

CROWN MEDIA HOLDINGS INC

FORM 10-Q (Quarterly Report)

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Address	12700 VENTURA BOULEVARD STUDIO CITY, CA 91604
Telephone	818 755-2400
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Sector	Services
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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, 2011

or

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

For the transition period from _____ to _____.

Commission File Number: 000-30700

Crown Media Holdings, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

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

**12700 Ventura Boulevard,
Suite 200
Studio City, California 91604**
(Address of Principal Executive Offices and Zip Code)

(818) 755-2400
(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 the definitions 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 Smaller reporting company
(do not check if a smaller reporting company)

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, 2011, 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” or the “Company,” refer to Crown Media Holdings, Inc. and, unless the context requires otherwise, subsidiaries of Crown Media Holdings that operate or have operated our businesses, including Crown Media United States, LLC (“Crown Media United States”). The 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 term “Preferred Stock” refers to our Series A Convertible Preferred Stock.

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

**CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)**

	<u>As of December 31, 2010</u>	<u>As of September 30, 2011</u>
ASSETS		
Cash and cash equivalents	\$ 30,565	\$ 21,002
Accounts receivable, less allowance for doubtful accounts of \$141 and \$404, respectively	77,684	65,034
Receivable from Hallmark Cards	—	2,076
Program license fees	99,574	100,463
Prepaid program license fees	4,099	18,405
Deferred tax asset, net	—	13,000
Prepaid and other assets	2,367	2,418
Total current assets	<u>214,289</u>	<u>222,398</u>
Program license fees	136,503	150,453
Property and equipment, net	12,701	11,441
Deferred tax asset, net	—	223,000
Debt issuance costs	—	12,098
Other assets	1,008	2,211
Goodwill	314,033	314,033
Total assets	<u>\$ 678,534</u>	<u>\$ 935,634</u>

CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)
(continued)

	<u>As of December 31, 2010</u>	<u>As of September 30, 2011</u>
LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY		
LIABILITIES:		
Accounts payable and accrued liabilities	\$ 27,835	\$ 12,643
Audience deficiency reserve liability	26,954	16,454
License fees payable	104,286	123,286
Payables to Hallmark Cards affiliates	1,005	2,267
Interest payable	—	9,266
Current maturities of long-term debt	—	2,100
Notes payable to HCC	38,174	—
Total current liabilities	<u>198,254</u>	<u>166,016</u>
Accrued liabilities	18,972	19,359
License fees payable	33,818	27,189
Long-term debt, net of current maturities	—	505,329
Notes payable to HCC	379,521	—
Total liabilities	<u>630,565</u>	<u>717,893</u>
COMMITMENTS AND CONTINGENCIES		
REDEEMABLE PREFERRED STOCK, \$.01 par value; \$1,000 liquidation preference;		
1,000,000 shares authorized; 185,000 and 0 shares issued and outstanding as of December 31, 2010, and September 30, 2011, respectively	198,934	—
STOCKHOLDERS' (DEFICIT) EQUITY:		
Class A common stock, \$.01 par value; 500,000,000 shares authorized; 359,675,936 shares issued and outstanding as of both December 31, 2010, and September 30, 2011	3,597	3,597
Paid-in capital	1,991,157	2,086,360
Accumulated deficit	(2,145,719)	(1,872,216)
Total stockholders' (deficit) equity	<u>(150,965)</u>	<u>217,741</u>
Total liabilities and stockholders' (deficit) equity	<u>\$ 678,534</u>	<u>\$ 935,634</u>

See accompanying notes to unaudited condensed consolidated financial statements.

CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2011	2010	2011
Revenue:				
Advertising	\$ 48,499	\$ 55,953	\$ 149,427	\$ 169,243
Advertising by Hallmark Cards	—	—	208	358
Subscriber fees	13,973	18,013	46,839	53,894
Other revenue	48	82	133	298
Total revenue, net	<u>62,520</u>	<u>74,048</u>	<u>196,607</u>	<u>223,793</u>
Cost of Services:				
Programming costs				
Non-affiliates	30,809	31,879	89,343	99,465
Hallmark Cards affiliates	437	455	1,274	1,241
Contract termination	—	—	103	—
Other costs of services	3,092	3,133	8,399	9,026
Total cost of services	<u>34,338</u>	<u>35,467</u>	<u>99,119</u>	<u>109,732</u>
Selling, general and administrative expense (exclusive of depreciation and amortization expense shown separately below)				
	12,294	13,469	36,581	41,740
Marketing expense	7,114	2,615	8,551	3,508
Depreciation and amortization expense	347	345	1,113	1,097
Loss on sale of film assets	—	—	155	—
Income from operations before interest and income tax expense	8,427	22,152	51,088	67,716
Interest income	—	—	43	—
Interest expense	(2,509)	(10,556)	(53,622)	(13,886)
Income (loss) from operations before income tax (expense) benefit	5,918	11,596	(2,491)	53,830
Income tax benefit (expense)	—	191,685	(2,897)	235,093
Income (loss) before discontinued operations	5,918	203,281	(5,388)	288,923
Gain from sale of discontinued operations, net of tax	—	(1)	—	188
Net income (loss) and comprehensive income (loss)	5,918	203,280	(5,388)	289,111
Income allocable to Preferred Shareholder	(6,860)	(40,076)	(6,860)	(63,096)
Net (loss) income and comprehensive (loss) income to common shareholders	<u>\$ (942)</u>	<u>\$ 163,204</u>	<u>\$ (12,248)</u>	<u>\$ 226,015</u>
Weighted average number of common shares outstanding, basic and diluted				
	<u>359,676</u>	<u>359,676</u>	<u>192,552</u>	<u>359,676</u>
(Loss) income per common share before discontinued operations, basic and diluted	\$ —	\$ 0.45	\$ (0.06)	\$ 0.63
Gain per common share from discontinued operations, basic and diluted	—	—	—	—
Net (loss) income per common share, basic and diluted	<u>\$ —</u>	<u>\$ 0.45</u>	<u>\$ (0.06)</u>	<u>\$ 0.63</u>

See accompanying notes to unaudited condensed consolidated financial statements.

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

	<u>Nine Months Ended September 30,</u>	
	<u>2010</u>	<u>2011</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	\$ (5,388)	\$ 289,111
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Loss on sale of film assets	155	—
Gain on sale of discontinued operations	—	(188)
Depreciation and amortization	93,186	96,911
Accretion on company obligated mandatorily redeemable preferred interest	1,717	—
Provision for allowance for doubtful accounts	44	261
Loss on sale of fixed asset	2	—
Costs associated with the Recapitalization	1,049	—
Income tax expense (benefit)	2,897	(235,093)
Stock-based compensation	233	28
Changes in operating assets and liabilities:		
Decrease in accounts receivable	5,795	12,389
Additions to program license fees	(41,946)	(108,582)
Increase in prepaid and other assets	(10,126)	(16,732)
Increase (decrease) in accounts payable, accrued and other liabilities	14,311	(24,168)
Increase in interest payable	33,820	9,232
Increase (decrease) in license fees payable	(44,312)	14,919
Increase (decrease) in payables to affiliates	78	(12,081)
Net cash provided by operating activities	<u>51,515</u>	<u>26,007</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(729)	(730)
Payments to buyer of international business	(686)	(94)
Net cash used in investing activities	<u>(1,415)</u>	<u>(824)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Funding of restricted cash account	(20,019)	—
Principal payments on the credit facility	(1,000)	—
Payment on notes payable to HCC	868	(330,390)
Redemption of Preferred Stock	—	(185,000)
Dividends paid to Preferred Stockholder	—	(13,837)
Issuance of the Notes	—	300,000
Issuance of Term Loan, net of original issue discount	—	207,900
Principal payments on the Term Loan	—	(525)
Payments for debt issuance costs	(3,596)	(12,109)
Principal payments on capital lease obligations	(659)	(785)
Net cash used in financing activities	<u>(24,406)</u>	<u>(34,746)</u>
Net increase (decrease) in cash and cash equivalents	25,694	(9,563)
Cash and cash equivalents, beginning of period	10,456	30,565
Cash and cash equivalents, end of period	<u>\$ 36,150</u>	<u>\$ 21,002</u>
Supplemental disclosure of cash and non-cash activities:		
Interest paid	\$ 15,079	\$ 2,572
Reduction of additional paid-in capital for obligation under tax sharing agreement	\$ 5,501	\$ 7,807
Asset acquired through capital lease obligation	\$ 248	\$ —
Additional paid-in capital arising from early extinguishment of debt	\$ —	\$ 87,305
Additional paid-in capital arising from redemption of preferred stock	\$ —	\$ 15,705
Non-cash activities related to the troubled debt restructuring:		
Elimination of deferred debt issuance costs related to old notes payable to HCC	\$ 475	\$ —
Satisfaction of payable to Hallmark Cards affiliates	(23,798)	—
Issuance of new notes payable to HCC	432,140	—
Satisfaction of old notes payable to HCC	(340,697)	—
Satisfaction of senior secured note payable to HCC, including accrued interest	(797,423)	—
Issuance of redeemable preferred stock	185,000	—
Issuance of common stock	2,549	—
Additional paid-in capital from issuance of redeemable preferred and common stock	541,754	—

See accompanying notes to unaudited condensed consolidated financial statements.

CROWN MEDIA HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the Three and Nine Months Ended September 30, 2010 and 2011

1. Business and Organization

Organization

Crown Media Holdings, Inc. (“Crown Media Holdings” or the “Company”), through its wholly-owned subsidiary 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. As of June 29, 2010, following the recapitalization of the Company as described below, the significant investor in the Company is H C Crown, LLC (“HCC”), a subsidiary of Hallmark Cards, Incorporated (“Hallmark Cards”).

The Company’s continuing operations are currently organized into one operating segment, the Channels.

Liquidity

As of September 30, 2011, the Company had \$21.0 million in cash and cash equivalents on hand. Also available to the Company was the full \$30.0 million bank credit facility. Day-to-day cash disbursement requirements have typically been satisfied with cash on hand and operating cash receipts supplemented with the borrowing capacity available under the bank credit facility and, prior to a series of recapitalization transactions consummated June 29, 2010 (the “Recapitalization”), forbearance by Hallmark Cards and its affiliates.

On July 14, 2011 the Company used the proceeds from a new \$210.0 million senior secured term loan (the “Term Loan”) and \$300.0 million of senior unsecured notes (the “Notes”) to repay the Term A Loan and the Term B Loan and redeem all of the outstanding Preferred Stock (collectively, the “2011 Refinancing”). All of these instruments are described further below.

The Company’s management anticipates that the principal uses of cash during the twelve month period ending September 30, 2012 will include the payment of operating expenses, accounts payable and accrued expenses, programming costs, interest and mandatory principal payments of \$44.0 million to \$48.0 million under the Term Loan and Notes, and such additional principal payments made from excess cash flows as defined, as may become due under the Term Loan. The Company believes that cash on hand, cash generated by operations, and borrowing availability under its bank credit facility, will be sufficient to fund the Company’s operations and enable the Company to meet its liquidity needs through September 30, 2012.

2. Summary of Significant Accounting Policies and Estimates

Interim Financial Statements

In the opinion of management, the accompanying condensed consolidated balance sheets and related interim condensed consolidated statements of operations and cash flows include all adjustments, consisting of normal recurring items necessary for their fair presentation in conformity with accounting principles generally accepted in the United States. Interim results are not necessarily indicative of results for a full year. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes to those statements, included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2010.

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.

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 revenue and expenses. Such estimates include the collectibility 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 and valuation allowance, 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 markets, and declines in consumer spending have combined to increase the uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes, if any, in those estimates resulting from continuing changes in the economic environment will be reflected in the financial statements in future periods.

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 \$12,000 for the three months ended September 30, 2010, and the Company's bad debt expense decreased \$39,000 in the three months ended September 30, 2011. The Company's bad debt expense was \$44,000 and \$261,000 for the nine months ended September 30, 2010 and 2011, respectively.

Fair Value of Financial Instruments

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

The Company does not have balance sheet items carried at fair value on a recurring basis. Significant balance sheet items which are subject to non-recurring fair value measurements consist of impairment

valuations of goodwill and property and equipment. In the course of recording the Company's June 2010 troubled debt restructuring, the Company estimated the fair values of its preferred and common stock issued in the Recapitalization. The standard did not have a significant impact on the determination of fair value related to non-financial assets and non-financial liabilities in 2011.

Net Income (Loss) per Share

Basic net income (loss) per share for each period is computed by dividing net income (loss) attributable to common stockholders 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 stockholders 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 and common shares issuable upon conversion of the preferred stock.

Net income attributable to common stockholders for both the three and nine months ended September 30, 2010, reflects allocations in favor of preferred stockholders for imputed preferred stock dividends for financial reporting purposes of \$6.9 million. Net income attributable to common stockholders for the three and nine months ended September 30, 2011, reflects the following allocations, stated respectively, in favor of preferred stockholders: (i) imputed preferred stock dividends for financial reporting purposes of \$134,000 and \$1.8 million, (ii) cumulative preferred stock dividends of \$993,000 and \$13.8 million, and (iii) the potential participation in common stock dividends (equivalent to approximately 71.2 million shares of common stock) of \$38.9 million and \$47.5 million. Approximately 66,000 and 37,000 stock options have been excluded from the determination of diluted net income or loss per share for the three months ended September 30, 2010 and 2011, respectively, because the individual effect in each instance was antidilutive. Approximately 75,000 and 46,000 stock options for the nine months ended September 30, 2010 and 2011, respectively, have been excluded.

Concentration of Risk

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

Five of our distributors each accounted for more than 10% of our consolidated subscriber revenue for both the three months ended September 30, 2010 and 2011, and together accounted for a total of 78% and 84% of consolidated subscriber revenue during the three months ended September 30, 2010 and 2011, respectively. Three and two of our distributors each accounted for approximately 15% or more of our consolidated subscribers for the three months ended September 30, 2010 and 2011, respectively, and together accounted for 60% and 46% of our subscribers during the three months ended September 30, 2010 and 2011, respectively.

Six and five of our distributors each accounted for more than 10% of our consolidated subscriber revenue for the nine months ended September 30, 2010 and 2011, respectively, and together accounted for a total of 80% and 83% of consolidated subscriber revenue during the nine months ended September 30, 2010 and 2011, respectively. Three and two of our distributors each accounted for approximately 15% or more of our consolidated subscribers for the nine months ended September 30, 2010 and 2011, respectively, and together accounted for 60% and 46% of our subscribers during the nine months ended September 30, 2010 and 2011, respectively.

Five and two of our programming content providers each accounted for more than 10% of our total license fees payable for the nine months ended September 30, 2010 and 2011, respectively, and together accounted for a total of 92% and 46% of the consolidated programming liability for the nine months ended September 30, 2010 and 2011, 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 nor third-party evidence is available. The adoption of this guidance on January 1, 2011, did not have a material impact on our consolidated 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 adoption of this guidance did not have a material impact on our consolidated financial statements.

On January 1, 2011, the Company adopted changes issued by the FASB regarding the testing of goodwill for impairment. These changes require an entity to perform all steps in the test for a reporting unit whose carrying value is zero or negative if it is more likely than not (more than 50%) that a goodwill impairment exists based on qualitative factors. This will result in the elimination of an entity's ability to assert that such a reporting unit's goodwill is not impaired and additional testing is not necessary despite the existence of qualitative factors that indicate otherwise. Based on the most recent impairment review of the Company's goodwill (November 2010), the adoption of these changes had no impact on our consolidated financial statements.

In May 2011, the FASB issued Accounting Standards Update ("ASU") No. 2011-04, *Fair Value Measurements (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, ("ASU 2011-04"). ASU 2011-04 changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements to ensure consistency between U.S. GAAP and IFRS. ASU 2011-04 also expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. This new guidance is to be applied prospectively. The Company anticipates that the adoption of this standard will not materially change its consolidated financial statement disclosures.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. ASU No. 2011-05 requires that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements, eliminating the option to present other comprehensive income in the statement of changes in equity. Under either choice, items that are reclassified from other comprehensive income to net income are required to be presented on the face of the financial statements where the components of net income and the components of other comprehensive income are presented. This amendment is effective for the Company in 2012 and will be applied retrospectively. This amendment will not change the manner in which the Company presents comprehensive income.

In September 2011, the FASB issued ASU No. 2011-08, *Testing for Goodwill Impairment (Topic 350)*, ("ASU 2011-08"). ASU 2011-08 allows entities to first assess qualitatively whether it is necessary to perform the two-step goodwill impairment test. If an entity believes, as a result of its qualitative assessment, that it is more likely than not that the fair value of a reporting period is less than its carrying amount, the quantitative two-step goodwill impairment test is required. An entity has the unconditional option to bypass the qualitative assessment and proceed directly to performing the first step of the goodwill impairment test.

The Company elected to adopt this accounting guidance at the beginning of its fourth quarter of 2011 on a prospective basis for goodwill impairment tests. The Company anticipates that the adoption of this standard will not have a material impact on its consolidated financial statements and footnote disclosures.

3. Program License Fees

Program license fees are comprised of the following:

	As of December 31, 2010	As of September 30, 2011
	(In thousands)	
Program license fees — non-affiliates	\$ 552,869	\$ 594,541
Program license fees — Hallmark Cards affiliates	15,000	14,500
Program license fees, at cost	567,869	609,041
Accumulated amortization	(331,792)	(358,125)
Program license fees, net	<u>\$ 236,077</u>	<u>\$ 250,916</u>

License fees payable are comprised of the following:

	As of December 31, 2010	As of September 30, 2011
	(In thousands)	
License fees payable — non-affiliates	\$ 126,375	\$ 140,116
License fees payable — Hallmark Cards affiliates	11,729	10,359
Total license fees payable	138,104	150,475
Less current maturities	(104,286)	(123,286)
Long-term license fees payable	<u>\$ 33,818</u>	<u>\$ 27,189</u>

In the regular course of evaluating the remaining usefulness of its various program licenses, the Company may determine that certain licenses have no remaining programming value. In such instances, the Company shortens the estimated remaining lives to zero, thereby accelerating amortization of the remaining net book value. During the three and nine months ended September 30, 2010, such changes in estimates resulted in additional amortization of program license fees of \$0 and \$227,000, respectively. During the three and nine months ended September 30, 2011, such changes in estimates resulted in additional amortization of program license fees of \$0 and \$600,000, respectively.

Under certain license agreements with RHI Entertainment Distribution, LLC (“RHIED”) the Company is obligated to pay \$5.3 million through December 1, 2013. In connection with its reorganization in bankruptcy, RHIED assigned its right to receive these license payments to Hallmark Cards. During 2011 the Company reclassified \$2.5 million from license fees payable (to non-affiliates) to payables to Hallmark Cards affiliates. During the same period the Company remitted payment of \$1.3 million to Hallmark Cards. Therefore, at September 30, 2011, the payable to Hallmark Cards affiliates includes \$1.2 million related to this assignment. The remaining \$2.8 million relates to license periods that have not commenced as of September 30, 2011; accordingly, such amount is not reflected in the accompanying condensed consolidated balance sheet. See Commitments and Contingencies below.

4. Revolving Credit Facilities, Term Loan, the Notes and Registration Rights Agreement

Credit Facilities and Term Loan

At December 31, 2010 the Company had no outstanding borrowings under a \$30.0 million revolving credit facility issued by JP Morgan Chase Bank, N.A. as most recently amended June 29, 2011. This agreement expired July 14, 2011. At September 30, 2011, the Company had no outstanding borrowings under a \$30.0 million revolving credit facility issued by JP Morgan Chase Bank, N.A. on July 14, 2011. There were no letters of credit outstanding at either December 31, 2010, or September 30, 2011. Interest expense on borrowings under these credit facilities for both the three months ended September 30, 2010 and

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2011, was \$0. Interest expense on borrowings under these credit facilities for each of the nine months ended September 30, 2010 and 2011, was \$4,000 and \$0, respectively.

On July 14, 2011, in connection with the 2011 Refinancing, the Company entered into a new \$240.0 million credit agreement (the “Credit Agreement”) with the lenders party thereto and JPMorgan Chase Bank, N.A., as Administrative Agent (the “Administrative Agent”). The Credit Agreement provides for a seven year \$210.0 million senior secured term loan facility (the “Term Loan”) and a five year \$30.0 million senior secured super-priority revolving credit facility. The Term Loan was issued at a discount of 1.0% or \$2.1 million.

The Term Loan was drawn on July 14, 2011, at LIBOR at the Company’s election. All LIBOR term loans will bear interest at the LIBOR Rate (subject to a minimum rate of 1.25%) plus 4.50%. The interest rate at September 30, 2011, was 5.75%. Commitment fees on the revolving credit facility are payable on the unused revolving credit commitment at the rate of 0.50% per annum, payable quarterly.

The provisions of the Term Loan require Crown Media Holdings to make principal payments of \$525,000 at each quarter’s end, commencing September 30, 2011, until maturity on July 14, 2018. The Company is required to make additional principal payments in amounts equal to (1) 50% of excess cash flow (as defined in the Credit Agreement) of Crown Media Holdings for the remainder of 2011, and each year thereafter, which percentage will be reduced to 25% if the Consolidated Leverage Ratio (as defined in the Credit Agreement) is equal to or less than 4.25 to 1 but greater than 3.25 to 1, and 0% if the Consolidated Leverage ratio is equal to or less than 3.25 to 1, respectively; (2) 100% of net cash proceeds of dispositions or casualty events if Crown Media Holdings has not invested such proceeds within one year after the occurrence of the disposition or casualty event; and (3) 100% of net cash proceeds from issuance of debt or preferred stock not otherwise permitted by the Credit Agreement.

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

The credit facility contains a number of affirmative and negative covenants. The Company was in compliance with these covenants as of September 30, 2011.

The Company made its first principal payment of \$525,000 under the Term Loan on September 30, 2011. Interest expense under the Term Loan was \$2.8 million for both the three and nine months ended September 30, 2011. After giving effect to the amortization of associated debt issuance costs and original issue discount, the effective interest rate of the Term Loan was approximately 6.3% during both the three and nine months ended September 30, 2011.

The Notes

On July 14, 2011, also as part of the 2011 Refinancing, the Company issued \$300.0 million in aggregate principal amount of 10.5% Senior Notes, at par, due July 15, 2019 (the “Notes”) in a private placement conducted pursuant to Rule 144A under the Securities Act of 1933, as amended (the “Securities Act”). The Notes are guaranteed on a senior basis by each of Crown Media Holdings’ subsidiaries (the “Guarantors”).

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

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

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

Interest expense under the Notes was \$6.8 million for both the three and nine months ended September 30, 2011. After giving effect to the amortization of associated debt issuance costs, the effective interest rate of the Notes was approximately 11.0% during both the three and nine months ended September 30, 2011.

Maturities

The aggregate maturities of long-term debt including future interest for each of the five years subsequent to September 30, 2011, are as follows:

	Payments Due by Period						
	Total	Year 1	Year 2	Year 3 (In thousands)	Year 4	Year 5	Thereafter
The Notes, due July 15, 2019	\$ 552,088	\$ 31,588	\$ 31,500	\$ 31,500	\$ 31,500	\$ 31,500	\$ 394,500
Term Loan, due July 14, 2018	292,316	14,326	14,170	14,047	13,925	13,835	222,013
	<u>\$ 844,404</u>	<u>\$ 45,914</u>	<u>\$ 45,670</u>	<u>\$ 45,547</u>	<u>\$ 45,425</u>	<u>\$ 45,335</u>	<u>\$ 616,513</u>

Early Extinguishment of Debt and Redemption of Preferred Stock

The proceeds of the Term Loan and the Notes were used by the Company to (i) repay borrowings under the Term A Loan and Term B Loan, both of which were payable to HCC and (ii) redeem all of the Company's outstanding Series A Preferred Stock, all of which was held by HCC.

At the time of the 2011 Refinancing, the carrying amounts of the Term A Loan, the Term B Loan and Preferred Stock significantly exceeded the respective reacquisition and redemption prices by approximately \$87.3 million and \$15.7 million, respectively. In consideration of these carrying amounts having been derived from the provisions of the Recapitalization in which HCC was a significant participant, the benefits arising from the extinguishments and redemption, \$103.0 million in the aggregate, have been deemed capital contributions by HCC. Accordingly, such benefits have been credited to additional paid-in capital in the accompanying balance sheet.

Transaction costs of \$12.1 million have been included as debt issuance costs in the accompanying balance sheet at September 30, 2011. The effective interest method is being used to amortize the \$2.1 million original issue discount related to the Term Loan as well as transaction costs associated with each of the Term Loan and the Notes. The Term Loan is a variable-rate instrument.

Registration Rights Agreement

The holders of the Notes are entitled to the benefits of a Registration Rights Agreement dated July 14, 2011 (the “Registration Rights Agreement”), by and among Crown Media Holdings, the Guarantors and the initial purchaser. Pursuant to the Registration Rights Agreement, Crown Media Holdings and the Guarantors agreed to file a registration statement with the Securities and Exchange Commission for an offer to exchange the Notes for a new issuance of substantially identical notes issued under the Securities Act and to use their commercially reasonable efforts to cause the registration statement to be declared effective on or before April 10, 2012 or otherwise be subject to specified default interest rate provisions until the commitment is fulfilled. As discussed further under Subsequent Events, such a registration statement was declared effective by the Securities and Exchange Commission on October 4, 2011.

Guarantees

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

5. Related Party Long-Term Obligations

2011 Refinancing Transaction

The proceeds of the Notes, the Term Loan and extensions of credit under the Credit Agreement were used to repay all borrowings under the Term A and Term B Loans and to redeem all the Series A Preferred Stock, consisting of 185,000 shares held by HCC. On July 14, 2011, the Company paid principal and interest of \$191.4 million and \$115.5 million under its Term A and Term B Loans, respectively, and redeemed its Preferred Stock of \$185.0 million and paid dividends on its Preferred Stock of \$993,000.

Related Party Long-Term Obligations

The Company paid principal of \$306.8 million and interest of \$91,000 during the three months ended September 30, 2011, on the Term A and Term B Loans. The Company paid principal of \$330.4 million and interest of \$1.5 million during the nine months ended September 30, 2011, on the Term A and Term B Loans. The Company paid principal of \$67,000 and interest of \$21,000 during the nine months ended September 30, 2010, on the Term A and Term B Loans. On October 1, 2010, the Company paid principal and interest of \$8.1 million, which was otherwise payable on 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. 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. During 2010 the Company paid \$4.3 million for interest. 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. During 2010 the Company paid \$6.8 million for interest. The Company's obligations under this note, including \$170.1 million 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. During 2010 the Company paid \$2.5 million for interest. 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 unconditionally guaranteed the Company's obligations to JPMorgan Chase Bank under the credit facility that expired on July 14, 2011. This credit support provided by Hallmark Cards resulted in reductions in the interest rate and commitment fees under the credit facility through July 14, 2011; 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. The Company paid Hallmark Cards a reduction amount of the interest rate and commitment fees equal to 0.75% and 0.125%, respectively. Interest expense to HCC in connection with the JPMorgan Chase Bank credit facility was \$0 for both the three months ended September 30, 2010 and 2011. Interest expense to HCC in connection with the JPMorgan Chase Bank credit facility was \$1,000 and \$0 for the nine months ended September 30, 2010 and 2011, respectively. Commitment fee expense for the three months ended September 30, 2010 and 2011, was \$10,000 and \$1,000, respectively. Commitment fee expense for the nine months ended September 30, 2010 and 2011, was \$32,000 and \$20,000, respectively.

6. Related Party Transactions

Tax Sharing Agreement

On March 11, 2003, the Company became a member of Hallmark Cards' consolidated federal tax group and entered into a federal tax sharing agreement with Hallmark Cards (the "federal tax sharing agreement"). Hallmark Cards includes the Company 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 may be generated by the Company. Based on the original federal tax sharing agreement, Hallmark Cards agreed to pay the Company all of the benefits realized by Hallmark Cards as a result of including the Company in its consolidated income tax return. Also, taxable income recognized by the Company that is included in the Hallmark Cards consolidated tax return will result in a payment by the Company to Hallmark Cards.

On a quarterly basis through December 31, 2008, Hallmark Cards paid the Company cash for 75% of the estimated benefit from losses with the balance applied as an offset against other 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 limitations under any loan indentures or contracts restricting such offsets. As part of the Recapitalization, the federal tax sharing agreement was amended to provide that 100% of any such benefit will be deferred for application against future tax liabilities of the Company. Pursuant to the August 2003 amendment to the federal tax sharing agreement, the benefit that would otherwise have resulted from interest accrued on the 10.25% senior secured note was not available to the Company until such interest was paid in cash. As a result of the Recapitalization, such interest accrued from January 1, 2010, through June 29, 2010, was treated as a deduction under the amended federal tax sharing agreement.

At December 31, 2009, the Company owed Hallmark Cards \$8.5 million under the federal tax sharing agreement for 2009. The liability was satisfied on June 29, 2010, in connection with the Recapitalization. For the year ended December 31, 2010, the Company owed Hallmark Cards \$12.9 million for tax as calculated pursuant to the amended federal tax sharing agreement and this amount was paid to Hallmark Cards in December 2010. The Company owed Hallmark Cards \$5.1 million under the federal tax sharing

agreement for the first quarter of 2011 which was paid in April 2011. The Company owed Hallmark Cards \$5.4 million under the federal tax sharing agreement for the second quarter of 2011 which was paid in July 2011. The Company owed Hallmark Cards \$0 under the federal tax sharing agreement for the third quarter of 2011. Hallmark Cards owed the Company \$2.1 million at September 30, 2011, under the federal tax sharing agreement subsequent to the September 2011 filing of the 2010 consolidated federal income tax return.

Since May 9, 2000, the Company has been included in certain combined state income tax returns of Hallmark Cards or Hallmark Entertainment Holdings. Consequently, Hallmark Entertainment Holdings and the Company entered into a state tax sharing agreement. Under the state tax sharing agreement, Hallmark Cards (as successor to Hallmark Entertainment Holdings) and the Company file consolidated, combined or unitary state tax returns. The Company makes tax-sharing payments to (or receives payments from) Hallmark Cards equal to the taxes (or tax refunds) that the Company would pay (or receive) if it filed on a stand-alone basis. Such payments are computed based on the Company's taxable income (loss) and other tax items beginning the day following the May 9, 2000, reorganization. Hallmark Cards has agreed to waive the state tax liability associated with the 2010 cancellation of debt income in those states in which Hallmark Cards files a combined return. Accordingly, the Company has reduced the liability for the state taxes and credited paid-in capital for that amount. As of September 30, 2011, it is estimated that the Company will owe Hallmark Cards approximately \$1.0 million with respect to the state tax sharing payments relating to 2010 and 2011. This amount will be payable two days prior to the due date of the state tax returns. In October 2011, the Company paid \$742,000 to Hallmark Cards related to California state taxes.

Any payments received from Hallmark Cards or credited against amounts owed by the Company 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 in excess of current tax expense have been recorded as reductions 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, cash management 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 \$387,000 for full year ending December 31, 2010, and are expected to be \$448,000 for the full year ending December 31, 2011.

At December 31, 2010, and September 30, 2011, the Company's payables to Hallmark Cards affiliates on the accompanying condensed consolidated balance sheets were \$1.0 million and \$2.3 million, respectively. The December 31, 2010, balance was comprised of \$757,000 of state taxes due under the state tax sharing agreement and \$248,000 of non-interest bearing unpaid accrued service fees and unreimbursed expenses. The September 30, 2011, balance was comprised of \$1.0 million of taxes due under the federal and state tax sharing agreements and \$1.3 million of assigned license payments. The \$15.2 million outstanding at December 31, 2009, was satisfied on June 29, 2010, in connection with the Recapitalization.

Additionally, Hallmark Cards owed the Company \$2.1 million at September 30, 2011, under the federal tax sharing agreement subsequent to the September 2011 filing of the 2010 consolidated federal income tax return. Such amount can be used as a credit in respect to any future payments due from the Company to Hallmark Cards.

Hallmark Hall of Fame

On July 6, 2011, the Company entered into an agreement with Hallmark Cards for six new “Hallmark Hall of Fame” two-hour movies to be produced by Hallmark Cards over a two-year license term. The Company has the right to broadcast each movie four times during a period which begins seven days after and ends 14 days after the initial broadcast of each movie on the ABC Network. The Company will retain over nine minutes of commercial time within or adjacent to the running time of each movie and such time will either be used for promos or sales to advertisers who sell products compatible with the Hallmark image. All other commercial time will be for Hallmark Cards and Hallmark-branded commercials. Hallmark Cards has agreed to pay the Company \$3.4 million during the two-year period. The program license agreement described herein will have no effect on the Hallmark Hall of Fame program license agreement which the Company entered into with Hallmark Cards in 2008.

Trademark License Agreements

In connection with the 2011 Refinancing, Hallmark Licensing, Inc., an affiliate of Hallmark Cards, Inc., extended two existing trademark licenses (the “Extended Licenses”) with Crown Media United States for an additional period terminating the earlier of (i) July 14, 2019 and (ii) the later of (x) the expiration or termination of the Credit Agreement and (y) the redemption of all of the Notes, subject to any earlier termination of such license agreements pursuant to the respective terms of such license agreements.

7. Release of Valuation Allowance

The Company had established a deferred tax asset of \$610.2 million as of December 31, 2010, and had recorded a full valuation allowance against it. After evaluating positive and negative evidence available as of the reporting date, including recent earnings history, the Company has determined that it is more likely than not that it will utilize a portion of its tax loss carry forwards, as if separate returns were filed. Consistent with ASC 740 *Income Taxes*, the following sources of taxable income may be available under the tax law to realize a portion or all of a tax benefit for deductible temporary differences and carry forwards:

- Future reversals of existing taxable temporary differences
- Taxable income in prior carry back year(s) if carry back is permitted under the tax law
- Tax planning strategies
- Future taxable income exclusive of reversing temporary differences and carry forwards

The Company has released a portion of its valuation allowance and has recognized an unreserved deferred tax asset of approximately \$236.0 million on its balance sheet as of September 30, 2011. This also results in a non-cash reduction in income tax expense.

In accordance with ASC 740, the Company recorded \$44.2 million of tax benefit for the portion of the change in valuation allowance arising from expected realization of deferred tax assets in future years as a discrete item in the first quarter of 2011. The tax benefit for the portion of the change in valuation allowance arising from income in the current year is included in the Company’s computation of the estimated annual effective tax rate for the year, and, therefore, will reduce the tax expense the Company otherwise would have recorded for the remainder of 2011 absent any beginning of year valuation allowance.

In accordance with ASC 740, the Company recorded \$191.8 million of tax benefit for the portion of the change in valuation allowance arising from expected realization of deferred tax assets in future years as a discrete item in the third quarter of 2011.

The Company will continue to evaluate the available positive and negative evidence available in subsequent periods and adjust its remaining valuation allowance to an amount it determines to be more likely than not to be realized.

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

Pursuant to a 1998 agreement among the Company and others then owning membership interests in Crown Media United States (the “Company Agreement”), VISN Management Corp. (“VISN,” a wholly-owned subsidiary of National Interfaith Cable Coalition, Inc., “NICC”) owned a \$25.0 million mandatorily redeemable, preferred membership interest (the “preferred interest”) in Crown Media United States. Until its December 2010 redemption, the preferred interest was reflected in the accompanying consolidated financial statements at its accreted fair value, which was established as of July 1, 2003 pursuant to ASC Topic 480 *Distinguishing Liabilities from Equity*. The \$25.0 million redemption fulfilled the Company’s obligations to NICC and VISN.

On January 2, 2008, the Company and NICC executed an agreement (the “Modification Agreement”) to resolve mutual disputes related to a December 2005 agreement (the “December 2005 NICC Agreement”). As part of the Modification Agreement, the Company agreed to pay NICC \$3.8 million in equal installments on 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 ended December 31, 2009, and 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.

The Company also paid NICC \$2.8 million and \$0 during the nine months ended September 30, 2010 and 2011, respectively, in connection with the provisions of the Company Agreement, the December 2005 NICC Agreement and the Modification Agreement. No amounts were paid to NICC during the three months ended September 30, 2010 or 2011.

9. Share-Based Compensation and Long Term Incentive Plan

Share-Based Compensation

The Company recorded \$124,000 of compensation expense and \$18,000 of compensation benefit associated with restricted stock units (RSUs) during the three months ended September 30, 2010 and 2011, respectively, which have been included in selling, general and administrative expense on the accompanying condensed consolidated statements of operations. The Company recorded \$233,000 and \$28,000 of compensation expense associated with the restricted stock units (RSUs) during the nine months ended September 30, 2010 and 2011, respectively, which have been included in selling, general and administrative expense on the accompanying condensed consolidated statements of operations.

As of December 31, 2010, and September 30, 2011, there was no unrecognized compensation cost, related to non-vested stock options granted. The closing price of a share of the Company’s common stock, which is used to calculate the RSU liability, was \$2.62 on December 31, 2010, and \$1.43 on September 30, 2011. The Company expects to settle its RSUs in cash and records the fair value of these awards as a liability. As of December 31, 2010, and September 30, 2011, there was unrecognized compensation cost, related to non-vested RSUs granted, in the amount of \$375,000 and \$340,000, respectively, using the aforementioned stock prices. Actual compensation costs recognized in future periods may vary based upon fluctuations in stock price and forfeitures.

The Company issued cash settlements related to the RSUs during the three and nine months ended September 30, 2010 and 2011, of \$163,000 and \$154,000, respectively.

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, executive vice president and president of the Company. The target award under each LTI Agreement is a percentage of the employee’s base salary and ranges from \$26,000 to \$469,000. Of each grant, 50% is an Employment Award (as defined under the

LTI Agreements) and 50% is a Performance Award (as defined under the LTI Agreements). The Employment Award vested on August 31, 2011, and was settled in cash on September 2, 2011. A portion of the Performance Award vested on December 31, 2010, and was subsequently settled in the first quarter of 2011, and the remaining 50% may vest and be settled 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.

The Company did not achieve the two-year EBITDA target but did obtain 91% achievement of the two-year Cash Flow target at December 31, 2010. The Company settled the Cash Flow target during first quarter of 2011 in the amount of \$157,000. The Company settled the Employment Award during the third quarter of 2011 in the amount of \$1.1 million.

In the first quarter of 2010, the Company granted LTI Agreements to each vice president, senior vice president, executive vice president and president of the Company. The target award under each LTI Agreement is a percentage of the employee's base salary and ranges from \$25,000 to \$536,000. Of each grant, 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, if the performance criteria are achieved, 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 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.

In the second quarter of 2011, the Company granted LTI Agreements to each vice president, senior vice president, executive vice president and president of the Company. The target award under each LTI Agreement is a percentage of the employee's base salary and ranges from \$23,000 to \$550,000. Of each grant, 50% is an Employment Award and 50% is a Performance Award. The Employment Award will vest on August 31, 2013, 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, 2013, if the performance criteria are achieved, and be settled in cash the later of 30 days thereafter or 15 days after the Company issues its audited financials for 2013, but by no later than March 15, 2014. 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 is provided in the case of involuntary termination of employment without cause on or after January 1, 2012, 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.

The Company recorded \$309,000 and \$607,000 of expense included in selling, general and administrative expense in the accompanying consolidated statement of operations for the three months ended September 30, 2010 and 2011, related to these agreements. The Company recorded \$1.0 million and \$1.5 million of expense included in selling, general and administrative expense in the accompanying consolidated statement of operations for the nine months ended September 30, 2010 and 2011, respectively, related to these agreements. Additionally, the \$1.9 million and \$2.0 million liability for these agreements was included

in accounts payable and accrued liabilities in the accompanying consolidated balance sheets at December 31, 2010 and September 30, 2011, respectively.

10. Fair Value

The following table presents the carrying amounts and estimated fair values of the Company's notes payable to HCC and redeemable preferred stock at December 31, 2010, and the Company's Term Loan and Notes at September 30, 2011.

	December 31, 2010		September 30, 2011	
	Carrying Amount	Significant Unobservable Inputs (Level 3) Fair Value	Carrying Amount	Significant Unobservable Inputs (Level 3) Fair Value
	(In thousands)			
Term A Loan and interest payable to HCC	\$ 261,433	\$ 199,361	\$ —	\$ —
Term B Loan and interest payable to HCC	156,262	119,528	—	—
Redeemable Preferred Stock	198,934	229,433	—	—
Term Loan	—	—	207,429	207,429
The Notes	—	—	300,000	300,000

ASC Topic 820 *Fair Value Measurements and Disclosures* defines fair value of a liability as the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. Estimates of the fair value of certain of the Company's financial instruments are presented in the table above.

As a result of recent market conditions, the Company's debt obligations with HCC had 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.

As the 2011 Refinancing closed on July 14, 2011, book value has been used to approximate fair value for the Term Loan and The Notes at September 30, 2011. In consideration of the 2011 Refinancing having closed recently on July 14, 2011, the carrying values of the Term Loan and Notes have been used to approximate their respective fair values.

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 rate will fluctuate.

11. Commitments and Contingencies

Lawsuit

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

A lawsuit was brought in July 2009 in the Delaware Court of Chancery against the Company's Board of Directors, Hallmark Cards, Incorporated and its affiliates, as well as the Company as a nominal defendant, by S. Muoio & Co. LLC ("Muoio"), a minority stockholder of the Company, regarding a recapitalization proposal which the Company received from Hallmark Cards in May 2009. The lawsuit alleged, among other things, that the recapitalization was for an unfair price and undervalued the Company. The complaint requested the court enjoin the defendants from consummating the recapitalization transactions and award plaintiff fees and expenses incurred in bringing the lawsuit. Following the execution by the Company of the Recapitalization agreements, on March 11, 2010, the plaintiff filed an amended complaint raising similar allegations and seeking rescission of the Recapitalization. The Recapitalization was consummated on June 29, 2010.

A trial took place in September 2010. On March 9, 2011, the Delaware Court of Chancery concluded that the process and the price of the Recapitalization were entirely fair and entered a final judgment order in favor of the defendants on all claims and dismissed the lawsuit with prejudice. On April 7, 2011, Muoio filed notice of appeal. Muoio's initial brief was filed on May 23, 2011, and the Company and the other appellees responded on June 22, 2011. A hearing date for the appeal has been set for December 14, 2011. Notwithstanding the favorable trial court ruling, at this time the Company cannot predict the eventual outcome of the appeal process.

Approximately \$2.1 million has been recorded in accounts receivable and approximately \$434,000 in accounts payable and accrued liabilities on the accompanying balance sheet at December 31, 2010, related to litigation costs to be reimbursed by the insurance company. Approximately \$2.3 million has been recorded in accounts receivable and approximately \$0 in accounts payable and accrued liabilities on the accompanying balance sheet at September 30, 2011, related to amounts to be reimbursed by the insurance company.

Guarantee

As discussed further under Program License Fees, RHIED assigned to Hallmark Cards its right to receive \$5.3 million in program license fees from the Company. The assignment relates to a 2002 guarantee issued by Hallmark Entertainment Holdings, Inc. ("HEH") to an unaffiliated movie production company on behalf of RHIED. At that time, HEH was a wholly-owned subsidiary of Hallmark Cards and an intermediate parent of the Company. Also at that time, RHIED was a wholly-owned subsidiary of HEH; it ceased to be affiliated with Hallmark Cards in January 2006. As part of the Recapitalization, HEH was merged with the Company. In August 2010 the unaffiliated production company made demand of the Company for payment of amounts owed by RHIED. Hallmark Cards subsequently assumed defense of the claim and fully indemnified the Company. On December 10, 2010, RHIED filed for reorganization in bankruptcy. Pursuant to a settlement and release agreement among the unaffiliated production company, RHIED, Hallmark Cards and the Company, the Company's obligation under the guarantee was extinguished. The settlement and release agreement was approved by the bankruptcy court on February 17, 2011 and became final and non-appealable on March 3, 2011.

Indemnifications of Third Parties for Residuals and Participations Liabilities

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, an affiliate of RHIED (“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. From time-to-time the Company reviews its estimate of the timing and amount of the otherwise unscheduled payments. At September 30, 2011, the Company has estimated the accreted and adjusted accrued liability to be \$5.5 million. Along with RHIED, RHI filed for reorganization in bankruptcy in December 2010. Pursuant to RHI’s court-approved plan of reorganization, the Company is obligated to make the following payments on behalf of RHI to certain creditors of RHI: \$2.5 million on May 1, 2011; and approximately \$8.0 million on July 5, 2011. The Company paid \$2.6 million in May 2011, \$7.6 million during the third quarter of 2011 and expects to pay the remaining amount due prior to December 31, 2011. The remainder of the estimated liability is classified as other than current.

In April 2005 the Company sold its international business including the international rights to its film library. As a condition of the sale, the Company agreed to pay an otherwise unlimited amount for residuals and participations related to the purchaser’s exploitation of the film assets for a ten-year period ending April 25, 2015. The Company estimated the fair value of this obligation to be approximately \$4.5 million at April 26, 2005. From time-to-time the Company reviews its estimate of the timing and amount of the otherwise unscheduled payments. At September 30, 2011, the Company has estimated the accreted and adjusted accrued liability to be \$449,000, \$277,000 of which is classified as current.

12. Subsequent Events

The Company commenced a registered exchange offer in October 2011 to exchange any and all of its \$300.0 M aggregate principal amount of 10.5% Senior Secured Notes due 2019 that were issued in a private placement, *i.e.*, the Notes as described above, for an equal principal amount of its 10.5% Senior Secured Notes due 2019 that have been registered under the Securities Act of 1933, as amended (the “Exchange Notes”).

The exchange offer is being made to satisfy the Company’s obligations under the July 14, 2011 registration rights agreement described above and related to the issuance of the Notes. The exchange offer does not represent a new financing transaction. The Company will not receive any further proceeds from the exchange offer.

The terms of the Exchange Notes are substantially identical to the terms of the Notes, except that certain transfer restrictions, registration rights and additional interest provisions do not apply to the Exchange Notes. Original Notes that are not exchanged in the exchange offer will continue to be subject to the existing transfer restrictions, and the Company will generally have no further obligation to provide for the registration of those notes under the Securities Act of 1933, as amended.

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

The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and related notes included in Part I, Item 1 in this Quarterly Report on Form 10-Q. The following analysis contains forward-looking statements about our future revenue, operating results and expectations. See "Forward-looking information" and "Risk factors" below for a discussion of the risks, assumptions and uncertainties affecting these statements.

Description of Business and Overview

Current Business

We own and operate pay television channels (the "Channels") known as the Hallmark Channel and the Hallmark Movie Channel, each of which is dedicated to high-quality, family friendly entertainment programming. Available in 87 million U.S. homes, Hallmark Channel presents original, made for television movies and specials and popular television series including *Golden Girls* and *Frasier*. The Hallmark Channel features a contemporary lifestyle programming block for daytime headlined by the Emmy Award-winning *The Martha Stewart Show*. In September, we premiered a new daytime series, *Emeril's Table*, featuring Master Chef Emeril Lagasse. The Hallmark Movie Channel is a 24-hour cable network dedicated to offering movies appropriate for the entire family, consisting primarily of original movies, classic theatrical and made-for-television films, and presentations from the award-winning Hallmark Hall of Fame collection. Consistent with the Hallmark brand, both Channels are a preeminent source of holiday programming, with the Hallmark Channel often ranking first on Saturday nights among cable network movies during the Christmas holiday season.

Reaching 87 million subscribers, the Hallmark Channel is one of the most widely distributed independent channels in the United States. The Hallmark Movie Channel is one of the fastest-growing new cable channels, adding over 25 million subscribers in the past three years. We believe that we have established these Channels as destinations for viewers seeking outstanding family entertainment and as attractive outlets for advertisers seeking to target these viewers.

Our Channels offer a range of high-quality entertainment programming for families including popular television series, movies, miniseries, theatricals, romances, literary classics, and contemporary stories. Sources for programming on our Channels include programming (both movies and series) licensed from Buena Vista Television, CBS Television Distribution, Hallmark Hall of Fame, Martha Stewart Living Omnimedia, Paramount Pictures, RHI Entertainment Distribution, and Twentieth Television, among others.

Programming acquired from third parties is an important component of our Channels as we continually develop and refine our programming strategy. This programming includes original movies produced by a variety of experienced television production companies and "off network" television series. Our production agreements for original movies cover one specific movie or a package of several movies. Typically under these agreements, our Channels have the right to exhibit the movies for an initial window of 5 to 8 years and have the right to extend the term for an additional 3 or more years, which we exercise based on the performance of the movies in their initial window. With respect to television series which we acquire from third parties, we typically have the right to exhibit the series for a window of 3 to 5 years.

The Hallmark Channel is currently distributed to approximately 84% of all United States pay television subscribers. We currently distribute (a) the Hallmark Channel through 5,253 cable, satellite and other pay television distribution systems and (b) the Hallmark Movie Channel through 2,415 such systems. Five of our distributors each accounted for more than 10% of our consolidated subscriber revenue for the three months ended September 30, 2011, and together accounted for a total of 84% of consolidated subscriber revenue during the three months ended September 30, 2011. Two of our distributors each accounted for

approximately 15% or more of our consolidated subscribers for the three months ended September 30, 2011, and together accounted for 46% of our subscribers during the three months ended September 30, 2011.

Five of our distributors each accounted for more than 10% of our consolidated subscriber revenue for the nine months ended September 30, 2011, and together accounted for a total of 83% of consolidated subscriber revenue during the nine months ended September 30, 2011. Two of our distributors each accounted for approximately 15% or more of our consolidated subscribers for the nine months ended September 30, 2011, and together accounted for 46% of our subscribers during the nine months ended September 30, 2011.

Two of our programming content providers each accounted for more than 10% of our total license fees payable for the nine months ended September 30, 2011, and together accounted for a total of 46% of the consolidated programming liability. From time to time, for promotional purposes, we also exhibit excerpts of certain programming on our website.

We view a “subscriber” as a household that receives, on a full or part-time basis, a channel on a program tier of a distributor. We determine our Hallmark Channel subscribers from subscriber numbers reported by Nielsen Media Research. Subscribers include both viewers who pay a monthly fee for the tier programming and so-called “promotional” subscribers who are given free access to the tier by the distributor for a limited time. We earn advertising revenue in the form of spot or general rate advertising and direct response advertising. During the three months ended September 30, 2011, no single advertiser accounted for more than 5.1% of advertising revenue and the top three advertiser categories (food products, drug/pharmaceutical and retail) accounted for 59.1% of total advertising revenue. Our advertisers include those in the following industries: auto; baby care, beauty and fitness; beverages; computers and electronics; drug and pharmaceutical; entertainment; financial; food products; home improvement; household supply; insurance; military, religion and services; pet; restaurants; retail; and travel. We license the trademark “Hallmark” for use on our Channels pursuant to certain trademark license agreements with a subsidiary of Hallmark Cards. We believe that the use of this trademark is important for our Channels due to the substantial name recognition and favorable characteristics associated with the name in the United States.

According to Nielsen Media Research (“Nielsen”), the Hallmark Channel had 87.0 million and 87.3 million subscribers at September 30, 2011, and December 31, 2010, respectively, making it the 38th most widely distributed advertising-supported cable channel in the United States at each date. Ratings for the Hallmark Channel changed from 24th in total day viewership with a 0.4 household rating and 25th for prime time with a household rating of 0.7 during the third quarter of 2010 among the 78 cable channels in the United States market to 25th in total day viewership with a 0.4 household rating and 24th for prime time with a 0.7 household rating during the third quarter of 2011 among the 86 cable channels in the United States market. Ratings for the Hallmark Channel changed from 20th in total day viewership with a 0.2 Women 25-54 rating and 25th for prime time with a Women 25-54 rating of 0.3 during the third quarter of 2010 among the 78 cable channels in the United States market to 22nd in total day viewership with a 0.2 Women 25-54 rating and 29th for prime time with a 0.3 Women 25-54 rating during the third quarter of 2011 among the 86 cable channels in the United States market.

In the second quarter of 2010, Nielsen began reporting ratings information for the Hallmark Movie Channel, after which we began selling Hallmark Movie Channel inventory to advertisers based on audience guarantees. This ratings information has increased and will continue to increase our ability to grow revenue from that channel. At September 30, 2011, Nielsen reported that the Hallmark Movie Channel was distributed to almost 42.6 million subscribers. Ratings for the Hallmark Movie Channel changed from 43rd in total day viewership with a 0.2 household rating and 43rd for prime time with a household rating of 0.3 during the third quarter of 2010 among the 78 cable channels in the United States market to 44th in total day viewership with a 0.2 household rating and 38th for prime time with a 0.4 household rating during the third quarter of 2011 among the 86 cable channels in the United States market. Ratings for the Hallmark Movie Channel changed from 38th in total day viewership with a 0.1 Women 25-54 rating and 49th for prime time with a Women 25-54 rating of 0.1 during the third quarter of 2010 among the 78 cable channels in the United States market to 37th in total

day viewership with a 0.1 Women 25-54 rating and 47th for prime time with a 0.1 Women 25-54 rating during the third quarter of 2011 among the 86 cable channels in the United States market.

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. 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.

Our 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 season six of *The Martha Stewart Show* on the Hallmark Channel. Additionally in September 2010, Hallmark Channel premiered several other original lifestyle shows for the daytime lifestyle block. These program changes have resulted in reductions in the ratings delivery of the Channel.

Advertising Revenue

The changes in the economy during third quarter of 2011 had a slightly negative impact on cable advertising rates, including the rates for our inventory. Our third quarter of 2011 scatter market inventory was sold at rates 1% below rates in the 2010 scatter market and 77% above the rates for 2011 inventory sold in the upfront. Additionally, direct response rates were down by 20% compared to that inventory sold in the same period of 2010, with the addition of overnight and early morning inventory reducing the 2011 average.

In the 2011/2012 upfront process representing the sale of our inventory for the last quarter of 2011 and the first three quarters of 2012, we entered into agreements with major advertising firms representing approximately 43% of our advertising inventory. 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 40% of our advertising inventory. The 2011/2012 inventory was sold at CPMs 11% higher than the inventory sold in the 2010/2011 upfront, including increases in rates related to our lifestyle programming block. We sold additional 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 will sell the balance in the scatter marketplace. Additionally, we sold approximately 32% of the Hallmark Movie Channel's available inventory in the 2011/2012 upfront, as compared to 9% in the 2010/2011 upfront.

Following the upfront period, sales of our general rate and direct response inventory are made closer to the timing of the actual advertisement. 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. The third quarter 2011 cancellation options that were exercised represent 18% of the third quarter 2011 upfront dollars.

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 March 2012 through December 2022, inclusive of renewal options. Of these distribution agreements, agreements accounting for approximately 28% of the Hallmark Channel subscriber base and 32% of the Hallmark Movie Channel subscriber base will expire or be the subject of renewal negotiations prior to December 31, 2012. A distribution agreement with Cox Communications, Inc. (“Cox”) ended on December 31, 2010. Our Channels continue to be distributed by Cox under the terms of the expired agreement through a series of extensions while renewal negotiations continue. The Cox distribution agreement covers approximately 5% of our subscribers for the Hallmark Channel and 8% of our subscribers for the Hallmark Movie Channel. In October 2011, a distribution agreement with Cablevision with a term ending on September 30, 2011, was amended and renewed through September 30, 2017.

The universe of cable and satellite TV subscribers in the United States is approximately 105 million homes. The top 30 cable TV networks in the United States, measured by the number of subscribers, have 90 million or more subscribers. It is a mature market with relatively high penetration. According to Nielsen Media Research, the Hallmark Channel had 87.0 million subscribers at September 30, 2011, and 87.3 million subscribers at December 31, 2010, making it the 38th most widely distributed advertising-supported cable channel in the United States at each date. As of September 30, 2011, the Hallmark Movie Channel is now distributed to 42.6 million subscribers.

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 59.2 in 2010, and, in December 2010, the total day average median age of viewers of the Hallmark Channel and Hallmark Movie Channel was 57 and 63, respectively. For the third quarter of 2011, the average median viewing age was 58 for the Hallmark channel and 65 for the Hallmark Movie Channel. In order to achieve our revenue goals, we need to draw in our target audience.

Revenue from Continuing Operations

Our revenue consists of advertising fees and subscriber fees.

Advertising

We earn advertising revenue in the form of spot or general rate advertising and direct response advertising. Beginning in the fourth quarter of 2010, we implemented program schedules that rely upon content that is supported by general rate and direct response advertising, effectively eliminating paid-programming (*i.e.*, “infomercials”) as a source of revenue. 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.

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.

We typically sell approximately 40% of our Channels’ advertising in the “up-front” season, generally in June and July of each year, for the last quarter of the same year and the first three quarters of the following year. We hold back a small percentage of our inventory for ADUs and sell the remainder in the spot or scatter market and to advertisers that purchase up-front inventory on a calendar year basis. Contracts executed in the 2010/2011 upfront period require that the Company use its best efforts to run sufficient make-good advertising spots within 12 months to achieve the impressions guarantees. If the Company does not make-good within 12 months, the Company is no longer obligated to satisfy the under-delivery of the guaranteed impressions.

Among the 86 ad-supported cable channels in the United States market in 2011, the Hallmark Channel ranked 24th in total day viewership with an average 0.4 household rating for the year and 30th for prime time with an average 0.6 household rating for the year, according to Nielsen Media Research. Among the 86 ad-supported cable channels in the United States market in 2011, the Hallmark Movie Channel ranked 43rd in total day viewership with an average 0.2 household rating for the year and 37th for prime time with an average 0.4 household rating for the year, according to Nielsen Media Research. Among the 86 ad-supported cable channels in the United States market in 2011, the Hallmark Channel ranked 21st in total day viewership with an average 0.2 Women 25-54 rating for the year and 28th for prime time with an average 0.3 Women 25-54 rating for the year, according to Nielsen Media Research. Among the 86 ad-supported cable channels in the United States market in 2011, the Hallmark Movie Channel ranked 36th in total day viewership with an average 0.1 Women 25-54 rating for the year and 48th for prime time with an average 0.1 Women 25-54 rating for the year, according to Nielsen Media Research.

Among the 78 ad-supported cable channels in the United States market in 2010, the Hallmark Channel ranked 26th in total day viewership with an average 0.4 household rating for the year and 23rd for prime time with an average 0.7 household rating for the year, according to Nielsen Media Research. Among the 78 ad-supported cable channels in the United States market in 2010, the Hallmark Movie Channel ranked 59th in total day viewership with an average 0.1 household rating for the year and 54th for prime time with an average 0.2 household rating for the year, according to Nielsen Media Research. Among the 78 ad-supported cable channels in the United States market in 2010, the Hallmark Channel ranked 19th in total day viewership with an average 0.2 Women 25-54 rating for the year and 26th for prime time with an average 0.3 Women 25-54 rating for the year, according to Nielsen Media Research. Among the 78 ad-supported cable channels in the United States market in 2010, the Hallmark Movie Channel ranked 61st in total day viewership with an average 0.0 Women 25-54 rating for the year and 48th for prime time with an average 0.1 Women 25-54 rating for the year, according to Nielsen Media Research.

Total day means the time period measured from the time each day the broadcast of commercially-sponsored programming commences to the time such commercially sponsored programming ends.

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 are decreased by our need to reserve inventory for the use of ADUs.

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

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;
- 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.

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 currently 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.

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 the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

For further information regarding our critical accounting policies, judgments and estimates, please see Notes to Unaudited Condensed Consolidated Financial Statements 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, 2010.

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, program licenses, an administrative services agreement, tax sharing agreements and the Recapitalization (described below), including the loans under the Credit Agreement, a registration rights agreement and a stockholders agreement. A summary of the terms and financial impact of these transactions is described in Item 1 “Business — Recent Developments — Recapitalization” in the Company’s Annual Report on Form 10-K as filed with the SEC for the year ended December 31, 2010.

Recapitalization

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, H C Crown, LLC (“HCC”), a subsidiary of Hallmark Cards, 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. and Hallmark Entertainment Holdings, Inc., with and into the Company; and
- Reclassification of shares of Class B Common Stock into shares of Class A Common Stock, elimination of the Class B Common Stock and an increase of the authorized shares of Class A Common Stock to 500,000,000 shares and decrease of the authorized Preferred Stock to 1,000,000 shares.

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 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;

- 185,000 shares of the Company's Series A Convertible Preferred Stock, \$0.01 par value; 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 Preferred Stock. In connection with the 2011 Refinancing, the Company paid off the HCC Debt and redeemed all outstanding shares of Preferred Stock. HCC continues to own 90.3% of the Company's Class A Common Stock.

2011 Refinancing

On July 14, 2011, the Company consummated the 2011 Refinancing, which included the issuance of the Notes (defined below), entry into a new credit agreement (including a \$210.0 million term loan and a \$30.0 million revolving credit facility) and the use of proceeds from those transactions to repay the existing Term A and Term B loans and to redeem the outstanding Preferred Stock.

Indenture

On July 14, 2011, the Company completed an offering of \$300.0 million in aggregate principal amount of 10.5% Senior Notes due 2019 (the "Notes"), at par value, in a private placement conducted pursuant to Rule 144A under the Securities Act of 1933, as amended (the "Securities Act"). The Notes are guaranteed on a senior basis by each of the Company's subsidiaries (the "Guarantors").

The Notes were issued under an Indenture dated as of July 14, 2011 (the "Indenture") among the Company, the Guarantors, and the Bank of New York Mellon Trust Company, N.A., as Trustee. The Notes bear interest at a rate of 10.5% per annum and were priced at 100% of par. The Company will pay interest on the Notes on January 15 and July 15 of each year, commencing January 15, 2012. The Notes will mature on July 15, 2019. At any time and from time to time, prior to July 15, 2014, the Company may redeem up to a maximum of 35% of the original aggregate principal amount of the Notes with the proceeds of one or more equity offerings, at a redemption price equal to 110.500% of the principal amount thereof, plus accrued and unpaid interest thereon, if any, to, but not including, the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), provided that: (i) at least 65% of the original aggregate principal amount of the Notes remains outstanding; and (ii) the redemption occurs within 90 days following the completion of the relevant equity offering. Prior to July 15, 2015, the Company may redeem some or all of the Notes by paying a "make-whole" premium based on U.S. Treasury rates. On or after July 15 of the relevant year described below, the Company may redeem some or all of the Notes at the prices listed below, plus accrued and unpaid interest, if any, to, but not including, the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date): 2015 at a redemption price of 105.250%; 2016 at a redemption price of 102.625%; 2017 and thereafter at a redemption price of 100.000%.

Each of the following constitutes an event of default under the Indenture: (1) failure to make the payment of any interest on the Notes when the same becomes due and payable, with such failure continuing for a period of 30 days; (2) failure to make the payment of any principal of, or premium, if any, on, the Notes when the same becomes due and payable at its stated maturity, upon acceleration, redemption, optional redemption, required repurchase or otherwise; (3) failure to comply with the covenants in the Indenture covering merger, consolidation and sale of property; (4) failure to comply with covenants in the Indenture requiring the Company to offer to purchase all of the Notes upon a change of control; (5) failure to comply with any other covenant or agreement in the Notes or in the Indenture with such failure continuing for 60 days after written notice is given to the Company by the Trustee or holders of not less than 25% in principal amount of the outstanding Notes; (6) a default under any debt of the Company or any restricted subsidiary

that results in acceleration of the final maturity of such debt, or failure to pay any such debt at final maturity (giving effect to applicable grace periods), in an aggregate amount greater than \$25.0 million; (7) any judgment or judgments for the payment of money in an aggregate amount in excess of \$25.0 million is rendered against the Company or any significant subsidiary and is not paid, discharged or stayed for a period of 60 days after such judgment becomes final; (8) certain events involving bankruptcy, insolvency or reorganization of the Company or any significant subsidiary; and (9) any subsidiary guarantee of a significant subsidiary ceases to be in full force and effect (subject to certain exceptions), or any significant subsidiary denies that it has any further liability under its guarantee.

The Company is not required to make mandatory sinking fund payments with respect to the Notes.

Upon a change of control, as defined in the Indenture, the Company is required to offer to purchase all of the Notes then outstanding at a purchase price equal to 101% of the principal amount thereof, plus accrued and unpaid interest, if any, to, but not including, the purchase date (subject to the rights of holders of record on the relevant record date to receive interest due on the relevant interest payment date).

If the Company consummates certain asset sales, it may, within 365 days after receiving the net proceeds of such sale, repay certain indebtedness of the Company or make certain investments, capital expenditures or acquisitions of certain properties or assets. Any net proceeds that are not invested or applied within such timeframe will be deemed "Excess Proceeds," and to the extent the Excess Proceeds exceed \$10.0 million, the Company will be required to offer to purchase Notes (and, in certain instances, to purchase other debt that is *pari passu* with the Notes) with such Excess Proceeds at a price equal to 100% of the principal amount of the Notes, plus accrued and unpaid interest, if any.

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

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

Registration Rights Agreement

The holders of the Notes are entitled to the benefits of a Registration Rights Agreement dated July 14, 2011 (the "Registration Rights Agreement"), by and among the Company, the Guarantors and the initial purchaser. Pursuant to the Registration Rights Agreement, the Company and the Guarantors agreed to file a registration statement with the Securities and Exchange Commission for an offer to exchange the Notes for a new issuance of substantially identical notes ("Exchange Notes") issued under the Securities Act and to use their commercially reasonable efforts to cause the registration statement to be declared effective on or before April 10, 2012.

The Company's registration statement registering the Exchange Notes was declared effective on October 4, 2011 and it commenced the registered exchange offer of Notes for Exchange Notes. The Company anticipates consummating the exchange in early November 2011. The exchange offer does not represent a new financing transaction. The Company will not receive any further proceeds from the exchange offer.

The terms of the Exchange Notes are substantially identical to the terms of the Notes, except that certain transfer restrictions, registration rights and additional interest provisions do not apply to the Exchange Notes. Notes that are not exchanged in the exchange offer will continue to be subject to the existing transfer restrictions, and the Company will generally have no further obligation to provide for the registration of those Notes.

Credit Agreement

Also on July 14, 2011, in connection with the 2011 Recapitalization, the Company entered into a new \$240.0 million Credit Agreement (the "Credit Agreement") with the lenders party thereto and JPMorgan Chase Bank, N.A., as Administrative Agent. The Credit Agreement provides for a seven year \$210.0 million senior secured term loan facility (the "Term Loan") and a five year \$30.0 million senior secured super-priority revolving credit facility. The Credit Agreement also provides for the issuance of letters of credit and the provision of swingline loans under the revolving credit facility, subject to a \$15.0 million sublimit for letters of credit and a \$5.0 million sublimit for swingline loans. The Guarantors have guaranteed the Company's obligations under the Credit Facility. The Credit Facility is collateralized by a first priority interest in substantially all of the present and future assets of the Company and the Guarantors, other than their interests in the Hallmark trademark and associated rights.

The Term Loan can be drawn at LIBOR or ABR at the company's election. All LIBOR term loans will bear interest at the LIBOR Rate (with that rate not to be deemed to be below 1.25%), plus 4.50%. All ABR term loans will bear interest at the base rate (as defined in the Credit Agreement), plus 3.50%. All LIBOR revolving loans will bear interest at the LIBOR Rate, plus 3.50%. All ABR revolving loans will bear interest at the base rate, plus 2.50%. Any swingline loans will bear interest at the base rate plus 2.50%.

Commitment fees on the revolving credit facility are payable on the unused revolving credit commitment at the rate of 0.50% per annum.

The provisions of the Term Loan require Crown Media Holdings to make principal payments of \$525,000 at each quarter's end, commencing September 30, 2011, until maturity on July 14, 2018. The Company is required to make additional principal payments in amounts equal to (1) 50% of excess cash flow (as defined in the Credit Agreement) of the Company for the remainder of 2011, and each year thereafter, which percentage will be reduced to 25% if the Consolidated Leverage Ratio (as defined in the Credit Agreement) is equal to or less than 4.25 to 1 but greater than 3.25 to 1, and 0% if the Consolidated Leverage ratio is equal to or less than 3.25 to 1, respectively; (2) 100% of net cash proceeds of dispositions or casualty events if the Company has not invested such proceeds within one year after the occurrence of the disposition or casualty event; and (3) 100% of net cash proceeds from issuance of debt or preferred stock not otherwise permitted by the Credit Agreement.

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

Each of the following constitutes an event of default under the Credit Agreement: (1) failure to make payment of any interest on the Notes when the same becomes due and payable, and with such failure continuing for a period of 5 business days; (2) failure to make the payment of any principal of any loan or any reimbursement obligation with respect to any letter of credit disbursement when the same becomes due and payable at the due date or at a date fixed for prepayment or otherwise; (3) any representation or warranty made by the Company or its restricted subsidiaries in the Credit Agreement, any other loan document or other documents delivered to the lenders proves to have been incorrect in any material respect when made or

deemed made; (4) failure to comply with the negative covenants in the Credit Agreement or covenants requiring the Company to keep its legal existence in full force and effect and to give notice to the Administrative Agent of any continuing default under the Credit Agreement; (5) failure to comply with the other covenants in the Credit Agreement with such failure continuing for 30 days after written notice is given to the Company by the Administrative Agent; (6) a default in payment of any material debt of the Company or its restricted subsidiaries beyond any applicable grace period; (7) a default in the performance by the Company or its restricted subsidiaries in the performance of any obligation in respect of material indebtedness that enables or permits the holders of any such debt to cause the debt to become due prior to its scheduled maturity; (8) certain events involving bankruptcy, insolvency or reorganization of the Company or any material subsidiary; (9) any judgment or judgments for the payment of money in an aggregate amount in excess of \$10.0 million is rendered against the Company or any significant subsidiary that is not paid, discharged or stayed for a period of 45 days after such judgment becomes final; (10) the occurrence of certain violations of ERISA; (11) the occurrence of a change of control (defined as (a) the sale, lease or transfer of all or substantially all of the assets of the Company or the restricted subsidiaries, taken as a whole, (b) the change of ownership of more than 35% of the voting stock of the Company, if such ownership represents a greater percentage of the voting stock of the Company than that beneficially owned by Hallmark Cards and its subsidiaries or (c) the adoption by the stockholders of the Company of a plan or proposal for the liquidation or dissolution of the Company); (11) any material provision of loan document or any security interest created by any loan document ceases to be in full force and effect (subject to certain exceptions), or the Company or any restricted subsidiary denies that it has any further liability under any loan document or purports in writing to revoke or rescind any loan document.

If an event of default under the credit facility occurs and is continuing, the commitments under the credit facility may be terminated and the principal amount outstanding under the credit facility, together with all accrued unpaid interest and other amounts owing under the Credit Agreement and related loan documents, may be declared immediately due and payable. In addition, upon an event of default that is continuing, the lenders would have the right to foreclose on the assets (both tangible and intangible) of the Company.

The proceeds of the Notes and the Term Loan were used to repay borrowings under the Company's existing credit agreement with HCC and to redeem all of the Company's outstanding Series A Preferred Stock, all of which was held by HCC. The revolving credit facility will be used in the future for general corporate purposes.

Redemption of the Series A Preferred Stock

The proceeds of the Notes and extensions of credit under the Credit Agreement were used in part to repay all borrowings under the Company's existing credit agreement with HCC and to redeem all of the Company's outstanding Series A Preferred Stock, consisting of 185,000 shares held by HCC. The Series A Preferred Stock had cumulative dividends that accrued 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" was \$1,000 per share. Cumulative dividends would have accrued from and after January 1, 2012 at the rate of 16% per annum of the Original Issue Price. Until December 31, 2014, dividends were payable in cash or in additional shares of Series A Preferred Stock, at the option of the Company. After December 31, 2014, dividends on the Preferred Stock would have been payable in cash only. In the event of any liquidation or winding up of the Company, the holders of the Series A Preferred Stock would have been 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) the amount that would be received by such holders on an "as converted" basis had all Series A Preferred Stock been converted into common stock immediately prior to such liquidation or winding up.

Termination of HCC Credit Facility

Effective July 14, 2011, the Company terminated its existing credit facility with HCC, which included \$315.0 million principal amount of debt issued pursuant to the terms of the credit agreement between the Company and HCC 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. The proceeds from the offering of Notes and the new Credit Agreement were used in part to repay and extinguish the Company' obligations under such HCC debt.

HCC continues to own approximately 90.3% of the outstanding shares of the Company' common stock following the repayment of the HCC debt and redemption of the Series A Preferred Stock held by HCC.

Extension and Expiration of Revolving Credit Facility

In connection with the issuance of the Notes and entry into the Credit Agreement, the Company allowed its existing \$30.0 million revolving credit facility with JPMorgan Chase Bank, N.A. to expire on its own terms. On June 29, 2011, such credit facility was amended to provide for a maturity date of the earlier to occur of (i) July 29, 2011 or (ii) the date of the execution of definitive documentation with respect to any Indebtedness of the type contemplated by Exhibit 99.1 of the Company's 8-K dated June 20, 2011 that was filed with the SEC on June 21, 2011.

Extension of Licenses

In connection with the 2011 Refinancing, Hallmark Licensing, Inc., an affiliate of Hallmark Cards, Inc., extended two existing trademark licenses (the "Extended Licenses") with Crown Media United States for an additional period terminating the earlier of (i) July 14, 2019 and (ii) the later of (x) the expiration or termination of the Credit Agreement and (y) the redemption of all of the Notes, subject to any earlier termination of such license agreements pursuant to the respective terms of such license agreements.

Hallmark Hall of Fame

On July 6, 2011, the Company entered into an agreement with Hallmark Cards for six new "Hallmark Hall of Fame" two-hour movies to be produced by Hallmark Cards over a two-year license term. The Company has the right to broadcast each movie four times during a period which begins seven days after and ends 14 days after the initial broadcast of each movie on the ABC Network. The Company will retain over nine minutes of commercial time within or adjacent to the running time of each movie and such time will either be used for promos or sales to advertisers who sell products compatible with the Hallmark image. All other commercial time will be for Hallmark Cards and Hallmark-branded commercials. Hallmark Cards has agreed to pay the Company \$3.4 million during the two-year period. The program license agreement described herein will have no effect on the Hallmark Hall of Fame program license agreement which the Company entered into with Hallmark Cards in 2008.

Selected Historical Consolidated Financial Data of Crown Media Holdings

In the table below, we provide selected historical condensed consolidated financial and other data of Crown Media Holdings and its subsidiaries. The following selected condensed consolidated statement of operations data for three and nine months ended September 30, 2010 and 2011, are derived from the unaudited financial statements of Crown Media Holdings and its subsidiaries. Ratings and subscriber information is also unaudited. This data should be read together with the condensed consolidated financial statements and related notes included elsewhere in this Form 10-Q.

	Three Months Ended September 30,		Percentage	Nine Months Ended September 30,		Percentage
	2010	2011	Change 2011 vs. 2010	2010	2011	Change 2011 vs. 2010
Revenue:						
Advertising	\$ 48,499	\$ 55,953	15%	\$ 149,635	\$ 169,601	13%
Subscriber fees	13,973	18,013	29%	46,839	53,894	15%
Other revenue	48	82	71%	133	298	124%
Total revenue	62,520	74,048	18%	196,607	223,793	14%
Cost of Services:						
Programming costs	31,246	32,334	3%	90,617	100,706	11%
Operating costs	3,092	3,133	1%	8,502	9,026	6%
Total cost of services	34,338	35,467	3%	99,119	109,732	11%
Selling, general and administrative expense	12,641	13,814	9%	37,694	42,837	14%
Marketing expense	7,114	2,615	-63%	8,551	3,508	-59%
Loss from sale of film assets	—	—		155	—	-100%
Income before interest and income tax expense	8,427	22,152	163%	51,088	67,716	33%
Interest expense	(2,509)	(10,556)	321%	(53,579)	(13,886)	-74%
Income (loss) before income tax expense and gain from sale of discontinued operations	5,918	11,596		(2,491)	53,830	
Income tax benefit (provision)	—	191,685		(2,897)	235,093	
Income (loss) before gain from sale of discontinued operations	5,918	203,281		(5,388)	288,923	
Gain from sale of discontinued operations	—	(1)		—	188	
Net income (loss)	\$ 5,918	\$ 203,280		\$ (5,388)	\$ 289,111	

Other Data:

Net cash provided by operating activities	\$ 22,727	\$ 11,877	-48%	\$ 51,515	\$ 26,007	-50%
Net cash used in investing activities	\$ (303)	\$ (123)	-59%	\$ (1,415)	\$ (824)	-42%
Net cash (used in) provided by financing activities	\$ (4,466)	\$ 2,174	-149%	\$ (24,406)	\$ (34,746)	42%
HC day household ratings (1)(3)(4)	0.4	0.4	0%	0.4	0.4	0%
HC primetime household ratings (2)(3)(4)	0.7	0.7	0%	0.7	0.6	-14%
HMC day household ratings (1)(3)(4)	0.2	0.2	0%	0.1	0.2	100%
HMC primetime household ratings (2)(3)(4)	0.3	0.4	33%	0.2	0.4	100%
HC day W25-54 ratings (1)(3)(4)	0.2	0.2	0%	0.2	0.2	0%
HC primetime W25-54 ratings (2)(3)(4)	0.3	0.3	0%	0.3	0.3	0%
HMC day W25-54 ratings (1)(3)(4)	0.1	0.1	0%	—	0.1	100%
HMC primetime W25-54 ratings (2)(3)(4)	0.1	0.1	0%	0.1	0.1	0%
HC subscribers at period end (4)	90,218	87,014	-4%	90,218	87,014	-4%
HMC subscribers at period end (4)	38,153	42,630	12%	38,153	42,630	12%

(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.

(4) "HC" represents Hallmark Channel and "HMC" represents Hallmark Movie Channel. Ratings and subscribers are reported by A.C. Nielsen ("Nielsen").

Results of Operations

Three Months Ended September 30, 2010, Compared to Three Months Ended September 30, 2011

Revenue. Our revenue from continuing operations, comprised primarily of subscriber and advertising fees, increased \$11.5 million or 18% in 2011 over 2010. The \$7.5 million or 15% increase in advertising revenue is primarily due to higher advertising rates. Advertising revenue from the Hallmark Movie Channel increased from \$4.6 million for the three months ended September 30, 2010, to \$7.8 million for the three months ended September 30, 2011.

For the three months ended September 30, 2011, Nielsen ranked the Hallmark Channel 25th in total day viewership with a 0.4 household rating and 24th in primetime with a 0.7 household rating among the 86 cable channels in the United States market. For the three months ended September 30, 2011, Nielsen ranked the Hallmark Movie Channel 44th in total day viewership with a 0.2 household rating and 38th in primetime with a 0.4 household rating among the 86 cable channels in the United States market.

Our subscriber fee revenue increased \$4.0 million or 29% due to rate increases under certain distribution agreements, net of a loss in the number of subscribers. Since the Company was in negotiations with one multiple systems operator during the third quarter of 2010 and did not renew a contract with another multiple systems operator that expired in August 2010, this had a negative impact on subscriber fee revenue during the third quarter of 2010. The amount of subscriber acquisition fees that was recorded as a reduction of subscriber fee revenue was approximately \$485,000 and \$298,000 for 2010 and 2011, respectively.

Cost of services. Cost of services as a percent of revenue decreased to 48% in 2011 as compared to 55% in 2010. This decrease results primarily from the effects of the 18% increase in total revenue discussed above, and is offset in part by the 3% increase in programming costs, discussed below.

Programming costs increased \$1.1 million or 3% from 2010 due to additional expense incurred in conjunction with the acquisition of new programming such as *Frasier* and lifestyle programming, which became available for viewing. Operating costs remained constant quarter over quarter.

Selling, general and administrative expense. Our selling, general and administrative expense increased approximately \$1.2 million over the three months ended September 30, 2010. Research costs increased \$269,000 due to the growth in Hallmark Movie Channel subscribers and employee costs increased \$1.1 million.

Marketing expense . Our marketing expense decreased \$4.5 million or 63% due to the Company allocating significant marketing resources to the 2010 launch of *The Martha Stewart Show* .

Interest expense. Interest expense increased \$8.1 million for the three months ended September 30, 2011, as compared to the three months ended September 30, 2010. Interest expense on the Term A and Term B loans was \$936,000 and interest on the Company obligated mandatorily redeemable preferred interest was \$572,000 for the three months ended September 30, 2010. On July 14, 2011, as part of the 2011 Refinancing, the Company issued \$300.0 million in aggregate principal amount of 10.5% Senior Notes, at par, due July 15, 2019. The Company also entered into a new \$240.0 million Credit Agreement. The Credit Agreement provides for a seven year \$210.0 million senior secured term loan facility and a five year \$30.0 million senior secured super-priority revolving credit facility. Interest on the Notes and the Term Loan was \$6.8 million and \$2.8 million for the three months ended September 30, 2011, respectively. At September 30, 2010, the balance of our Term A and Term B loans was \$433.0 million, with an effective interest rate of less than 1%. At September 30, 2011, the balance of our Term Loan and Notes was \$507.4 million.

Income tax (expense) benefit . During the three months ended September 30, 2011, the Company has

released \$191.8 million of the valuation allowance previously recorded against its deferred tax asset, resulting in an unreserved deferred tax asset of approximately \$236.0 million on its balance sheet as of September 30, 2011. This also results in a non-cash reduction in income tax expense. The Company recorded \$115,000 of income tax expense for estimated AMT and state tax for the three months ended September 30, 2011.

Nine Months Ended September 30, 2010, Compared to Nine Months Ended September 30, 2011

Revenue. Our revenue, comprised primarily of subscriber and advertising fees, increased \$27.2 million or 14% in 2011 over 2010. The \$20.0 million or 13% increase in advertising revenue is primarily due to higher advertising rates. Due to ratings information being provided for the Hallmark Movie Channel from April 1, 2010, forward and growth in its subscribers, advertising revenue from the Hallmark Movie Channel increased from \$12.5 million for the nine months ended September 30, 2010, to \$23.5 million for the nine months ended September 30, 2011. For the nine months ended September 30, 2011, Nielsen ranked the Hallmark Channel 24th in total day viewership with a 0.4 household rating and 30th in primetime with a 0.6 household rating among the 86 cable channels in the United States market.

Our subscriber fee revenue increased \$7.1 million or 15%. The amount of subscriber acquisition fees that was recorded as a reduction of subscriber fee revenue was approximately \$1.5 million and \$894,000 for 2010 and 2011, respectively. Since the Company was in negotiations with one multiple systems operator from mid-May through mid-November 2010, this had a negative impact on subscriber fee revenue during part of 2010.

Cost of services. Cost of services as a percent of revenue decreased to 49% in 2011 as compared to 50% in 2010. This decrease results primarily from the 14% increase in total revenue discussed above, offset in part by the effects of the \$10.1 million or 11% increase in programming costs, discussed below.

Operating costs for 2011 increased \$524,000 over 2010 due in part to the \$217,000 increase in bad debt expense. The Company's bad debt expense was \$44,000 for 2010, as compared to \$261,000 for 2011. Additionally, employee costs increased \$134,000 and tape duplication costs increased \$148,000 as compared to 2011.

Programming costs increased \$10.1 million or 11% from 2010 due to additional expense incurred in conjunction with the acquisition of new programming such as *Frasier* and lifestyle programming. Additionally, the Company wrote off one series that is no longer aired on the Hallmark Channel during 2011. Because *The Martha Stewart Show* was aired during all of the nine months ended September 30, 2011, but only during part of September 2010, the programming expense associated with this show was significantly higher.

Selling, general and administrative expense. Our selling, general and administrative expense increased \$5.2 million over 2010. Research costs increased \$1.4 million due to ratings information being provided for the Hallmark Movie Channel from April 1, 2010 forward, and growth in its subscribers, and employee costs increased \$2.2 million. The Company recorded non-recurring debt issuance costs attributable to the 2010 Recapitalization of \$1.0 million and banking fees of \$2.5 million in 2010 and 2011, respectively.

Marketing expense . Our marketing expense decreased \$5.0 million or 59% in 2011 versus 2010 due to the Company allocating significant marketing resources to the 2010 launch of *The Martha Stewart Show* . The Company expects its marketing expenses to increase during the fourth quarter of 2011 due to the promotion of original holiday programming.

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 based upon a request for payment received in July 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.

Interest expense. Interest expense decreased \$39.7 million for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. Interest expense on the old debt prior to the 2010 Recapitalization was \$47.7 million, interest expense on the Term A and Term B loans was \$957,000, and interest expense on the Company obligated mandatorily redeemable preferred interest was \$1.7 million for the nine months ended September 30, 2010. Interest on the Term A and Term B loans was \$1.5 million for the nine months ended September 30, 2011. Interest on the Notes and the Term Loan was \$6.8 million and \$2.8 million for the nine months ended September 30, 2011, respectively. At September 30, 2010, the balance of our Term A and Term B loans was \$433.0 million, with an effective interest rate of less than 1%. At September 30, 2011, the balance of our Term Loan and Notes was \$507.4 million.

Income tax (expense) benefit. During the nine months ended September 30, 2011, the Company released \$236.0 million of the valuation allowance previously recorded against its deferred tax asset, resulting in an unreserved deferred tax asset of approximately \$236.0 million on its balance sheet as of September 30, 2011. This also resulted in a non-cash reduction in income tax expense. For tax purposes, the Recapitalization generated cancellation of debt income of \$147.0 million. Accordingly, the Company generated federal and state taxable income for both regular tax and alternative minimum tax ("AMT") purposes. For regular tax purposes, this income is fully offset by net operating loss carryforwards. However, for federal AMT purposes, loss carryforwards have been used against AMT income but were limited to 90% of AMT income. As a result, the Company has recorded an income tax expense of \$2.9 million for the AMT in its consolidated statements of operations for the nine months ended September 30, 2010. The Company recorded income tax expense for estimated AMT of \$641,000 for the nine months ended September 30, 2011. This reflects accounting for income taxes on a separate return basis.

Gain on sale of discontinued operations. The terms of our April 2005 sale of the international business require that we reimburse the buyer for certain costs. At the time of the sale, we recorded an estimate of our liability for these obligations and considered the amount in our determination of our loss from the sale of discontinued operations as reported in 2005. During the second quarter of 2011, the Company adjusted its estimate for these amounts. This change in estimate was reflected as a \$193,000 gain on sale of discontinued operations, net of \$4,000 of tax.

Liquidity and Capital Resources

Cash provided by operating activities was \$51.5 million and \$26.0 million for the nine months ended September 30, 2010 and 2011, respectively. The Company had net income of \$289.1 million for the nine months ended September 30, 2011, as compared to a net loss of \$5.4 million for the nine months ended September 30, 2010. Our depreciation and amortization expense for the nine months ended September 30, 2011, increased to \$96.9 million from \$93.2 million while our income tax benefit increased \$238.0 million for the nine months ended September 30, 2011. The Company made programming payments of \$94.1 million and \$108.2 million during the nine months ended September 30, 2010 and 2011, respectively.

Cash used in investing activities was \$1.4 million and \$824,000 during the nine months ended September 30, 2010 and 2011, respectively. During the nine months ended September 30, 2010 and 2011, we purchased property and equipment of \$729,000 and \$730,000, respectively. During the nine months ended September 30, 2010 and 2011, the Company paid \$686,000 and \$94,000, 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 \$24.4 million and \$34.7 million for the nine months ended September 30, 2010 and 2011, respectively. The Company made principal payments on its Term A and Term B loans of \$67,000 and \$330.4 million for the nine months ended September 30, 2010 and 2011, respectively. The Company made dividend payments of \$13.8 million to the Preferred Stockholder during the nine months ended September 30, 2011. The Company redeemed its Preferred Stock for \$185.0 million on July 14, 2011. The Company made its first \$525,000 principal payment under its Term Loan on

September 30, 2011. In conjunction with the 2011 Refinancing, the Company paid \$12.1 million of debt issuance costs and received proceeds of \$300.0 million and \$207.9 million from the issuance of the Note and the Term Loan, respectively. In conjunction with the 2010 Recapitalization, the company paid \$3.6 million of debt issuance costs. Also, during the nine months ended September 30, 2010, pursuant to provisions of the Recapitalization, the Company sequestered \$20.0 million for payment on the Company obligated mandatorily redeemable preferred interest, which was subsequently paid on December 1, 2010.

In December 2010, the Company paid Hallmark Cards \$12.9 million under the federal tax sharing agreement, marking the first time that the Company has remitted cash under the agreement since it became a member of the consolidated federal tax reporting group in March 2003. In June 2010, \$8.5 million owed by the Company under the tax sharing agreement comprised a portion of HCC Debt that was subject to the Recapitalization. During the nine months ended September 30, 2011, the Company paid Hallmark Cards \$10.5 million under the federal tax sharing agreement relating to income generated in first and second quarters of 2011. No amounts were due for the third quarter of 2011. In October 2011, the Company paid \$742,000 to Hallmark Cards related to California state taxes.

The Company's management anticipates that the principal uses of cash during the twelve month period ending September 30, 2012 will include the payment of operating expenses, accounts payable and accrued expenses, programming costs, interest and mandatory principal payments of \$44.0 million to \$48.0 million under the Term Loan and Notes, and such additional principal payments made from excess cash flows as defined, as may become due under the Term Loan. The Company believes that cash on hand, cash generated by operations, and borrowing available under its bank credit facility, will be sufficient to fund the Company's operations and enable the Company to meet its liquidity needs through September 30, 2012.

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, 2010, and subsequent Quarterly Reports on Form 10-Q. 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; 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, the 2010 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, 2011, the decline of the fair value of the fixed income portfolio would not be material.

As of September 30, 2011, our cash, cash equivalents and short-term investments had a fair value of \$21.0 million and were invested in cash. The primary purpose of these investing activities has been to preserve principal until the cash is required to fund operations. Consequently, the size of this portfolio fluctuates significantly as cash is provided by and used in our business.

The value of certain investments in this portfolio can be impacted by the risk of adverse changes in securities and economic markets and interest rate fluctuations. For the three and nine months ended September 30, 2011, the impact of interest rate fluctuations, changed business prospects and all other factors did not have a material impact on the fair value of this portfolio, or on our income derived from this portfolio.

We have not used derivative financial instruments for speculative purposes. As of September 30, 2011, we are not hedged or otherwise protected against risks associated with any of our investing or financing activities.

We are exposed to market risk.

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

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

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

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

Our material interest bearing assets consisted of cash equivalents and short-term investments. The balance of our interest bearing assets was \$21.0 million, or 3% of total assets, as of September 30, 2011. Our material liability subject to interest rate risk consisted of our Term Loan. The balance of this liability was \$207.4 million, or 29% of total liabilities, as of September 30, 2011. Net interest expense for the three months ended September 30, 2011, was \$10.6 million, 14%, of our total revenue. Net interest expense for the nine months ended September 30, 2011, was \$13.9 million, 6%, of our total revenue. Our net interest expense for this liability is sensitive to changes in the general level of interest rates, primarily U.S. and LIBOR interest rates. In this regard, changes in U.S. and LIBOR (“Eurodollar”) interest rates affect the fair value of interest bearing liabilities.

If market interest rates were to increase or decrease by 1%, our interest expense for both the three and nine months ended September 30, 2011, would change by \$455,000.

Item 4. Controls and Procedures.

a. Disclosure Controls and Procedures

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

b. Changes in Internal Control over Financial Reporting

There was no change in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2011, 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 Recapitalization, please see *Note 10- Commitments and Contingencies* to the Unaudited Condensed Consolidated Financial Statements contained in Item 1 of this Report.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A, Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, as such risk factors have been updated by the filing with the SEC of subsequent periodic and current reports from time to time, which factors could materially affect our business, financial condition, or future results. Such risks, however, are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, and/or reporting results.

Item 6. Exhibits

INDEX TO EXHIBITS

<u>Exhibit Number</u>	<u>Exhibit Title</u>
3.1	Amended and Restated By-Laws (previously filed as Exhibit 3.2 to our Registration Statement on Form S-1/A (Amendment No. 3), Commission File No. 333-95573, and incorporated herein by reference).
3.2	Second Amended and Restated Certificate of Incorporation of Crown Media Holdings (previously filed as Exhibit 3.1 to our Current Report on Form 8-K filed on March 1, 2010 and incorporated herein by reference).
3.3	Certificate of Designation, Powers, Preferences, Qualifications, Limitations, Restrictions and Relative Rights of Series A Convertible Preferred Stock of Crown Media Holdings, Inc. (previously filed as Exhibit 3.2 to our Current Report on Form 8-K filed on March 1, 2010 and incorporated herein by reference).
4.1	Indenture, dated July 14, 2011, by and among Crown Media Holdings, Inc., the Guarantors named therein and The Bank of New York Mellon Trust Company, N.A., as Trustee

	(previously filed as Exhibit 4.1 to our Current Report on Form 8-K filed on July 14, 2011, and incorporated hereby in reference).
4.2	Form of 10.5% Senior Notes due 2019 (previously filed as Exhibit 4.2 to our Current Report on Form 8-K filed on July 14, 2011, and incorporated hereby in reference).
10.1	Registration Rights Agreement, dated July 14, 2011, by and among Crown Media Holdings, Inc., the Guarantors named therein and J.P. Morgan Securities LLC (previously filed as Exhibit 10.1 to our Current Report on Form 8-K filed on July 14, 2011, and incorporated herein in reference).
10.2	Credit Agreement, dated as of July 14, 2011, among Crown Media Holdings, Inc., as Borrower, the lenders named therein, and JPMorgan Chase Bank, N.A., as Administrative Agent (previously filed as Exhibit 10.2 to our Current Report on Form 8-K filed on July 14, 2011, and incorporated hereby in reference).
10.3	Trademark License Extension Agreement (Hallmark Movie Channel) dated as of July 14, 2011 by and between Hallmark Licensing, Inc. and Crown Media United States, LLC (previously filed as Exhibit 10.3 to our Current Report on Form 8-K filed on July 14, 2011, and incorporated hereby in reference) .
10.4	Trademark License Extension Agreement (Hallmark Channel) dated as of July 14, 2011 by and between Hallmark Licensing, Inc. and Crown Media United States, LLC (previously filed as Exhibit 10.4 to our Current Report on Form 8-K filed on July 14, 2011, and incorporated hereby in 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.
101.INS††	XBRL Instance Document
101.SCH††	XBRL Taxonomy Extension Schema Document
101.CAL††	Taxonomy Extension Calculation Linkbase Document
101.DEF††	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB††	XBRL Taxonomy Extension Label Linkbase Document
101.PRE††	XBRL Taxonomy Extension Presentation Linkbase Document

† Furnished, not filed.

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

SIGNATURES

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

CROWN MEDIA HOLDINGS, INC.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
By: <u> /s/ WILLIAM J. ABBOTT </u> William J. Abbott	Principal Executive Officer	November 3, 2011
By: <u> /s/ ANDREW ROOKE </u> Andrew Rooke	Principal Financial and Accounting Officer	November 3, 2011

EXHIBIT INDEX

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101.LAB††	XBRL Taxonomy Extension Label Linkbase Document
101.PRE††	XBRL Taxonomy Extension Presentation Linkbase Document

† Furnished, not filed.

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

CERTIFICATION

I, William J. Abbott, certify that:

1. I have reviewed this 10-Q Report for the quarter ended September 30, 2011, of Crown Media Holdings, Inc.;
 2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
 3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
 4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
 5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
-

- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Dated: November 3, 2011

/s/ WILLIAM J. ABBOTT

William J. Abbott
President and Chief Executive Officer

CERTIFICATION

I, Andrew Rooke, certify that:

1. I have reviewed this 10-Q Report for the quarter ended September 30, 2011, of Crown Media Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the

registrant's ability to record, process, summarize and report financial information; and

- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Dated: November 3, 2011

/s/ ANDREW ROOKE

Andrew Rooke
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

1. The undersigned are the Chief Executive Officer and the Chief Financial Officer of Crown Media Holdings, Inc. (“Crown Media Holdings”). This Certification is made pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. This Certification accompanies the 10-Q Report of Crown Media Holdings for the quarter ended September 30, 2011.
2. We certify to our knowledge that such 10-Q Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in such 10-Q Report fairly presents, in all material respects, the financial condition and results of operations of Crown Media Holdings.

This Certification is executed as of November 3, 2011.

/s/ WILLIAM J. ABBOTT

William J. Abbott, President and
Chief Executive Officer

/s/ ANDREW ROOKE

Andrew Rooke, Chief Financial Officer