The Company has minority interests in certain entities as discussed in Note 9. In connection with the adoption of FIN 46R, the Company's preliminary assessment is that certain of its immaterial unconsolidated international joint ventures may be VIEs in which the Company is the primary beneficiary. Pursuant to the transition provisions of FIN 46R, the Company will begin consolidating such ventures commencing 2005, however the impact on the consolidated financial statements is not expected to be material. See Note 9 for summarized balance sheets, statements of operations and cash flows of all equity method investments.

FASB Statement No. 150 *Financial Instruments with Characteristics of Both Liabilities and Equity*, (FAS 150) establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have traditionally been characterized as equity. The Financial Accounting Standards Board delayed the FAS 150 effective date for nonpublic companies with respect to instruments that are mandatorily redeemable on fixed dates for amounts that are either fixed or determined by reference to an index to January 1, 2005. If the Company were a public registrant, mandatorily redeemable minority interests in the amount of $142.9 million would be classified as current liabilities.

Revenue Recognition

The Company derives revenues from five primary sources: (1) advertising revenue for commercial spots aired on the Company's networks, (2) subscriber revenue from cable system operators (affiliates), (3) retail sales of consumer product inventory, (4) licensing of the Company's programming and other intellectual property, and (5) product and service sales to educational institutions.

Advertising revenue is recorded net of agency commissions and audience deficiency liabilities in the period when the advertising spots are broadcast. Subscriber revenue is recognized in the period the service is provided, net of launch incentives and other vendor consideration. Retail revenues are recognized either at the point-of-sale or upon product shipment. Program licensing revenues are recognized when the programming is available to broadcast and upon satisfaction of other revenue recognition conditions. Trademarks and other non-programming licensing are generally recognized ratably over the term of the agreement. Product and service sales to educational institutions are generally recognized ratably over the term of the agreement or as the product is delivered.

Advertising Costs

The Company expenses advertising costs as incurred. The Company incurred advertising costs of $170.3 million, $140.2 million and $111.9 million in 2004, 2003 and 2002.

Cash and Cash Equivalents

Highly liquid investments with original maturities of ninety days or less are recorded as cash equivalents. The Company had $4.3 million and $3.9 million in restricted cash included in other assets as of December 31, 2004 and 2003 due to foreign currency restrictions.

Derivative Financial Instruments

Derivative financial instruments are recorded on the balance sheet at fair value. The Company did not apply hedge accounting during 2004, 2003 and 2002, and therefore changes in the fair values of derivative financial instruments are recorded in the statements of operations.

Inventories

Inventories are carried at the lower of cost or market and include inventory acquisition costs. Cost is determined using the weighted average cost method.

Programming Rights

Costs incurred in the direct production or licensing of programming rights are capitalized and stated at the lower of unamortized cost, fair value, or net realizable value. The Company evaluates the net realizable value of programming by considering the fair value and net realizable values of the underlying produced and licensed programs, respectively. The costs of produced programming are capitalized and amortized based on the expected realization of revenues, resulting in an accelerated basis over four years for developed networks (Discovery Channel, TLC, Animal Planet, and The Travel Channel) in the United States, a straight-line basis over three to five years for developing networks in the United States, and a straight-line basis over three years for all International networks.

The cost of licensed programming is capitalized and amortized over the term of the license period based on the expected realization of revenues, resulting in an accelerated basis for developed networks in the United States, and a straight-line basis for all International networks and developing networks in the United States.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is recognized on a straight-line basis over the estimated useful lives of three to seven years for equipment, furniture and fixtures, five to forty years for building structure and construction, and six to fifteen years for satellite transponders. Leasehold improvements are amortized on a straight-line basis over the lesser of their estimated useful lives or the terms of the related leases. Equipment under capital lease represents the present value of the minimum lease payments at the inception of the lease, net of accumulated depreciation.

Capitalized Software Costs

Capitalization of software development costs occurs during the application development stage. Costs incurred during the pre and post implementation stages are expensed as incurred. Capitalized software is amortized on a straight-line basis over its estimated useful lives of one to five years. Unamortized computer software costs totaled $55.2 million and $49.6 million at December 31, 2004 and 2003.

Recoverability of Long-Lived Assets, Goodwill, and Intangible Assets

The Company periodically reviews the carrying value of its acquired intangible assets, including goodwill, and its other long-lived assets, including deferred launch incentives, to determine whether an impairment may exist. Goodwill impairment is determined by comparing the fair value of the reporting unit to its carrying value. If the fair value of the reporting unit is less than its carrying value, an impairment loss is recorded to the extent that the fair value of the goodwill within the reporting unit is less than its carrying value. Intangible assets and other long-lived assets are grouped for purposes of evaluating recoverability at the lowest level for which independent cash flows are identifiable. If the carrying amount of an intangible asset, long-lived asset, or asset grouping exceeds its fair value, an impairment loss is recognized. Fair values for reporting units, goodwill and other intangible assets are determined based on discounted cash flows, market multiples, or comparable assets as appropriate. Generally, the Company's reporting units and asset groups consist of the individual networks or other operating units.

The determination of recoverability of goodwill and other intangible and long lived assets requires significant judgment and estimates regarding future cash flows, fair values, and the appropriate grouping of assets. Such estimates are subject to change and could result in impairment losses being recognized in the future. If different reporting units, asset groupings, or different valuation methodologies had been used, the impairment test results could have differed.

Deferred Launch Incentives

Consideration issued to cable affiliates in connection with the execution of long-term network distribution agreements is deferred and amortized on a straight-line basis as a reduction to revenue over the terms of the agreements. Obligations for fixed launch incentives are recorded at the inception of the agreement. Obligations for performance-based arrangements are recorded when performance thresholds have been achieved. Following the extension or renewal of an original launch agreement, remaining deferred consideration is amortized over the new period. Amortization of deferred launch incentives and interest on unpaid deferred launch incentives was $98.4 million, $122.7 million and $122.8 million in 2004, 2003 and 2002.

Foreign Currency Translation

The Company's foreign subsidiaries' assets and liabilities are translated at exchange rates in effect at the balance sheet date, while results of operations are translated at average exchange rates for the respective periods. The resulting translation adjustments are included as a separate component of stockholders' equity in accumulated other comprehensive income. The effect of exchange rate changes on cash balances held in foreign currencies impacting the Consolidated Statements of Cash Flows totals $2.5 million, $1.2 million, and $0.2 million in 2004, 2003 and 2002.

Long-term Compensation Programs

The Company grants unit awards under its long-term incentive plans. These unit awards, which vest over a period of years, are granted to employees and increase or decrease in value based on a specified formula of certain business metrics of the Company. The Company accounts for these units similar to stock appreciation rights and applies the guidance in FASB Interpretation Number 28, "Accounting for Stock Issued to Employees." The Company adjusts compensation expense for the changes in the accrued value of these awards over the vesting period.

Mandatorily Redeemable Interests in Subsidiaries

Mandatorily redeemable interests in subsidiaries are initially recorded at fair value and accreted or decreted to the estimated redemption value ratably over the period to the redemption date, as appropriate. The Company records accretion and decretion on these instruments in minority interest expense.

Treasury Stock

Treasury stock is accounted for using the cost method. The repurchased shares are held in treasury and are presented as if retired. Treasury stock activity for the three years ended December 31, 2004 is presented in the Consolidated Statements of Stockholders' Deficit.

Income Taxes

Income taxes are recorded using the asset and liability method of accounting for income taxes. Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. A valuation allowance is provided for deferred tax assets if it is more likely than not such assets will not be realized.

Reclassifications

Certain prior period financial statement amounts have been reclassified to conform to the 2004 presentation.

During 2004, the Company reclassified book overdrafts at December 31, 2003 and 2002. These reclassifications increased cash and current liabilities by $42.9 million and $0.6 million at December 31, 2003 and 2002. Additionally, the Company reclassified approximately $15.5 million and $6.0 million in restricted cash and other assets previously reported as cash at December 31, 2003 and 2002. As a result of these reclassifications, cash flows from operating activities decreased $9.5 million and $1.9 million for the years ended December 31, 2003 and 2002, and cash flows from financing activities increased $42.3 million and decreased $23.4 million for the same year ends.

3. Supplemental Disclosures to Consolidated Statements of Cash Flows

Year ended December 31,	2004	2003	2002
		In thousands	
Cash paid for acquisitions:			
Fair value of assets acquired	$21,414	$50,509	$ —
Net liabilities assumed	(4,196)	(3,968)	—
Cash paid for acquisitions, net of cash acquired	17,218	46,541	—
Cash paid for interest, net of capitalized interest	166,584	162,904	154,288
Cash paid for income taxes	28,999	32,395	25,537

4. Business Combinations

During 2004, the Company completed two acquisitions in its Education division, in which the Company acquired customer lists valued at $14.6 million, covenants not to compete valued at $0.6 million and trademarks valued at $0.1 million, which are being amortized over their useful lives, of three years for the customer lists and covenants not to compete.

During 2003, the Company completed two acquisitions, one in its Education division and one in its International Networks division. In connection with these acquisitions, the Company acquired customer lists valued at $27.7 million, which are being amortized over their useful lives of three years. The Company also acquired deferred launch incentives valued at $16.7 million. Of these, $13.2 million are being amortized over the five-year term of the agreements, and $3.5 million relate to a penalty for non-renewal in 2008. If no renewal is effectuated in 2008, the acquiree will refund the Company. If renewed, the Company will amortize this amount over the renewal period.

Purchase price in excess of the fair value of the assets and liabilities acquired of $1.1 million and $6.0 million was recorded to goodwill in 2004 and 2003.

5. Programming Rights

Programming Rights, December 31,	2004	2003
	In thousands	
Produced programming rights		
Completed	$1,099,483	$ 892,867
In process	100,086	77,062
Co-produced programming rights		
Completed	698,758	626,934
In process	38,575	44,464
Licensed programming rights		
Acquired	189,662	243,541
Prepaid	4,232	7,719
Programming rights, at cost	2,130,796	1,892,587
Accumulated amortization	(1,052,839)	(964,488)
Programming rights, net	1,077,957	928,099
Current portion, licensed programming rights	(50,578)	(46,364)
Non-current portion	$1,027,379	$ 881,735

Amortization of programming rights was $494.2 million, $413.9 million and $365.4 million in 2004, 2003 and 2002, and is recorded as a cost of revenue.

The Company estimates that 91.1% of unamortized costs of programming rights at December 31, 2004 will be amortized within the next three years. The Company expects to amortize $377.0 million of unamortized programming rights, not including in-process and prepaid productions, during the next twelve months.

6. Property and Equipment

Property and Equipment, December 31,	2004	2003
	In thousands	
Equipment and software	$ 344,525	$ 346,438
Land	28,781	27,575
Buildings	136,088	137,190
Furniture, fixtures, leasehold improvements and other assets	160,418	160,744
Assets in progress	60,806	29,582
Property and equipment, at cost	730,618	701,529
Accumulated depreciation and amortization	(350,328)	(341,118)
Property and equipment, net	$ 380,290	$ 360,411

The cost and accumulated depreciation of satellite transponders under capital leases were $23.5 million and $4.1 million at December 31, 2004, and $64.3 million and $45.4 million at December 31, 2003. Depreciation and amortization of property and equipment, including equipment under capital lease, was $85.4 million, $86.4 million and $96.3 million in 2004, 2003 and 2002.

Through December 31, 2004, total capitalized costs associated with facility construction projects include land costs of $2.3 million, and building and leasehold improvement costs of $43.8 million. The Company expects these facilities to be completed in 2005.

The Company completed construction of its worldwide headquarters facility in Silver Spring, Maryland, in the first quarter of 2003. The final facility is comprised of land costs of $26.5 million, building structure and construction costs of $121.4 million, and interest costs of $14.7 million.

7. Sale of Long-lived Assets

In 2004, the Company recorded a net gain of $22.0 million on the sale of certain of the Company's television technology patents. The transaction closed August 19, 2004 and the gain represents the sale price less costs to sell. The Company expensed all of the costs to develop this technology in prior years.

8. Goodwill and Intangible Assets

Goodwill and Intangible Assets, December 31,	2004	2003
	In thousands	
Goodwill	$257,460	$253,308
Trademarks	13,383	13,230
Customer relationships and lists, net of amortization of $86,406 and $64,393	64,109	72,153
Non-compete and other, net of amortization of $43,021 and $33,229	33,068	42,343
Representation rights, net of amortization of $60,528 and $51,198	77,201	85,934
Goodwill and intangible assets, net	$445,221	$466,968

Goodwill and trademarks are not amortized. Customer relationships and lists are amortized on a straight-line basis over estimated useful lives of three to seven years. Non-compete assets are amortized on a straight-line basis over the contractual term of five to seven years. Other intangibles are amortized on a straight-line basis over estimated useful lives of ten years. Representation rights are amortized on a straight-line basis over the contractual term of fifteen years.

During 2004 and 2003 the Company reduced its estimate of certain pre-acquisition contingencies associated with certain subscriber contractual arrangements acquired as part of the acquisition of The Health Network. These revisions resulted in a reduction of goodwill of $8.0 million and $26.7 million at December 31, 2004 and 2003.

The $4.2 million net increase in goodwill results from 1) a $8.0 million reduction related to an adjustment for pre-acquisition contingent liabilities (discussed above), 2) a $9.5 million adjustment to increase goodwill for recognition of certain deferred tax liabilities, 3) a $1.1 million addition related to current year acquisitions and 4) a $1.6 million increase for foreign currency translation effect.

The Company has the exclusive rights to represent BBC America ("BBCA"), a cable network, in sales, marketing, distribution and other operational activities through 2013. As a part of this agreement, the Company will receive a percentage of revenues earned and collected by BBCA during the representation term. The cost of acquiring the representation rights is being amortized on a straight-line basis over the fifteen-year term of the agreement, and is reported as a reduction of revenue.

Amortization of intangible assets amounted to $41.8 million, $33.8 million and $17.8 million in 2004, 2003 and 2002.

The Company estimates that unamortized costs of intangible assets at December 31, 2004 will be amortized over the next five years as follows: $44.1 million in 2005, $41.1 million in 2006, $28.6 million in 2007, $20.1 million in 2008, and $9.8 million in 2009.

9. Investments in Affiliated Companies

Joint Ventures with the British Broadcasting Corporation ("BBC")

The Company and the BBC have formed cable and satellite television network joint ventures, a venture to produce and acquire factual based programming ("JV Programs" or "JVP") and a venture to provide debt funding to the cable and satellite television network joint ventures and JV Programs venture ("JV Network"). In addition to its own funding requirements, the Company has assumed the BBC funding requirements for each of these ventures. As a result, the Company has preferential cash distribution agreements with these ventures. The ventures had no distributable cash in 2004 and distributed $1.7 million in accordance with the agreements in 2004 and 2003.

Because the BBC does not have risk of loss, no losses were allocated to minority interest for consolidated joint ventures with the BBC. The Company recognizes both its own and the BBC's share of losses in equity method ventures with the BBC.

Variable Interest Entities

The Company is a partner in several joint ventures accounted for under the equity method in which it has a variable interest.

JV Programs produces and acquires factual based programming that it then sells to the Company for use on many of the Company's joint venture and wholly owned networks. The Company's funding to JVP was $14.4 million, $5.4 million and $3.4 million during 2004, 2003 and 2002. The Company acquired and licensed $44.1 million, $43.9 million and $35.9 million of programming from JVP for its networks during 2004, 2003 and 2002. At December 31, 2004, the Company's maximum exposure to loss as a result of its involvement with JVP is the $55.1 million book value of its investment in JVP and future operating losses of JVP that the Company is obligated to fund. JVP has no third party debt. If JVP were to be consolidated under FIN 46R, the Company expects the net impact to the consolidated financial statements to be insignificant. Substantially all of JVP's activities are with the Company and those are already reflected in the financial statements.

The Company is a partner in other international joint venture cable and satellite television networks in which the Company has a variable interest. The Company's funding to these joint ventures totaled $3.3 million, $7.5 million and $9.9 million during 2004, 2003 and 2002. At December 31, 2004, the Company's maximum exposure to loss as a result of its involvement with these joint ventures is the

$19.3 million book value of its investments in these joint ventures and future operating losses of these joint ventures that the Company is obligated to fund. These joint ventures have no third party debt.

The following table outlines the Company's joint ventures and the method of accounting during 2004, 2003 and 2002:

Affiliates:	Accounting Method
Joint Ventures with the BBC:	
JV Network	Consolidated
JV Programs	Equity
Animal Planet United States (see Note 11)	Consolidated
Animal Planet Europe	Consolidated
Animal Planet Latin America	Consolidated
People & Arts Latin America	Consolidated
Animal Planet Asia	Consolidated
Animal Planet Japan	Equity
Animal Planet Canada	Equity
Other Ventures:	
Discovery Times Channel (see Note 11)	Consolidated
FitTV (f.k.a. The Health Network) (see Note 11)	Consolidated
Discovery Canada	Equity
Discovery Japan	Equity
Discovery Health Canada	Equity
Discovery Kids Canada	Equity
Discovery Civilization Canada	Equity
Meteor Studios	Equity

Combined financial information of the Company's unconsolidated ventures (amounts do not reflect any eliminations of activity with the Company):

Operating Results, Year ended December 31,	2004	2003	2002
		In thousands	
Revenue	$163,630	$145,786	$106,598
Income from operations	26,201	13,278	4,806
Net income (loss)	8,688	1,155	(1,060)

Balance Sheets, December 31,	2004	2003
	In thousands	
Current assets	$68,554	$65,046
Total assets	136,703	117,772
Current liabilities	21,817	17,880
Total liabilities	46,683	42,382
Total shareholders' equity or partners' capital	90,020	75,390

10. Long-Term Debt

Long-Term Debt, December 31,	2004	2003
	In thousands	
$1,250.0 Term Loan, due quarterly from 2007 to 2009	$1,250,000	$ —
$1,250.0 Revolving Loan, due June 2009	238,000	—
$2,036.5 Term Loan and Revolving Loans, paid 2004	—	1,334,000
7.81% Senior Notes, semi annual interest, due March 2006	300,000	300,000
8.06% Senior Notes, semi annual interest, due March 2008	180,000	180,000
8.37% Senior Notes, semi annual interest, due March 2011	220,000	220,000
7.45% Senior Notes, semi annual interest, due September 2009	55,000	55,000
8.13% Senior Notes, semi annual interest, due September 2012	235,000	235,000
Obligations under capital leases	25,125	19,631
Other notes payable	4,898	8,061
Total long-term debt	2,508,023	2,351,692
Current portion	(9,736)	(517,750)
Non-current portion	$2,498,287	$1,833,942

In June 2004, the Company successfully refinanced the Term Loan and the Revolving Loans, maturing in 2004 and 2005, with a new Term Loan and Revolving Facility. The Company capitalized $8.5 million in deferred financing costs as part of the new term and revolving loan facility and expensed $6.3 million in capitalized costs associated with the previous term loan and revolving loans.

All Term and Revolving Loans are unsecured. Interest, which is payable quarterly, is based on the London Interbank Offered Rate ("LIBOR") or prime rate plus a margin based on the Company's leverage ratios. The weighted average interest rate on these facilities was 3.7% and 2.5% at December 31, 2004 and 2003, and the interest rate averaged 2.9% and 2.7% during 2004 and 2003. The cost of the Revolving Loans includes a fee (ranging from 0.125% to 0.375%) based on the Company's leverage ratios. The Company uses derivative instruments to modify its exposure to interest rate fluctuations on its debt.

The Term Loans, Revolving Loans, and Senior Notes contain covenants that require the Company to meet certain financial ratios and place restrictions on the payment of dividends, sale of assets, additional borrowings, mergers, and purchases of capital stock, assets, and investments. The Company was in compliance with all debt covenants at December 31, 2004.

Future principal payments under the current debt arrangements, excluding obligations under capital leases and other notes payable, are as follows: no payments in 2005, $300 million in 2006, $234 million in 2007, $961 million in 2008, $527 million in 2009 and $456 million from 2011 to 2012. Future minimum payments under capital leases are as follows: $5.1 million in 2005, $5.5 million in 2006, $5.7 million in 2007, $3.8 million in 2008, $3.8 million in 2009 and $8.4 million thereafter.

11. Mandatorily Redeemable Interests in Subsidiaries

Mandatorily Redeemable Interests in Subsidiaries, December 31,	2004	2003
	In thousands	
Discovery Times	$125,763	$123,896
FitTV (f.k.a. The Health Network)	92,874	94,000
Discovery Health Channel	—	143,736
Animal Planet LLC	50,000	—
Animal Planet LP	48,730	48,620
People & Arts Latin America and Animal Planet Channel Group	2,200	—
Mandatorily redeemable interests in subsidiaries	$319,567	$410,252

Discovery Times

In April 2002, the Company sold a 50% interest in Discovery Times Channel to the New York Times ("NYT") for $100 million. Due to NYT redemption rights, this transaction resulted in no gain or loss to the Company. While the Company consolidates the financial results of Discovery Times, no losses of Discovery Times have been allocated to minority interest due to the NYT's redemption feature, and the Company has recorded the interest held by NYT as mandatorily redeemable interest in a subsidiary.

NYT has the right, in April 2005, and again in April 2006, to put its interest back to the Company for a value determined by a specified formula, with a floor of $80 million and a ceiling of $125 million in April 2005, and a floor of $80 million and a ceiling of $135 million in April 2006. The Company accretes or decretes the mandatorily redeemable interest in a subsidiary to its estimated redemption value through the redemption date. The Company updates its estimate of the redemption value each period and based on its most recent calculations, the Company will decrete to an amount representing the estimated value of $101.1 million. The Company recorded decretion of $1.3 million in 2004 and accretion of $7.0 million and $6.5 million to minority interest expense in 2003 and 2002.

After 2006, the NYT has certain other protective rights that, if triggered and not cured, could require the Company to repurchase the NYT interest for a value determined by a specified formula.

FitTV (f.k.a. The Health Network)

Fox Entertainment Group (FEG) had the right, from December 2003 to February 2004, to put its FitTV interests back to the Company. In December 2003, FEG notified the Company of its intention to put its interest in FitTV back to the Company. The Company estimates that it will acquire this interest for approximately $92.9 million in 2005. The Company recorded decretion of $1.1 million in 2004 and recorded accretion of $8.5 million and $11.1 million in 2003 and 2002 to minority interest expense.

Discovery Health Channel (DHC)

During the second quarter of 2004, Comcast put its DHC interests back to the Company for $148.9 million. The Company recorded accretion of $5.1 million, $20.4 million and $28.3 million to minority interest expense in 2004, 2003 and 2002.

Animal Planet LLC

Beginning March 2003, the BBC has the right to put its Animal Planet LLC ("APUS") interests back to the Company. In April 2004, the BBC notified the Company of its intention to put its interest in APUS back to the Company. The Company estimates a range of possible outcomes to acquire this interest. Given the uncertainty associated with the determination of the final redemption value of this interest (which will be based on the terms outlined in the agreement), the Company has recorded accretion of $50.0 million in 2004 to minority interest expense. At December 31, 2003, the Company determined there was no redemption value associated with this right.

Animal Planet LP

One of the Company's stockholders holds 44,000 senior preferred partnership units of Animal Planet LP ("APLP") that have a redemption value of $44.0 million and carry a rate of return ranging from 8.75% to 13%. Payments are made quarterly and totaled $4.6 million, $5.8 million and $4.4 million during 2004, 2003 and 2002. APLP's senior preferred partnership units may be called by APLP during the period January 2007 through December 2011 for $44.0 million, and may be put to the Company by the holder beginning in January 2012 for $44.0 million. At December 31, 2004, and 2003, the Company has recorded this security at the redemption value of $44.0 million plus accrued returns of $4.7 million and $4.6 million. Preferred returns are recorded as a component of interest expense and aggregated $4.7 million in 2004, 2003 and 2002.

People & Arts Latin America and Animal Planet Channel Group

The BBC has the right, upon a failure of the People & Arts Latin America or the Animal Planet Channel Group (comprised of Animal Planet Europe, Animal Planet Asia, and Animal Planet Latin America) to achieve certain financial performance benchmarks as of December 2005, and every three years thereafter, to put its interests back to the Company for a value determined by a specified formula. The Company accretes or decretes the mandatorily redeemable equity in a subsidiary to its estimated redemption value through the 2005 redemption date. The redemption value is based on a contractual formula utilizing projected results of each network within the channel group. At December 31, 2004, the Company has estimated a redemption value of $15.3 million. At December 31, 2003, the Company determined there was no redemption value associated with this right. Accretion to the redemption value has been recorded as a component of minority interest expense of $2.2 million in 2004.

12. Stockholders' Deficit

In September 2001, the Company sold 50,615 shares of Class B Non-voting Common Stock to its existing shareholders for $100.0 million. In September 2002, the Company repurchased these shares for $109.0 million. The appreciation of the shares represented a fair transition value as was confirmed in consultation with an investment bank.

Stockholder Put Right

In June 2003, the Company's founder, John Hendricks, put 215 outstanding shares of Class A Common Stock to the Company in exchange for $55.3 million. Concurrent with this transaction, outstanding loans, secured by Mr. Hendricks' shares and vested compensation units, of $23.6 million to Mr. Hendricks were repaid to the Company with interest. Prior to this purchase, the value of these shares had been recorded as redeemable common stock and changes in value had been recorded to stockholders' deficit.

The Company received a third party valuation to record the transactions. The valuation reflected a lower value for the Company than had been previously estimated and, as a result, the Company decreased the carrying value of the stock by $13.7 million and reduced compensation expense recorded in prior years associated with the loans by $2.3 million in connection with the settlement.

13. Commitments and Contingencies

The Company leases certain satellite transponders, facilities and equipment under operating leases that expire through 2019. The Company is obligated to license programming under agreements that expire through 2012.

Future Minimum Payments, Year ending December 31,	Leases	Programming	Other	Total
		In thousands		
2005	$ 80,088	$201,857	$ 66,170	$ 348,115
2006	67,689	64,857	52,908	185,454
2007	62,298	55,155	54,550	172,003
2008	57,336	55,893	46,570	159,799
2009	31,596	57,010	16,907	105,513
Thereafter	178,748	100,898	4,080	283,726
Total	$477,755	$535,670	$241,185	$1,254,610

Expenses recorded in connection with operating leases, including rent expense, were $127.8 million, $128.7 million and $131.7 million for the years ended December 31, 2004, 2003 and 2002.

In connection with the long-term distribution agreements for certain of its European cable networks, the Company is committed to pay a satellite system operator 25% to 49% of the increase in value of these networks, if any, at the termination of the contract on December 31, 2006. The value of the networks at the termination date, and the Company's liability thereon, are materially impacted by the terms of future renewed or extended distribution agreements with the satellite system operator. The Commitment was designed as an incentive to enter into a renewed or extended agreement. However, the Company is currently unable to predict the terms and conditions of any renewal or extension of the distribution agreements. The Company has recorded a liability associated with this arrangement based on the estimated value of the networks at the termination of the agreement if no renewal is in place and adjusts such liability each period for changes in value. However, if the current distribution agreement is renewed or extended before the expiration of the existing agreement, amounts to be paid in 2007 to this system operator could be significantly higher than amounts currently accrued. The Company will record the effect of a renewed or extended distribution agreement when such terms are in place.

The Company is solely responsible for providing financial, operational and administrative support to the JV Programs, JV Network, Animal Planet United States, Animal Planet Latin America, People & Arts Latin America, Animal Planet Asia, and Animal Planet Europe ventures and has committed to do so through at least fiscal 2005.

The Company is involved in litigation incidental to the conduct of its business. In addition, the Company is involved in negotiations with organizations holding the rights to music used in the Company's programming. The Company believes the reserves related to these music rights are adequate and does not expect the outcome of such litigation and negotiations to have a material adverse effect on the Company's results of operations, cash flows, or financial position.

14. Employee Savings Plans

The Company maintains two separate employee savings plans, a defined contribution savings plan for its employees and a Supplemental Deferred Compensation Plan (together, the "Savings Plans") for certain management employees.

The Company matches participant contributions at a rate of 75% up to a maximum of 6% of the participant's annual compensation. The Company contributions to the Savings Plans were $6.8 million, $5.5 million and $5.7 million during 2004, 2003 and 2002.

15. Long-term Compensation Programs

The Company recorded expense of $71.5 million, $76.5 million, and $94.6 million in connection with these plans during 2004, 2003, and 2002.

Long-term Incentive Plans

The Company maintains unit-based, long-term incentive plans for its employees who meet certain eligibility criteria. Units are awarded to eligible employees upon their one-year anniversary of hire and vest at a rate of 25% per year thereafter. Upon exercise, participants receive the increase in value of the units from the unit value at the date of issuance. The Company has authorized the issuance of up to 33.1 million units under these plans.

From the period April 1 to May 31, certain eligible participants have the option to exercise any portion of their vested units. All other employees may redeem some or all of their units during a window of time five years subsequent to the date of the award. The Company pays amounts for the exercise of units on September 30 of the year of exercise. However, the Company may defer, with interest, payment of up to 75% of any benefit for a period not longer than September 30 of the year subsequent to exercise.

Upon voluntary termination of employment the Company distributes 75% of vested and exercisable benefits to certain senior executives. These employees are required to comply with post-employment obligations to receive payment of withheld benefits upon the one-year anniversary of employment termination. All other participants receive their full vested benefit upon voluntary termination.

The 25% vested and exercisable employee benefits that would be withheld upon employee termination in the amount of $60.7 million, have been classified as long-term liability in the accompanying balance sheet. All other vested employee unit incentive compensation liabilities are classified as current liabilities in the accompanying balance sheet. Although classified as current liabilities, the Company's actual cash disbursements under the plans were $45.9 million, $27.9 million and $36.9 million during 2004, 2003 and 2002.

All awards must be redeemed and applicable benefits paid by the Company on the tenth anniversary of each award. During 2004, the Company paid $8.5 million in awards, which had reached their tenth anniversary date.

Unit appreciation is recorded as compensation expense over the vesting periods. Compensation expense was $68.8 million, $101.7 million and $61.7 million in 2004, 2003 and 2002. The accrued value of units based on the Company's vesting schedule was $322.4 million and $299.5 million at December 31, 2004 and 2003.

The unaccrued value of awarded units was $15.4 million and $4.5 million at December 31, 2004 and 2003.

During 2004, 2003 and 2002, the Company granted 8.7 million, 4.1 million and 2.3 million units with weighted average exercise prices of $34.22, $29.02, and $25.74. Units redeemed or cancelled during 2004, 2003, and 2002 totaled 2.3 million, 2.1 million, and 3.5 million with weighted average exercise prices of $13.49, $14.18, and $13.66. For the years ended December 31, 2004, 2003, and 2002, units outstanding totaled 25.6 million, 19.1 million, and 17.2 million with weighted average exercise prices of $24.10, $18.18, and $15.12, and units exercisable totaled 17.5 million, 16.5 million, and 13.9 million with weighted average exercise prices of $19.76, $16.65, and $13.18. At the beginning of fiscal year 2002, outstanding units totaled 18.4 million with a weighted average exercise price of $13.52.

As of December 31, 2004, outstanding units had several ranges of exercise prices. The Company has 1.6 million units outstanding and exercisable at exercise prices ranging from $3.33 to $8.14 with a weighted average contractual life remaining of 1 year and a weighted average exercise price of $6.47. The Company has 9.5 million units outstanding and exercisable at exercise prices ranging from $10.96 to $22.18 with a weighted average contractual life remaining of 4.2 years and a weighted average exercise price of $15.30. The Company has 14.5 million units outstanding at exercise prices ranging from $25.02 to $37.35 with a weighted average contractual life remaining of 8.5 years and weighted average exercise price of $31.95. Of these, 6.4 million units, with a weighted average exercise price of $29.78, are exercisable.

The value of units at the end of the year was $37.35, $34.06, and $28.60 for 2004, 2003, and 2002. The value of the units is determined based on changes in the Company's value as estimated by an external investment banking firm. The average assumptions used in the valuation model include adjusted projected operating cash flows segregated by business group. The valuation also includes a business group specific discount rate and terminal value based on business risk.

Unit Appreciation and Incentive Agreement

As part of his long-term incentive plan with the Company, the Company's founder, John Hendricks, had a 10-year incentive agreement with the Company that granted him a cash award equal to 1.6% of the difference between the Company's value at December 31, 1993 and December 31, 2003 for his services as Chairman and Chief Executive Officer during the period. This cash award was paid out to Mr. Hendricks in two installments, one in December 2003 and one in February 2004. The final determination of value was based on an appraisal from an investment banking firm using a consistent valuation methodology both at the beginning and the end of the 10-year term. The portion of the cash award that was paid out in February 2004 has been included as a current liability at December 31, 2003. The estimated change in value of this incentive has been recorded as a component of compensation expense during the term of the agreement.

Discovery Communications, Inc.

Notes to Consolidated Financial Statements (Continued)

16. Income Taxes

Income Tax Expense (Benefit), Year ended December 31,	2004	2003	2002
		In thousands	
Current			
Federal	$ (231)	$ 2,813	$ —
State	3,952	6,722	6,156
Foreign	32,556	22,970	21,588
Total current income tax provision	36,277	32,505	27,744
Deferred			
Federal	95,761	33,963	(25,189)
State	7,723	5,175	(12,134)
Total deferred income tax expense (benefit)	103,484	39,138	(37,323)
Change in valuation allowance	2,038	3,142	(478)
Total income tax expense (benefit)	$141,799	$74,785	$(10,057)

	2004		2003	
Deferred Income Tax Assets and Liabilities December 31,	Current	Non-current	Current	Non-current
		In thousands		
Assets				
Loss carryforwards	$ 1,148	$ 20,090	$ 21,077	$ 18,460
Compensation	102,595	22,745	169,003	24,216
Accrued expenses	26,474	—	30,857	—
Reserves and allowances	8,720	10,132	9,568	10,214
Tax credits	4,330	—	3,118	—
Derivative financial instruments	—	16,979	—	34,186
Investments	—	69,729	—	84,306
Intangibles	—	31,627	—	23,756
Other	3,066	8,342	441	2,480
	146,333	179,644	234,064	197,618
Valuation allowance	—	(19,554)	—	(17,516)
Total deferred income tax assets	146,333	160,090	234,064	180,102
Liabilities				
Accelerated depreciation	—	(20,908)	—	(18,263)
Intangibles	—	—	—	(788)
Foreign currency translation	—	(13,687)	—	(7,193)
Unrealized gains on investments	—	(720)	—	(2,343)
Other	(1,727)	(10,102)	(1,371)	(4,747)
Total deferred income tax liabilities	(1,727)	(45,417)	(1,371)	(33,334)
Deferred income tax assets, net	$144,606	$114,673	$232,693	$146,768

Reconciliation of Effective Tax Rate, Year ended December 31,	2004	2003	2002
Federal statutory rate	35.0%	35.0%	35.0%
Increase (decrease) in tax rate arising from:			
State income taxes, net of Federal benefit	2.4	7.9	6.7
Foreign withholding taxes, net of Federal benefit	6.4	12.2	(24.1)
Other	2.0	(0.9)	(0.3)
Effective income tax rate	45.8%	54.2%	17.3%

The Company has Federal operating loss carryforwards of $3.3 million expiring in 2021 and state operating loss carryforwards of $526.9 million in various state jurisdictions available to offset future taxable income that expire in various amounts through 2024. The Company also has $4.3 million of alternative minimum tax credits that do not have an expiration date.

Deferred tax assets are reduced by a valuation allowance relating to the state tax benefits attributable to net operating losses in certain jurisdictions where realizability is not more likely than not.

Deferred taxes of $3.8 million have been provided for the excess book basis in the shares of certain foreign subsidiaries, because these are not permanent in nature as defined by Accounting Principles Board Opinion 23, *Accounting for Income Taxes—Special Areas*.

17. Financial Instruments

Derivative Financial Instruments

The Company uses derivative financial instruments to modify its exposure to market risks from changes in interest rates and foreign exchange rates. The Company does not hold or enter into financial instruments for speculative trading purposes.

The Company's interest expense is exposed to movements in short-term interest rates. Derivative instruments, including both fixed to variable and variable to fixed interest rate instruments, are used to modify this exposure. These instrument contracts include a combination of swaps, caps, collars, and other structured instruments to modify interest rate exposure. At December 31, 2004, the variable to fixed interest rate instruments have a notional principal amount of $800 million and have a weighted average interest rate of 5.93%. At December 31, 2004, the fixed to variable interest rate agreements have a notional principal amount of $240 million and have a weighted average interest rate of 6.46%. At December 31, 2004, an unexercised interest rate swap put right held by a bank had a notional amount of $25 million and a written rate of 5.4%. As a result of unrealized mark to market adjustments, the Company recognized $44.1 million, $21.6 million and $(13.4) million in gains and losses on these instruments during 2004, 2003 and 2002.

The foreign exchange instruments used are spot, forward, and option contracts. Additionally, the Company enters into non-designated forward contracts to hedge non-dollar denominated cash flows and foreign currency balances. At December 31, 2004, the notional amount of foreign exchange derivative contracts was $92.8 million. As a result of unrealized mark to market adjustments, the Company recognized $(0.4) million, $(0.1) million and $1.8 million in losses and gains on these instruments during 2004, 2003 and 2002.

The Company's derivative financial instruments are recorded at fair value as a component of long-term liabilities and other current liabilities in the consolidated balance sheets.

Fair Value of Financial Instruments

The fair values of cash and cash equivalents, receivables, and accounts payable approximate their carrying values. Investments are carried at fair value and fluctuations in fair value are recorded through other comprehensive income. Losses on investments that are other than temporary declines in value are recorded in the statement of operations.

The carrying amount of the Company's borrowings was $2,478 million and the fair value was $2,586 million at December 31, 2004. The carrying amount of the Company's borrowings was $2,324 million and the fair value was $2,440 million at December 31, 2003.

The carrying amount of all derivative instruments represents their fair value. The net fair value of the Company's short and long-term derivative instruments is $(44.8) million at December 31, 2004; 8.9%, 6.5% and 84.6% of these derivative instrument contracts will expire in 2005, 2006, and thereafter. The fair value of the Company's derivative instruments totaled $(90.3) million at December 31, 2003.

The fair value of derivative contracts was estimated by obtaining interest rate and volatility market data from brokers. As of December 31, 2004, an estimated 100 basis point parallel shift in the interest rate yield curve would change the fair value of the Company's portfolio by approximately $11.4 million.

Credit Concentrations

The Company continually monitors its positions with, and the credit quality of, the financial institutions that are counterparties to its financial instruments and does not anticipate nonperformance by the counterparties. In addition, the Company limits the amount of investment credit exposure with any one institution.

The Company's trade receivables and investments do not represent a significant concentration of credit risk at December 31, 2004 due to the wide variety of customers and markets in which the Company operates and their dispersion across many geographic areas.

18. Related Party Transactions

The Company identifies related parties as investors and their consolidated businesses, equity investment companies, and executive management. The most significant transactions with related parties result from companies that distribute networks, produce programming, or provide media uplink services. Gross revenue earned from related parties was $71.8 million, $209.2 million and $205.1 million in 2004, 2003 and 2002. Accounts receivable from these entities were $10.9 million and $33.3 million at December 31, 2004 and 2003. Purchases from related parties totaled $133.2 million, $164.7 million, and $144.7 million in 2004, 2003, 2002; of these $91.0 million, $101.1 million and $99.9 million relate to capitalized assets, principally programming. Amounts payable to these parties totaled $4.3 million and $52.6 million at December 31, 2004 and 2003.

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2006

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 000-51205

DISCOVERY HOLDING COMPANY

(Exact name of Registrant as specified in its charter)

State of Delaware	**20-2471174**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
12300 Liberty Boulevard Englewood, Colorado	**80112**
(Address of principal executive offices)	*(Zip Code)*

Registrant's telephone number, including area code:
(720) 875-4000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of exchange on which registered
Series A Common Stock, par value $.01 per share	Nasdaq
Series B Common Stock, par value $.01 per share	Nasdaq

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. Yes ☐ No ☑

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934. Yes ☐ No ☑

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 and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☑

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Act).

Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐

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

The aggregate market value of the voting stock held by nonaffiliates of Discovery Holding Company computed by reference to the last sales price of such stock, as of the closing of trading on June 30, 2006, was approximately $3.9 billion.

The number of shares outstanding of Discovery Holding Company's common stock as of January 31, 2007 was:

Series A Common Stock – 268,197,601; and
Series B Common Stock – 12,025,078 shares.

Documents Incorporated by Reference
The Registrant's definitive proxy statement for its 2007 Annual Meeting of Stockholders is hereby incorporated by reference into Part III of this Annual Report on Form 10-K

DISCOVERY HOLDING COMPANY
2006 ANNUAL REPORT ON FORM 10-K

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PART I.

Item 1. *Business.*

(a) General Development of Business

Discovery Holding Company was incorporated in the state of Delaware on March 9, 2005 as a wholly-owned subsidiary of Liberty Media Corporation, which we refer to as Liberty. On July 21, 2005, Liberty completed the spin off of Discovery Holding Company to Liberty's shareholders. In the spin off, each holder of Liberty common stock received 0.10 of a share of our Series A common stock for each share of Liberty Series A common stock held and 0.10 of a share of our Series B common stock for each share of Liberty Series B common stock held. Approximately 268.1 million shares of our Series A common stock and 12.1 million shares of our Series B common stock were issued in the spin off, which is intended to qualify as a tax-free transaction.

We are a holding company. Through our wholly owned subsidiary, Ascent Media Group, LLC ("Ascent Media"), and our 50% owned equity affiliate Discovery Communications, Inc. ("Discovery" or "DCI"), we are engaged primarily in (1) the production, acquisition and distribution of entertainment, educational and information programming and software, (2) the retail sale and licensing of branded and other specialty products and (3) the provision of creative and network services to the media and entertainment industries. Our subsidiaries and affiliates operate in the United States, Europe, Latin America, Asia, Africa and Australia.

The assets and operations of Ascent Media are composed primarily of the assets and operations of 13 companies acquired by Liberty from 2000 through 2004, including The Todd-AO Corporation, Four Media Company, certain assets of SounDelux Entertainment Group, Video Services Corporation, Group W Network Services, London Playout Centre and the systems integration business of Sony Electronics. The combination and integration of these and other acquired entities allow Ascent Media to offer integrated outsourcing solutions for the technical and creative requirements of its clients, from content creation and other post-production services to media management and transmission of the final product to broadcast television stations, cable system head-ends and other destinations and distribution points.

Discovery is a leading global media and entertainment company. Discovery has grown from the 1985 launch in the United States of its core property, Discovery Channel, to current global operations in over 170 countries across six continents, with over 1.5 billion total cumulative subscription units. Discovery operates its businesses in three groups: Discovery networks U.S., Discovery networks international, and Discovery commerce, education and other.

On January 27, 2006, we acquired AccentHealth, LLC ("AccentHealth") for cash consideration of $45 million, plus working capital adjustments of $1.8 million. AccentHealth operates an advertising-supported captive audience television network in doctor office waiting rooms nationwide. For financial reporting purposes, the results of operations of AccentHealth have been included in our consolidated results as part of Ascent Media's network services group.

* * * *

Certain statements in this Annual Report on Form 10-K constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding our business, marketing and operating strategies, integration of acquired businesses, new service offerings and anticipated sources and uses of capital. In particular, statements under Item 1. "Business," Item 1A. "Risk Factors", Item 2. "Properties," Item 3. "Legal Proceedings," Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 7A. "Quantitative and Qualitative Disclosures About Market Risk" contain forward-looking statements. Where, in any forward-looking statement, we express an expectation or belief as to future results or events, such expectation or belief is expressed in good faith and believed to have a reasonable basis, but there can be no assurance that the expectation or belief will result or be achieved or accomplished. The following include some but not all of the factors that could cause actual results or events to differ materially from those anticipated:

- general economic and business conditions and industry trends including the timing of, and spending on, feature film and television production;
- spending on domestic and foreign television advertising and spending on domestic and foreign first-run and existing content libraries;
- the regulatory and competitive environment of the industries in which we, and the entities in which we have interests, operate;
- continued consolidation of the broadband distribution and movie studio industries;

- uncertainties inherent in the development and integration of new business lines, acquired operations and business strategies;
- changes in the distribution and viewing of television programming, including the expanded deployment of personal video recorders and other technology, and their impact on television advertising revenue;
- rapid technological changes;
- uncertainties associated with product and service development and market acceptance, including the development and provision of programming for new television and telecommunications technologies;
- future financial performance, including availability, terms and deployment of capital;
- fluctuations in foreign currency exchange rates and political unrest in international markets;
- the ability of suppliers and vendors to deliver products, equipment, software and services;
- the outcome of any pending or threatened litigation;
- availability of qualified personnel;
- the possibility of an industry-wide strike or other job action affecting a major entertainment industry union;
- changes in, or failure or inability to comply with, government regulations, including, without limitation, regulations of the Federal Communications Commission, and adverse outcomes from regulatory proceedings;
- changes in the nature of key strategic relationships with partners and joint venturers;
- competitor responses to our products and services, and the products and services of the entities in which we have interests; and
- threatened terrorists attacks and ongoing military action in the Middle East and other parts of the world.

These forward-looking statements and such risks, uncertainties and other factors speak only as of the date of this Annual Report, and we expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement contained herein, to reflect any change in our expectations with regard thereto, or any other change in events, conditions or circumstances on which any such statement is based. When considering such forward-looking statements, you should keep in mind the factors described in Item 1A, "Risk Factors" and other cautionary statements contained in this Annual Report. Such risk factors and statements describe circumstances which could cause actual results to differ materially from those contained in any forward-looking statement.

(b) Financial Information About Operating Segments

We identify our reportable segments based on financial information reviewed by our chief operating decision maker, or his designee. We report financial information for our consolidated business segments that represent more than 10% of our consolidated revenue or earnings before taxes and equity affiliates whose share of earnings represent more than 10% of our earnings before taxes.

Based on the foregoing criteria, our three reportable segments are our Creative Services group and Network Services group, which are operating segments of Ascent Media, and Discovery, which is an equity affiliate. A fourth reportable segment, media management services group, existed for a portion of 2006, but was realigned within the Creative Services group and Network Services group during the third and fourth quarters of 2006. Financial information related to our operating segments can be found in note 17 to our consolidated financial statements found in Part II of this report.

(c) Narrative Description of Business

ASCENT MEDIA

Ascent Media provides a wide variety of creative and network services to the media and entertainment industries. Ascent Media's clients include major motion picture studios, independent producers, broadcast networks, programming networks, advertising agencies and other companies that produce, own and/or distribute entertainment, news, sports, corporate, educational, industrial and advertising content.

Following an operational realignment in 2006, Ascent Media's operations are organized into two main categories: Creative services and Network services.

Creative Services

Ascent Media's creative services group provides various technical and creative services necessary to complete principal photography into final products, such as feature films, movie trailers, documentaries and independent films, episodic television, TV movies and mini-series, television commercials, music videos, interactive games and new digital media, promotional and identity campaigns and corporate communications. These services are referred to generally in the entertainment industry as "post-production" services. In addition, the creative services group provides a full complement of facilities and services necessary to optimize, archive, manage and repurpose completed media assets for global distribution via freight, satellite, fiber and the Internet.

Ascent Media markets its creative services under various brand names that are well known in the entertainment industry, including *Blink Digital, Cinetech, Company 3, Design Music Group (DMG), Digital Media Data Center (DMDC), Digital Symphony, Encore Hollywood, FilmCore, Level 3 Post, Method, Modern Music, One Post, POP Sound, R!OT, Rushes, Soho Images, Soundelux, Sound One, St. Anne's Post, Todd-AO* and *VisionText.*

The creative services client base comprises major motion picture studios and their international divisions, independent television production companies, broadcast networks, advertising agencies, creative editorial companies, corporate media producers, independent owners of television and film libraries and emerging new media distribution channels. The principal facilities of the creative services group are in Los Angeles, New York, Northvale (New Jersey), Atlanta, San Francisco, Mexico City and London.

Key services provided by Ascent Media's creative services group include the following:

Dailies. Clients require daily screening of their previous day's recorded work in order to evaluate technical and aesthetic qualities of the production and to begin the creative editorial process. Ascent Media provides the film development, digital transfer from film to video and video processing necessary for clients to view principal photography on a daily basis, also known as "dailies." For clients that record their productions on film, Ascent Media processes and prints film negatives for film projection. The company also delivers dailies that are transferred from film to digital media using telecine equipment. The transfer process is technically challenging and is used to integrate various forms of audio and encode the footage with feet and frame numbers from the original film. Dailies delivered as a digital file can be processed in high definition or standard definition video and can be screened in a nonlinear manner on a variety of playback equipment.

Telecine. Telecine is the process of transferring film into video (in either analog or digital medium). During this process, a variety of parameters can be manipulated, such as color and contrast. Because the color spectrum of film and digital media are different, Ascent Media has creative talent who utilize creative colorizing techniques, equipment and processes to enable its clients to achieve a desired visual look and feel for television commercials and music videos, as well as feature films and television shows. Ascent Media also provides live telecine services via satellite, using a secure closed network able to accurately transmit subtle color changes to connect its telecine artists with client offices or other affiliated post-production facilities.

Digital intermediates. Ascent Media's digital intermediates service provides customers with the ability to convert film to a high resolution digital master file for color correction, creative editorial and electronic assembly of masters in other formats. If needed, the digital file can then be converted back to film.

Creative editorial. After principal photography has been completed, Ascent Media's editors assemble the various elements into a cohesive story consistent with the messaging, branding and creative direction by Ascent Media's advertising agency clients. Ascent Media provides the tools and talent required to support its clients through all stages of the editing process, beginning with the low-resolution digital images and off-line editing workstations used to create an edit decision list, through the high-resolution editorial process used to complete a final product suitable for broadcast. In addition, Ascent Media is able to offer expanded communications infrastructure to provide digital images directly from the film-to-tape transfer process to a workstation through dedicated data lines.

Visual effects. Visual effects are used to enhance the viewing audience's experience by supplementing images obtained in principal photography with computer-generated imagery and graphical elements. Visual effects are typically used to create images that cannot be created by any other cost-effective means. Ascent Media also provides services on an array of graphics and animation workstations using a variety of software to accomplish unique effects, including three-dimensional animation.

Assembly, formatting and duplication. Ascent Media implements clients' creative decisions, including decisions regarding the integration of sound and visual effects, to assemble source material into its final form. In addition, Ascent Media uses sophisticated computer graphics equipment to generate titles and character imagery and to format a given program to meet specific network requirements, including time compression and commercial breaks. Finally, Ascent

Media creates multiple master videotapes for delivery to the network for broadcast, archival and other purposes designated by the customer.

Distribution. Once a television commercial has been completed, Ascent Media provides broadcast and support services, including complete video and audio duplication, distribution, and storage and asset management, for advertising agencies, corporate advertisers and entertainment companies. Ascent Media uses domestic and international satellite, fiber and Integrated Services Digital Network, or ISDN, Internet access, and conventional air freight for the delivery of television and radio spots. Ascent Media currently houses over 85,000 commercial production elements in its vaults for future use by its clients. Ascent Media's commercial television distribution facilities in Los Angeles and San Francisco, California enable Ascent Media to service any regional or national client.

Sound supervision, sound design and sound editorial. Ascent Media provides creative talent, facilities and support services to create sound for feature films, television content, commercials and trailers, interactive multimedia games and special live venues. Sound supervisors ensure that all aspects of sound, dialogue, sound effects and music are properly coordinated. Ascent Media's sound services include, but are not limited to, sound editing, sound design, sound effect libraries, ADR (automated dialogue replacement, a process for recording dialogue in synchronization with previously recorded picture) and Foley (non-digital sound effects).

Music services. Music services are an essential component of post-production sound. Ascent Media has the technology and talent to handle all types of music-related services, including original music composition, music supervision, music editing, scoring/recording, temporary sound tracks, composer support and preparing music for soundtrack album release.

Re-recording / Mixing. Once sound editors, sound designers, composers, music editors, ADR and Foley crews, and many others, have prepared the elements that will make up the finished product, the final component of the creative sound post production process is the mix (or re-recording). Mixing a film involves the process of combining multiple elements, such as tracks of sound effects, dialogue and music, to complete the final product. Ascent Media maintains a significant number of mixing stages, purpose-built and provisioned with advanced recording equipment, capable of handling any type of project, from major motion pictures to smaller independent films.

Sound effects and music libraries. Through its Soundelux brand, Ascent Media maintains an extensive sound effects library with over 300,000 unique sounds, which editors and clients access through the company's intranet and remotely via the Internet. The company also owns several production music libraries through its Hollywood Edge brand. Ascent Media's clients use the sound effects and music libraries in feature films, television shows, commercials, interactive and multimedia games. Ascent Media actively continues to add new, original recordings to its library.

Negative developing and cutting. Ascent Media's film laboratories provide negative developing for television shows such as one-hour dramas and movie-length programming, including negative developing of "dailies" (the original negative shot during each production day), as well as the often complex and technically demanding commercial work and motion picture trailers. Ascent Media also provides negative cutting services for the distribution of commercials on film.

Restoration, preservation and asset protection of existing and damaged content. Ascent Media provides film restoration, preservation and asset protection services. Ascent Media's technicians use photochemical and digital processes to clean, repair and rebuild a film's elements in order to return the content to its original and sometimes to an improved image quality. Ascent Media also protects film element content from future degradation by transferring the film's image to newer archival film stocks. Ascent Media also provides asset protection services for its clients' color library titles, which is a preservation process whereby B/W, silver image, polyester, positive and color separation masters are created, sufficiently protecting the images of new and older films.

Transferring film to analog video or digital media. A considerable amount of film content is ultimately distributed to the home video, broadcast, cable or pay-per-view television markets. This requires film images to be transferred to an analog video or digital file format. Each frame must be color corrected and adapted to the size and aspect ratio of a television screen in order to ensure the highest level of conformity to the original film version. Because certain film formats require transfers with special characteristics, it is not unusual for a motion picture to be mastered in many different versions. Technological developments, such as the domestic introduction of television sets with a 16 X 9 aspect ratio and the implementation of advanced and high definition digital television systems for terrestrial and satellite broadcasting, are expected to contribute to the growth of Ascent Media's film transfer business. Ascent Media also digitally removes dirt and scratches from a damaged film master that is transferred to a digital file format.

Professional duplication and standards conversion. Ascent Media provides professional duplication, which is the process of creating broadcast quality and resolution independent sub-masters for distribution to professional end users. Ascent Media uses master elements to make sub-masters in numerous domestic and international broadcast standards as well as up to 22 different tape formats. Ascent Media also provides standards conversion, which is the process of changing the frame rate of a video signal from one video standard, such as the United States standard (NTSC), to another, such as a European standard (PAL or SECAM). Content is regularly copied, converted and checked by quality control for use in intermediate processes, such as editing, on-air backup and screening and for final delivery to cable and pay-per-view programmers, broadcast networks, television stations, airlines, home video duplicators and foreign distributors. Ascent Media's duplication and standards conversion facilities are technically advanced with unique characteristics that significantly increase equipment capacity while reducing error rates and labor cost.

DVD compression and authoring and menu design. Ascent Media provides all stages of DVD production, including creative menu design, special feature production, project management, encoding, 5.1 surround editing and quality control. Ascent Media also prepares and optimizes content for evolving formats of digital distribution, such as video-on-demand and interactive television.

Storage of original elements and working masters. Ascent Media's archives are designed to store working master videotapes and film elements in a highly controlled environment protected from temperature and humidity variation, seismic disturbance, fire, theft and other external events. In addition to the physical security of the archive, content owners require frequent and regular access to their libraries. Physical elements stored in Ascent Media's archive are uniquely bar-coded and maintained in a library management database offering rapid access to elements, concise reporting of element status and element tracking throughout its travel through Ascent Media's operations.

Syndicated television distribution. Ascent Media's syndication services provide AMOL-encoding and closed-captioned sub-mastering, commercial integration, library distribution, station list management and v-chip encoding. Ascent Media distributes syndicated television content by freight, satellite, fiber or the Internet, in formats ranging from low-resolution proxy streams to full-bandwidth high-definition television and streaming media.

Network Services

Ascent Media's network services group provides origination, transmission/distribution and technical services to broadcast, cable and satellite programming networks, local television channels, broadcast syndicators, satellite broadcasters, government, other broadband telecommunications companies and corporations that operate private networks. Ascent Media's network services group operates from facilities located in California, Connecticut, Florida, Minnesota, New York, New Jersey, Virginia and the United Kingdom and Singapore.

Key services provided by Ascent Media's network services group include the following:

Network origination and master control. The network services group provides videotape and file-based playback and origination to cable, satellite and pay-per-view programming networks. Ascent Media accepts daily program schedules, programs, promotional materials and advertising and transmits 24 hours of seamless daily programming to cable operators, direct broadcast satellite systems and other destinations, over fiber and satellite, using automated systems for broadcast playback. Associated services include cut-to-clock and compliance editing, tape library management, ingest & quality control, format conversion, and tape duplication. For programming designed for export to other markets, Ascent Media provides subtitling and voice dubbing. Ascent Media also operates industry-standard encryption and/or compression systems as needed for customer satellite transmission. Currently, over two hundred programming feeds — running 24 hours a day, seven days a week — are supported by Ascent Media's facilities in the United States, London and Singapore. Ascent Media operates television production studios with live-to-satellite interview services, cameras, production and audio control rooms, videotape playback and record, multi-language prompters, computerized lighting, dressing and makeup rooms and field and teleconferencing services. Ascent Media offers complete post-production services for on-air promotions, including graphics, editing, voice-over record, sound effects editing, sound mixing and music composition.

Transport and connectivity. Ascent Media operates satellite earth station facilities in Singapore, California, New York, New Jersey, Minnesota, Connecticut and Florida. Ascent Media's facilities are staffed 24 hours a day and may be used for uplink, downlink and turnaround services. Ascent Media accesses various "satellite neighborhoods," including basic and premium cable, broadcast syndication, direct-to-home and DBS markets. Ascent Media resells transponder capacity for occasional and full-time use and bundles its transponder capacity with other broadcast and syndication services to provide a complete broadcast package at a fixed price. Ascent Media's "teleports" are high-bandwidth communications gateways with video switches and facilities for satellite, optical fiber and microwave transmission. Ascent Media's facilities offer satellite antennae capable of transmitting and receiving feeds in both C-Band and Ku-Band frequencies. Ascent Media also provides transportable services, including point-to-point microwave transmission, transportable up-link and downlink transmission and broadcast quality teleconference services. Ascent Media operates