Liquidity and Capital Resources**

During the nine months ended September 30, 2009, our cash provided by operating activities was \$33.4 million as compared to \$51.5 million for the nine months ended September 30, 2010. The Company's net loss for the nine months ended September 30, 2010, decreased \$17.6 million to \$5.4 million from \$23.0 million for the nine months



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ended September 30, 2009. Our depreciation and amortization expense for the nine months ended September 30, 2010 decreased \$6.1 million to \$93.2 million from \$99.3 million in 2009. The Company made programming payments of \$96.5 million and \$94.1 million during the nine months ended September 30, 2009 and 2010, respectively.

Cash used in investing activities was \$1.1 million and \$1.4 million during the nine months ended September 30, 2009 and 2010, respectively. During the nine months ended September 30, 2009 and 2010, we purchased property and equipment of \$371,000 and \$729,000, respectively. During the nine months ended September 30, 2009 and 2010, the Company paid \$691,000 and \$686,000, respectively, to the buyer of the international business for amounts due under the terms of the sale agreement, primarily for reimbursement of transponder lease payments. The related liability was recognized in 2005 as part of the sale of our international business.

Cash used in financing activities was \$26.7 million and \$24.4 million for the nine months ended September 30, 2009 and 2010. We borrowed \$18.1 million and \$0 under our credit facility to supplement the cash requirements of our operating and investing activities during the nine months ended September 30, 2009 and 2010, respectively. We repaid principal of \$44.1 million and \$1.0 million under our bank credit facility during the nine months ended September 30, 2009 and 2010, respectively. Also, during 2010, pursuant to provisions of the Recapitalization, the Company sequestered \$20.0 million, which is now restricted to the payment of the NICC preferred interest on or before December 31, 2010.

The Company expects to make its first cash payment through the fourth quarter of 2010 prior to December 31, 2010, for tax liabilities incurred under the tax sharing agreement as amended. The Company may also have to make cash payments to Hallmark Cards during 2011 under the amended tax sharing agreement.

Additionally, the Company may make a principal payment on its Term A loan of approximately \$8.6 million during the next 12 months.

*Cash Flows*

As of September 30, 2010, the Company had \$36.2 million in cash and cash equivalents on hand. Also available to the Company was the full \$30.0 million bank credit facility which expires June 30, 2011. Day-to-day cash disbursement requirements have typically been satisfied with cash on hand and operating cash receipts supplemented with the borrowing capacity available under the bank credit facility and, prior to the Recapitalization, forbearance by Hallmark Cards and its affiliates.

The Company's management anticipates that the principal uses of cash during the twelve month period ending September 30, 2011, will include the payment of operating expenses, accounts payable and accrued expenses, programming costs, and nominal interest of approximately \$30.0 million to \$45.0 million due under the New Debt issued in the Recapitalization. Subject to the legal availability of funds and approval by the Company's board of directors, the Company may also pay approximately \$19.5 million for cash dividends on Preferred Stock during the nine months ending September 30, 2011; at the option of the Company's board of directors, such dividends, if any, may be paid in the form of additional shares of Preferred Stock.

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At September 30, 2010, the Company also had an additional \$20.0 million of cash, the use of which is restricted to payment of the \$25.0 million company obligated, mandatorily redeemable preferred interest payable to VISN Management Corp. on December 31, 2010. The Company believes that it will be able to fund all, or substantially all, of the remaining \$5.0 million with cash provided by operating activities.

Increases in the Company's audience deficiency liability during the nine month periods ended September 30, 2009, and 2010, contributed \$5.8 million and \$13.3 million, respectively, to cash flows from operating activities (reflected as part of the changes in accounts payable, accrued and other liabilities in the accompanying condensed consolidated statements of cash flows included in Part I of this report). At September 30, 2010, the Company's audience deficiency liability was \$31.1 million, an amount equivalent to approximately 14% of advertising revenue for the year ended December 31, 2009. Settlement of any portion of this liability will not require the direct use of cash because it is the Company's policy to settle in kind. However, such settlement requires the use of advertising

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spots that otherwise may be sold for cash. Accordingly, any decrease in this liability will indirectly require the use of cash with little or no corresponding effect on reported advertising revenue.

**Risk Factors and Forward-Looking Statements**

The discussion set forth in this Form 10-Q contains statements concerning potential future events. Such forward-looking statements are based on assumptions by Crown Media Holdings management, as of the date of this Form 10-Q including assumptions about risks and uncertainties faced by Crown Media Holdings. Readers can identify these forward-looking statements by their use of such verbs as expects, anticipates, believes, or similar verbs or conjugations of such verbs. If any of management's assumptions prove incorrect or should unanticipated circumstances arise, Crown Media Holdings' actual results, levels of activity, performance, or achievements could 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 this Report below and in the Company's filings with the Securities and Exchange Commission, including the Risk Factors stated in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, and the Quarterly Report on Form 10-Q for the quarter ended June 30, 2010. Such Risk Factors include, but are not limited to, the following: competition for distribution of channels, viewers, advertisers and the acquisition of programming; fluctuations in the availability of programming; fluctuations in demand for programming which we air on our channels; our ability to address our liquidity needs; our incurrence of losses; and our substantial indebtedness affecting our financial condition and results.

**Available Information**

We will make available free of charge through our website, [www.hallmarkchannel.com](http://www.hallmarkchannel.com), the 2009 Annual Report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and amendments to such reports, as soon as reasonably practicable after we electronically file or furnish such material with the Securities and Exchange Commission.

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

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

We only invest in instruments that meet high credit and quality standards, as specified in our investment policy guidelines. These instruments, like all fixed income instruments, are subject to interest rate risk. The fixed income portfolio will decline in value if interest rates increase. If market interest rates were to increase immediately and uniformly by 10% from levels as of September 30, 2010, the decline of the fair value of the fixed income portfolio would not be material.

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As of September 30, 2010, our cash, cash equivalents and short-term investments had a fair value of \$56.2 million (including restricted cash) and were invested in cash and short-term commercial paper. The primary purpose of these investing activities has been to preserve principal until the cash is required to fund operations and to fund the \$25.0 mandatorily redeemable preferred interest amount payable in December 2010. Consequently, the size of this portfolio fluctuates significantly as cash is provided by and used in our business.

The value of certain investments in this portfolio can be impacted by the risk of adverse changes in securities and economic markets and interest rate fluctuations. For the three and nine months ended September 30, 2010, the impact of interest rate fluctuations, changed business prospects and all other factors did not have a material impact on the fair value of this portfolio, or on our income derived from this portfolio.

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We have not used derivative financial instruments for speculative purposes. As of September 30, 2010, 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.

**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, 2010, that materially affected, or was reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

For information regarding a lawsuit concerning the Company's proposed Recapitalization, please see Note 11 to the Unaudited Condensed Consolidated Financial Statements contained in Item 1 of this Report.

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**Item 6. Exhibits**

**INDEX TO EXHIBITS**

<b>Exhibit Number</b>	<b>Exhibit Title</b>
2.4	Agreement and Plan of Merger of Crown Media Holdings, Inc. and Hallmark Entertainment Investments Co., dated as of February 26, 2010 (previously filed as an exhibit to our Schedule 14C Information Statement filed on May 21, 2010 and incorporated herein by reference).
2.5	Agreement and Plan of Merger of Crown Media Holdings, Inc. and Hallmark Entertainment Holdings, Inc., dated as of February 26, 2010 (previously filed as an exhibit to our Schedule 14C Information Statement filed on May 21, 2010 and incorporated herein by reference).
3.1	Amended and Restated Certificate of Incorporation (previously filed as Exhibit 3.1 to our Registration Statement on Form S-1/A (Amendment No. 2), Commission File No. 333-95573, and incorporated herein by reference).
3.2	Amendment to the Amended and Restated Certificate of Incorporation (previously filed as Exhibit 3.2 to our Quarterly Report on Form 10-Q filed on July 31, 2001 (File No. 000-30700; Film No. 1693331) and incorporated herein by reference).
3.3	Amended and Restated By-Laws (previously filed as Exhibit 3.2 to our Registration Statement on Form S-1/A (Amendment No. 3), Commission File No. 333-95573, and incorporated herein by reference).
3.4	Second Amended and Restated Certificate of Incorporation of Crown Media Holdings (previously filed as an exhibit to our Schedule 14C Information Statement filed on May 21, 2010 and incorporated herein by reference).
3.5	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 an exhibit to our Schedule 14C Information Statement filed on May 21, 2010 and incorporated herein by reference).
3.6	Proposed form of 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).
10.1	Amendment No. 16, dated as of March 2, 2010, to the Credit, Security, Guaranty and Pledge Agreement, dated as of August 31, 2001 among Crown Media Holdings, Inc. as Borrower, the Guarantors named therein, and JP Morgan Chase Bank as Administrative Agent and as Issuing Bank (previously filed as Exhibit 10.26 to our Annual Report on Form 10-K filed on March 4, 2010 and incorporated herein by reference).
10.2	Amendment No. 17, dated as of June 29, 2010, to the Credit, Security, Guaranty and Pledge Agreement, dated as of August 31, 2001 among Crown Media Holdings, Inc. as Borrower, the Guarantors named therein, and JP Morgan Chase Bank as Administrative Agent and as Issuing Bank (previously filed as Exhibit 10.1 to our Current Report on Form 8-K filed on June 29, 2010 and incorporated herein by reference).
10.3	Waiver to the Trademark License Extension Agreement (Hallmark Channel and Hallmark Movie Channel) dated March 3, 2010, by and between Hallmark Licensing Inc. and Crown Media United States, LLC (previously filed as Exhibit 10.46 to our Annual Report on Form 10-K filed on March 4, 2010 and incorporated herein by reference).
10.4	Intercompany Services Extension Agreement, dated as of January 1, 2010, by and between Hallmark Cards, Incorporated and Crown Media Holdings, Inc. (previously filed as Exhibit 10.58 to our Annual Report on Form 10-K filed on March 4, 2010 and incorporated herein by reference).
10.5	Master Recapitalization Agreement by and among Hallmark Cards, Incorporated, H C Crown Corp., Hallmark Entertainment Holdings, Inc., Crown Media Holdings, Inc., Crown Media United States, LLC, and The Subsidiaries of Crown Media Holdings, Inc. Listed as Guarantors on the Credit Facility, dated as of February 26, 2010 (previously filed as an exhibit to our Schedule 14C Information Statement filed on May 21, 2010 and incorporated herein by reference).
10.6	Credit Agreement, dated June 29, 2010, Among Crown Media Holdings, Inc. as Borrower and HC Crown Corp., as Lender and Each of the Credit Parties Identified on the Signature Pages

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	Hereto (previously filed as an exhibit to our Schedule 14C Information Statement filed on May 21, 2010 and incorporated herein by reference).
10.7	Stockholders Agreement, dated June 29, 2010, by and among H C Crown Corp., Hallmark Cards, Incorporated and Crown Media Holdings, Inc. (previously filed as an exhibit to our Schedule 14C Information Statement filed on May 21, 2010 and incorporated herein by reference).
10.8	Registration Rights Agreement, dated June 29, 2010, among H C Crown Corp., any Other HEIC Stockholder and Crown Media Holdings, Inc. (previously filed as an exhibit to our Schedule 14C Information Statement filed on May 21, 2010 and incorporated herein by reference).
10.9	Amendment No. 2 to Federal Income Tax Sharing Agreement, dated June 29, 2010, between Hallmark Cards, Incorporated and Crown Media Holdings, Inc. (previously filed as an exhibit to our Schedule 14C Information Statement filed on May 21, 2010 and incorporated herein by reference).
10.10	Amendment by letter dated March 19, 2010 to Master Recapitalization Agreement (previously filed as Exhibit 10.10 to our Quarter Report on Form 10-Q filed on August 12, 2010, and incorporated herein by reference).
10.11	Security Agreement, dated June 29, 2010, between the Company and HCC (previously filed as Exhibit 10.11 to our Quarter Report on Form 10-Q filed on August 12, 2010, and incorporated herein by reference).
10.12	Pledge Agreement, dated June 29, 2010, between the Company and HCC (previously filed as Exhibit 10.12 to our Quarter Report on Form 10-Q filed on August 12, 2010, and incorporated herein by reference).
10.13	Trademark License Extension Agreement (Hallmark Channel) dated June 29, 2010 by and between Hallmark Licensing Inc. and Crown Media United States, LLC (previously filed as Exhibit 10.13 to our Quarter Report on Form 10-Q filed on August 12, 2010, and incorporated herein by reference).
10.14	Trademark License Extension Agreement (Hallmark Movie Channel) dated June 29, 2010 by and between Hallmark Licensing Inc. and Crown Media United States, LLC (previously filed as Exhibit 10.14 to our Quarter Report on Form 10-Q filed on August 12, 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 Certifications.

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\*Management contract or compensating plan or arrangement.



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**SIGNATURES**

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

CROWN MEDIA HOLDINGS, INC.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
By: /s/ WILLIAM J. ABBOTT William J. Abbott	Principal Executive Officer	November 9, 2010
By: /s/ MICHAEL J. HARMON Michael J. Harmon	Principal Financial and Accounting Officer	November 9, 2010