

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Discovery Holding Company's management is responsible for establishing and maintaining adequate internal control over the Company's financial reporting. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the consolidated financial statements and related disclosures in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of the consolidated financial statements and related disclosures in accordance with generally accepted accounting principles; (3) provide reasonable assurance that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (4) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the consolidated financial statements and related disclosures.

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

The Company assessed the design and effectiveness of internal control over financial reporting as of December 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control-Integrated Framework*.

Based upon our assessment using the criteria contained in COSO, management has concluded that, as of December 31, 2006, Discovery Holding Company's internal control over financial reporting is effectively designed and operating effectively.

Discovery Holding Company's independent registered public accountants audited the consolidated financial statements and related disclosures in the Annual Report on Form 10-K and have issued an audit report on management's assessment of the Company's internal control over financial reporting. This report appears on page II-16 of this Annual Report on Form 10-K.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Discovery Holding Company:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting appearing on page II-15, that Discovery Holding Company maintained effective internal control over financial reporting as of December 31, 2006, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Management of Discovery Holding Company is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the internal control over financial reporting of Discovery Holding Company based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements and related disclosure in accordance with generally accepted accounting principles; (3) provide reasonable assurance that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (4) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Discovery Holding Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control — Integrated Framework* issued by COSO. Also, in our opinion, Discovery Holding Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the criteria established in *Internal Control — Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Discovery Holding Company and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations and comprehensive earnings (loss), cash flows and stockholders' equity for each of the years in the three-year period ended December 31, 2006, and our report dated February 28, 2007 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP
Denver, Colorado
February 28, 2007

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Discovery Holding Company:

We have audited the accompanying consolidated balance sheets of Discovery Holding Company and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations and comprehensive earnings (loss), cash flows and stockholders' equity for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Discovery Communications, Inc., (a 50 percent owned investee company). The Company's investment in Discovery Communications, Inc. at December 31, 2006 and 2005, was \$3,129,157,000 and \$3,018,622,000, respectively, and its equity in earnings of Discovery Communications, Inc. was \$103,588,000, \$79,810,000 and \$84,011,000 for the years ended December 31, 2006, 2005 and 2004, respectively. The financial statements of Discovery Communications, Inc. were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Discovery Communications, Inc., is based solely on the report of the other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Discovery Holding Company and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in note 3 to the accompanying consolidated financial statements, effective January 1, 2006, Discovery Holding Company adopted SFAS No. 123R, *Share Based Payment*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Discovery Holding Company's internal control over financial reporting as of December 31, 2006, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 28, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

Denver, Colorado
February 28, 2007

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES
Consolidated Balance Sheets

	December 31,	
	2006	2005
	amounts in thousands	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 154,775	250,352
Trade receivables, net	147,436	134,615
Prepaid expenses	11,522	10,986
Other current assets	3,629	4,433
Total current assets	317,362	400,386
Investments in marketable securities	51,837	—
Investment in Discovery Communications, Inc. ("Discovery" or "DCI") (note 5)	3,129,157	3,018,622
Property and equipment, net (note 6)	280,775	256,245
Goodwill (note 7)	2,074,789	2,133,518
Other assets, net	17,062	10,465
Total assets	\$ 5,870,982	5,819,236
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 43,656	26,854
Accrued payroll and related liabilities	32,292	21,651
Other accrued liabilities	29,924	27,777
Deferred revenue	16,015	17,491
Total current liabilities	121,887	93,773
Deferred income tax liabilities (note 10)	1,174,594	1,127,677
Other liabilities	25,237	22,361
Total liabilities	1,321,718	1,243,811
Commitments and contingencies (notes 14 and 15)		
Stockholders' equity (note 11):		
Preferred stock, \$.01 par value. Authorized 50,000,000 shares; no shares issued	—	—
Series A common stock, \$.01 par value. Authorized 600,000,000 shares; issued and outstanding 268,194,966 shares at December 31, 2006 and 268,097,442 shares at December 31, 2005	2,682	2,681
Series B common stock, \$.01 par value. Authorized 50,000,000 shares; issued and outstanding 12,025,088 shares at December 31, 2006 and 12,106,093 shares at December 31, 2005	120	121
Series C common stock, \$.01 par value. Authorized 600,000,000 shares; no shares issued	—	—
Additional paid-in capital	5,714,379	5,712,304
Accumulated deficit	(1,183,831)	(1,137,821)
Accumulated other comprehensive earnings (loss)	15,914	(1,860)
Total stockholders' equity	4,549,264	4,575,425
Total liabilities and stockholders' equity	\$ 5,870,982	5,819,236

See accompanying notes to consolidated financial statements.

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES
Consolidated Statements of Operations and Comprehensive Earnings (Loss)

	Years Ended December 31,		
	2006	2005	2004
	amounts in thousands, except per share amounts		
Net revenue	\$ 688,087	694,509	631,215
Operating expenses:			
Cost of services	454,482	445,839	380,290
Selling, general, and administrative, including stock-based compensation	177,366	174,428	155,905
Depreciation and amortization	67,929	76,377	77,605
Restructuring and other charges (note 8)	12,092	4,112	—
Loss (gain) on sale of operating assets	(2,047)	(4,845)	429
Impairment of goodwill (note 7)	93,402	—	51
	803,224	695,911	614,280
Operating income (loss)	(115,137)	(1,402)	16,935
Other income:			
Share of earnings of Discovery (note 5)	103,588	79,810	84,011
Other, net	9,481	3,704	132
	113,069	83,514	84,143
Earnings (loss) before income taxes	(2,068)	82,112	101,078
Income tax expense (note 10)	(43,942)	(48,836)	(34,970)
Net earnings (loss)	\$ (46,010)	33,276	66,108
Other comprehensive earnings (loss), net of taxes (note 13):			
Unrealized holding gains (losses) arising during the period	(148)	651	(1,162)
Foreign currency translation adjustments	17,922	(14,821)	6,797
Other comprehensive earnings (loss)	17,774	(14,170)	5,635
Comprehensive earnings (loss)	\$ (28,236)	19,106	71,743
Basic and diluted earnings (loss) per common share (note 3)	\$ (0.16)	0.12	0.24

See accompanying notes to consolidated financial statements.

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Years Ended December 31,		
	2006	2005	2004
	amounts in thousands (see note 4)		
Cash flows from operating activities:			
Net earnings (loss)	\$ (46,010)	33,276	66,108
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:			
Depreciation and amortization	67,929	76,377	77,605
Stock-based compensation	1,817	4,383	2,775
Payments for stock-based compensation	—	(2,139)	—
Impairment of goodwill	93,402	—	51
Share of earnings of Discovery	(103,588)	(79,810)	(84,011)
Deferred income tax expense	42,115	50,363	31,692
Other non-cash charges (credits), net	(1,342)	(4,684)	706
Changes in assets and liabilities (net of acquisitions):			
Trade receivables	(9,718)	16,237	(36,405)
Prepaid expenses and other current assets	1,345	10,804	(6,631)
Payables and other liabilities	27,683	(19,516)	32,432
Net cash provided by operating activities	73,633	85,291	84,322
Cash flows from investing activities:			
Capital expenditures	(77,541)	(90,526)	(49,292)
Cash paid for acquisitions, net of cash acquired	(46,793)	—	(44,238)
Net sales (purchases) of marketable securities	(51,837)	12,800	(12,800)
Cash proceeds from dispositions	5,697	15,374	3,978
Other investing activities, net	992	(394)	73
Net cash used in investing activities	(169,482)	(62,746)	(102,279)
Cash flows from financing activities:			
Net cash transfers from Liberty	—	206,044	30,999
Net cash from option exercises	279	—	—
Payments of long-term debt and capital lease obligations	(7)	(12)	—
Other financing activities, net	—	134	—
Net cash provided by financing activities	272	206,166	30,999
Net increase (decrease) in cash and cash equivalents	(95,577)	228,711	13,042
Cash and cash equivalents at beginning of year	250,352	21,641	8,599
Cash and cash equivalents at end of year	\$ 154,775	250,352	21,641

See accompanying notes to consolidated financial statements.

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity
Years ended December 31, 2006, 2005 and 2004

	Preferred Stock	Common Stock			Additional Paid-in Capital	Parent's Investment	Accumulated Deficit	Accumulated Other Comprehensive Earnings (loss)	Total Stockholders' Equity
		Series A	Series B	Series C					
					amounts in thousands				
Balance at January 1, 2004	\$—	—	—	—	5,490,799	(1,237,205)	6,675	4,260,269	
Net earnings	—	—	—	—	—	66,108	—	56,108	
Other comprehensive earnings	—	—	—	—	—	—	5,635	5,635	
Stock compensation	—	—	—	—	2,268	—	—	2,268	
Reallocation of enterprise level goodwill from Liberty (note 5)	—	—	—	—	(18,000)	—	—	(18,000)	
Net cash transfers from Liberty	—	—	—	—	30,999	—	—	30,999	
Balance at December 31, 2004	—	—	—	—	5,506,066	(1,171,097)	12,310	4,347,279	
Net earnings	—	—	—	—	—	33,276	—	33,276	
Other comprehensive loss	—	—	—	—	—	—	(14,170)	(14,170)	
Stock compensation	—	—	—	—	640	2,222	—	2,862	
Net cash transfers from Liberty	—	—	—	—	206,044	—	—	206,044	
Change in capitalization in connection with Spin Off (note 2)	—	2,681	121	—	5,711,530	(5,714,332)	—	—	
Stock option exercises	—	—	—	—	134	—	—	134	
Balance at December 31, 2005	—	2,681	121	—	5,712,304	(1,137,821)	(1,860)	4,575,425	
Net loss	—	—	—	—	—	(46,010)	—	(46,010)	
Other comprehensive earnings	—	—	—	—	—	—	17,774	17,774	
Stock compensation	—	—	—	—	1,796	—	—	1,796	
Conversion of Series B to Series A	—	1	(1)	—	—	—	—	—	
Stock option exercises	—	—	—	—	279	—	—	279	
Balance at December 31, 2006	\$—	2,682	120	—	5,714,379	(1,183,831)	15,914	4,549,264	

See accompanying notes to consolidated financial statements.

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements December 31, 2006, 2005 and 2004

(1) Basis of Presentation

The accompanying consolidated financial statements of Discovery Holding Company ("DHC" or the "Company") represent a combination of the historical financial information of (1) Ascent Media Group, LLC ("Ascent Media"), a wholly-owned subsidiary of Liberty, and Liberty's 50% ownership interest in Discovery for periods prior to the July 21, 2005 consummation of the spin off transaction ("the Spin Off") described in note 2 and (2) DHC and its consolidated subsidiaries (including its 50% share of Discovery's earnings) for the period following such date. The Spin Off has been accounted for at historical cost due to the pro rata nature of the distribution. Accordingly, DHC's historical financial statements are presented in a manner similar to a pooling of interests.

Ascent Media is comprised of two operating segments. Ascent Media's creative services group provides services necessary to complete the creation of original content, including feature films, mini-series, television shows, television commercials, music videos, promotional and identity campaigns, and corporate communications programming. The group manipulates or enhances original visual images or audio captured in principal photography or creates new three dimensional images, animation sequences, or sound effects. 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. The networks services group provides the facilities and services necessary to assemble and distribute programming content for cable and broadcast networks via fiber, satellite, and the Internet to viewers in North America, Europe, and Asia. Additionally, the networks services group provides systems integration, design, consulting, engineering and project management services.

Substantially all of the assets of AccentHealth, LLC were acquired by a subsidiary of DHC in January 2006, and are included as part of the network services group for financial reporting purposes. AccentHealth operates an advertising-supported captive audience television network in doctor office waiting rooms nationwide.

Discovery is a global media and entertainment company that provides original and purchased cable and satellite television programming in the United States and over 170 other countries. Discovery also develops and sells branded commerce and educational product lines in the United States.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of revenue and expenses for each reporting period. The significant estimates made in preparation of the Company's consolidated financial statements primarily relate to valuation of goodwill, other intangible assets, long-lived assets, deferred tax assets, and the amount of the allowance for doubtful accounts. Actual results could differ from the estimates upon which the carrying values were based.

(2) Spin Off Transaction

On July 21, 2005 (the "Spin Off Date"), Liberty completed the spin off of the capital stock of DHC. The Spin Off was effected as a dividend by Liberty to holders of its Series A and Series B common stock of shares of DHC Series A and Series B common stock, respectively. Holders of Liberty common stock on July 15, 2005 received 0.10 of a share of DHC Series A common stock for each share of Liberty Series A common stock owned and 0.10 of a share of DHC Series B common stock for each share of Liberty Series B common stock owned. Approximately 268.1 million shares of DHC Series A common stock and 12.1 million shares of DHC Series B common stock were issued in the Spin Off. The Spin Off did not involve the payment of any consideration by the holders of Liberty common stock and is intended to qualify as a tax-free transaction.

In addition to Ascent Media and its investment in Discovery, Liberty transferred \$200 million in cash to a subsidiary of DHC prior to the Spin Off.

Following the Spin Off, the Company and Liberty operate independently, and neither has any stock ownership, beneficial or otherwise, in the other. In connection with the Spin Off, the Company and Liberty entered into certain agreements in order to govern certain of the ongoing relationships between the Company and Liberty after the Spin Off and to provide for an orderly transition. These agreements include a Reorganization Agreement, a Services Agreement and a Tax Sharing Agreement.

The Reorganization Agreement provides for, among other things, the principal corporate transactions required to effect the Spin Off and cross indemnities. Pursuant to the Services Agreement, Liberty provides the Company with office

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements — (Continued)

space and certain general and administrative services including legal, tax, accounting, treasury and investor relations support. The Company reimburses Liberty for direct, out-of-pocket expenses incurred by Liberty in providing these services and for the Company's allocable portion of costs associated with any shared services or personnel. Liberty and DHC have agreed that they will review cost allocations every six months and adjust such charges, if appropriate.

Under the Tax Sharing Agreement, Liberty is generally responsible for U.S. federal, state, local and foreign income taxes reported on a consolidated, combined or unitary return that includes the Company or one of its subsidiaries and Liberty or one of its subsidiaries. The Company is responsible for all other taxes that are attributable to the Company or one of its subsidiaries, whether accruing before, on or after the Spin Off. The Tax Sharing Agreement requires that the Company will not take, or fail to take, any action where such action, or failure to act, would be inconsistent with or prohibit the Spin Off from qualifying as a tax-free transaction. Moreover, the Company has indemnified Liberty for any loss resulting from (i) such action or failure to act or (ii) any agreement, understanding, arrangement or substantial negotiations entered into by DHC prior to the day after the first anniversary of the Spin Off, with respect to any transaction pursuant to which any of the other shareholders of Discovery would acquire shares of, or other interests in DHC's capital stock, in each case relating to the qualification of the Spin Off as a tax-free transaction. As of December 31, 2006, no such loss has been incurred.

(3) Summary of Significant Accounting Policies

Cash and Cash Equivalents

The Company considers investments with original purchased maturities of three months or less to be cash equivalents.

Trade Receivables

Trade receivables are shown net of an allowance based on historical collection trends and management's judgment regarding the collectibility of these accounts. These collection trends, as well as prevailing and anticipated economic conditions, are routinely monitored by management, and any adjustments required are reflected in current operations. The allowance for doubtful accounts as of December 31, 2006 and 2005 was \$9,045,000 and \$7,708,000, respectively.

A summary of activity in the allowance for doubtful accounts is as follows:

	<u>Balance Beginning of Year</u>	<u>Charged (Credited) to Expense</u>	<u>Write-Offs</u>	<u>Acquired and Other Activity</u>	<u>Balance End of Year</u>
	amounts in thousands				
2006.	<u>\$ 7,708</u>	<u>1,023</u>	<u>—</u>	<u>314</u>	<u>9,045</u>
2005.	<u>\$12,104</u>	<u>(619)</u>	<u>(2,443)</u>	<u>(1,334)</u>	<u>7,708</u>
2004.	<u>\$11,580</u>	<u>555</u>	<u>—</u>	<u>(31)</u>	<u>12,104</u>

Concentration of Credit Risk and Significant Customers

For the years ended December 31, 2006, 2005 and 2004, no single customer accounted for more than 10% of consolidated revenue.

Investment in Discovery

DHC accounts for its 50% ownership interest in Discovery using the equity method of accounting. Under this method, the investment, originally recorded at cost, is adjusted to recognize the Company's share of the net earnings or losses of Discovery as they occur, rather than as dividends or other distributions are received. The excess of the Company's carrying value over its proportionate share of Discovery's equity is accounted for as equity method goodwill, and accordingly, is not amortized, but periodically reviewed for impairment.

Changes in the Company's proportionate share of the underlying equity of Discovery which result from the issuance of additional equity securities by Discovery are recognized as increases or decreases in stockholders' equity. No such adjustments were recorded during the three years ended December 31, 2006.

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements — (Continued)

The Company periodically compares the carrying value of its investment in Discovery to its estimated fair value to determine if there are any other-than-temporary declines in value, which would require an adjustment in the statement of operations. The estimated fair value of the investment in Discovery exceeds its carrying value for all periods presented.

Property and Equipment

Property and equipment are carried at cost and depreciated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the shorter of their estimated useful lives or the term of the underlying lease. Estimated useful lives by class of asset are as follows:

Buildings	20 years
Leasehold improvements	15 years or lease term, if shorter
Furniture and fixtures	7 years
Computers	3 years
Machinery and equipment	5 to 7 years

Depreciation expense for property and equipment was \$66,435,000, \$74,805,000 and \$74,986,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

Goodwill

The Company accounts for its goodwill pursuant to the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets* ("SFAS No. 142"). In accordance with SFAS No. 142, goodwill is not amortized, but is tested for impairment annually and whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

SFAS No. 142 requires the Company to consider equity method affiliates as separate reporting units. As a result, \$1,771,000,000 of DHC's enterprise-level goodwill balance has been allocated to a separate reporting unit which includes only its investment in Discovery. This allocation is performed for goodwill impairment testing purposes only and does not change the reported carrying value of the investment. However, to the extent that all or a portion of an equity method investment which is part of a reporting unit containing allocated goodwill is disposed of in the future, the allocated portion of goodwill will be relieved and included in the calculation of the gain or loss on disposal.

Other Intangible Assets

In accordance with SFAS No. 142, amortizable other intangible assets are amortized on a straight-line basis over their estimated useful lives of four to five years, and are reviewed for impairment in accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets* ("SFAS No. 144").

Long-Lived Assets

In accordance with SFAS No. 144, management reviews the realizability of its long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In evaluating the value and future benefits of long-term assets, their carrying value is compared to management's best estimate of undiscounted future cash flows over the remaining economic life. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying value of the assets exceeds the estimated fair value of the assets.

Foreign Currency Translation

The functional currencies of the Company's foreign subsidiaries are their respective local currencies. Assets and liabilities of foreign operations are translated into U.S. dollars using exchange rates on the balance sheet date, and revenues and expenses are translated into U.S. dollars using average exchange rates for the period. The effects of the foreign currency translation adjustments are deferred and are included in stockholder equity as a component of accumulated other comprehensive earnings (loss).

Revenue Recognition

Revenue from post-production and certain distribution related services is recognized when services are provided. Revenue on other long-term contracts is recorded on the basis of the estimated percentage of completion of individual

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements — (Continued)

contracts. Percentage of completion is calculated based upon actual labor and equipment costs incurred compared to total forecasted costs for the contract. Estimated losses on long-term contracts are recognized in the period in which a loss becomes evident.

Prepayments received for services to be performed at a later date are reflected in the consolidated balance sheets as deferred revenue until such services are provided.

Income Taxes

The Company accounts for income taxes under Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* ("SFAS No. 109"). SFAS No. 109 is an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's consolidated financial statements or tax returns. In estimating future tax consequences, SFAS No. 109 generally considers all expected future events other than proposed changes in the tax law or rates.

Advertising Costs

Advertising costs generally are expensed as incurred. Advertising expense aggregated \$3,990,000, \$3,465,000 and \$3,303,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

Stock-Based Compensation

As a result of the Spin Off and related adjustments to Liberty's stock incentive awards, options ("Spin Off DHC Awards") to acquire an aggregate of approximately 2.0 million shares of DHC Series A common stock and 3.0 million shares of DHC Series B common stock were issued to employees of Liberty. In addition, employees of Ascent Media who held stock options or stock appreciation rights ("SARs") to acquire shares of Liberty common stock prior to the Spin Off continue to hold such options. Pursuant to the Reorganization Agreement, DHC is responsible for all stock options related to DHC common stock, and Liberty is responsible for all incentive awards related to Liberty common stock. Notwithstanding the foregoing, the Company records stock-based compensation for all stock incentive awards held by DHC's and its subsidiaries' employees regardless of whether such awards relate to DHC common stock or Liberty common stock. Any stock-based compensation recorded by DHC with respect to Liberty stock incentive awards is treated as a capital transaction with the offset to stock-based compensation expense reflected as an adjustment of additional paid-in capital.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payments* ("Statement 123R"). Statement 123R, which is a revision of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* ("Statement 123") and supersedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB Opinion No. 25"), establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services, primarily focusing on transactions in which an entity obtains employee services. Statement 123R generally requires companies to measure the cost of employee services received in exchange for an award of equity instruments (such as stock options and restricted stock) based on the grant-date fair value of the award, and to recognize that cost over the period during which the employee is required to provide service (usually the vesting period of the award). Statement 123R also requires companies to measure the cost of employee services received in exchange for an award of liability instruments (such as stock appreciation rights that will be settled in cash) based on the current fair value of the award, and to remeasure the fair value of the award at each reporting date.

The Company adopted Statement 123R effective January 1, 2006. The provisions of Statement 123R allow companies to adopt the standard using the modified prospective method or to restate all periods for which Statement 123 was effective. The Company has adopted Statement 123R using the modified prospective method, and the impact of adoption was not material.

Liberty calculated the grant-date fair value for all of its awards using the Black-Scholes Model. Liberty calculated the expected term of the awards using the methodology included in SEC Staff Accounting Bulletin No. 107. The volatility used in the calculation is based on the implied volatility of publicly traded Liberty options with a similar term (generally 20%-21%). Liberty uses the risk-free rate for Treasury Bonds with a term similar to that of the subject options and has assumed a dividend rate of zero. The Company has allocated the grant-date fair value of the Liberty awards to the Spin Off DHC Awards based on the relative trading prices of DHC and Liberty common stock after the Spin Off.

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements — (Continued)

Prior to the adoption of Statement 123R, the Company applied the intrinsic-value-based method of accounting prescribed by APB Opinion No. 25, to account for its fixed-plan stock options. Under this method, compensation expense was recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price and was recognized on a straight-line basis over the vesting period.

The following table illustrates the effect on net earnings for the years ended December 31, 2005 and 2004 as if the fair-value-based method of Statement 123R had been applied to all outstanding and unvested awards. Compensation expense for SARs was the same under APB Opinion No. 25 and Statement 123R. Accordingly, no pro forma adjustment for such awards is included in the following table.

	<u>Years Ended December 31,</u>	
	<u>2005</u>	<u>2004</u>
	<u>amounts in thousands,</u>	
	<u>except per share amounts</u>	
Net earnings, as reported	\$33,276	66,108
Add:		
Stock-based employee compensation expense included in reported net earnings, net of taxes	2,309	2,268
Deduct:		
Stock-based employee compensation expense determined under fair value based method for all awards, net of taxes	<u>(8,247)</u>	<u>(6,247)</u>
Pro forma net earnings	<u>\$27,338</u>	<u>62,129</u>
Pro forma basic and diluted earnings per common share:		
As reported	<u>\$.12</u>	<u>.24</u>
Pro forma for fair value stock compensation	<u>\$.10</u>	<u>.22</u>

Earnings (Loss) Per Common Share

Basic earnings (loss) per common share ("EPS") is computed by dividing net earnings (loss) by the weighted average number of common shares outstanding for the period. EPS in the accompanying consolidated statements of operations is based on (1) 280,199,000 shares, which is the number of shares issued in the Spin Off, for all periods prior to the Spin Off and (2) the actual number of shares outstanding for all periods subsequent to the Spin Off. The weighted average outstanding shares for the years ended December 31, 2006 and 2005 were 279,951,000 and 279,557,000, respectively. Dilutive EPS presents the dilutive effect on a per shares basis of potential common shares as if they had been converted at the beginning of the periods presented. Due to the relative insignificance of the dilutive securities in 2006 and 2005, their inclusion does not impact the EPS amount as reported in the accompanying consolidated statements of operations.

Estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of revenue and expenses for each reporting period. The significant estimates made in preparation of the Company's consolidated financial statements primarily relate to valuation of goodwill, other intangible assets, long-lived assets, deferred tax assets, and the amount of the allowance for doubtful accounts. Actual results could differ from the estimates upon which the carrying values were based.

Recent Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") has issued interpretation No. 48, "Accounting for Uncertainty in Income Taxes — An Interpretation of FASB Statement No. 109" ("FIN 48"), regarding accounting for, and disclosure of, uncertain tax positions. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting for interim periods, disclosure and transition. FIN 48 is effective for fiscal years

II-27

December 31,	
2006	2005
amounts in thousands	
\$ 52,263	34,491
918,373	796,878
424,041	397,578
472,939	397,927
1,253,553	1,175,988
255,384	371,758
<u>\$3,376,553</u>	<u>3,174,620</u>
Total assets	
\$ 734,524	692,465
2,633,237	2,590,440
175,255	101,571
94,825	272,502
(261,288)	(482,358)
<u>\$3,376,553</u>	<u>3,174,620</u>
Total liabilities and stockholders' deficit	

Consolidated Balance Sheets

Summarized financial information for Discovery is as follows:

Prior to the Spin Off, it was necessary for Liberty to periodically reallocate its enterprise level goodwill due to changes in reporting units caused by transactions or by internal reorganizations. These reallocation adjustments were made based on the relative fair values of the remaining reporting units in accordance with SFAS No. 142. As a result, there was an \$18,000,000 adjustment to the enterprise level goodwill allocated to DHC in 2004. Such adjustment is reflected in DHC's consolidated statement of stockholders' equity.

DHC's carrying value for Discovery was \$3,129,157,000 at December 31, 2006. In addition, as described in note 7, \$1,771,000,000 of enterprise-level goodwill has been allocated to the investment in Discovery.

The Company has a 50% ownership interest in Discovery and accounts for its investment using the equity method of accounting. Discovery is a global media and entertainment company, that provides original and purchased video programming in the United States and over 170 other countries. Discovery also develops and sells branded commerce and educational product lines in the United States.

(5) Investment in Discovery

Years Ended December 31,	
2006	2005
amounts in thousands	
\$48,264	—
(1,471)	—
361	—
<u>\$46,793</u>	<u>—</u>
44,238	—
<u>\$ 1,871</u>	<u>1,190</u>
Cash paid during the year for income taxes	

(4) Supplemental Disclosure of Cash Flow Information

beginning after December 15, 2006. The Company is in the process of evaluating the potential impact of the adoption of FIN 48 on its consolidated balance sheet and statements of operations and comprehensive earnings (loss), and does not believe this adoption will have a material impact.

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES
Notes to Consolidated Financial Statements — (Continued)

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements — (Continued)

Consolidated Statements of Operations

	Years Ended December 31,		
	2006	2005	2004
	amounts in thousands		
Revenue	\$ 3,012,988	2,671,754	2,365,346
Operating expenses	(1,120,377)	(979,765)	(846,316)
Selling, general and administrative	(1,170,187)	(1,005,351)	(856,340)
Equity-based compensation	(39,233)	(49,465)	(71,515)
Depreciation and amortization	(133,634)	(123,209)	(129,011)
Gain on sale of patent	—	—	22,007
Operating income	549,557	513,964	484,171
Interest expense	(194,227)	(184,575)	(167,420)
Other income (expense)	28,634	(7,426)	(6,930)
Income tax expense	(176,788)	(162,343)	(141,799)
Net earnings	<u>\$ 207,176</u>	<u>159,620</u>	<u>168,022</u>
DHC's share of net earnings	<u>\$ 103,588</u>	<u>79,810</u>	<u>84,011</u>

(6) Property and Equipment

During the year ended December 31, 2006, the Company retired approximated \$95 million of fully depreciated property and equipment. Property and equipment at December 31, 2006 and 2005 consist of the following:

	2006	2005
	amounts in thousands	
Property and equipment, net:		
Land	\$ 42,336	48,365
Buildings	217,210	186,389
Equipment	<u>192,208</u>	<u>215,595</u>
	451,754	450,349
Accumulated depreciation	<u>(170,979)</u>	<u>(194,104)</u>
	<u>\$ 280,775</u>	<u>256,245</u>

(7) Goodwill and Other Intangible Assets

The following table provides the activity and balances of goodwill:

	Creative Services Group	Network Services Group	Discovery	Total
	amounts in thousands			
Net balance at January 1, 2005	\$200,727	163,719	1,771,000	2,135,446
Foreign exchange and other	<u>(726)</u>	<u>(1,202)</u>	—	<u>(1,928)</u>
Net balance at December 31, 2005	200,001	162,517	1,771,000	2,133,518
Acquisition of AccentHealth, LLC	—	32,224	—	32,224
Goodwill impairment	<u>(93,402)</u>	—	—	<u>(93,402)</u>
Foreign exchange and other	—	<u>2,449</u>	—	<u>2,449</u>
Net balance at December 31, 2006	<u>\$106,599</u>	<u>197,190</u>	<u>1,771,000</u>	<u>2,074,789</u>

On August 18, 2006, Ascent Media announced that it intended to streamline its structure into two global operating divisions — creative services group and network services group — to better align Ascent Media's organization with the company's strategic goals and to respond to changes within the industry driven by technology and customer requirements.

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements — (Continued)

The operations of the media management services group were realigned with the other two groups and the realignment was completed in the fourth quarter of 2006.

As technology and customer requirements drove changes in this industry, revenue and operating cash flows had been declining for this group. As a result of the restructuring and the declining financial performance of the media management services group, including ongoing operating losses, the media management services group was tested for goodwill impairment in the third quarter of 2006, prior to DHC's annual goodwill valuation assessment of the entire company. DHC estimated the fair value of that reporting unit principally by using trading multiples of revenue and operating cash flows of similar companies in the industry. In September 2006, Ascent Media recognized a goodwill impairment loss for the media management services group of \$93,402,000, which represents the excess of the carrying value over the implied fair value of such goodwill.

Included in other assets at December 31, 2006 are amortizable intangibles with a net book value of \$5,711,000 and tradename intangibles (which are not subject to amortization) of \$6,040,000.

For the years ended December 31, 2006, 2005 and 2004, the Company recorded \$1,494,000, \$1,572,000 and \$2,619,000, respectively, of amortization expense for other intangible assets.

(8) Restructuring Charges

During 2006 and 2005, the Company completed certain restructuring activities designed to improve operating efficiencies and to strengthen its competitive position in the marketplace primarily through cost and expense reductions. In connection with these integration and consolidation initiatives, the Company recorded charges of \$12,092,000 and \$4,112,000, respectively. The 2006 restructuring charge related primarily to severance in the Corporate and other group in the United States and United Kingdom and to the closure of facilities in the United Kingdom. The 2005 restructuring charge relates primarily to the closure and consolidation of facilities in the United Kingdom.

The following table provides the activity and balances of the restructuring reserve.

	<u>Opening Balance</u>	<u>Additions</u>	<u>Deductions</u>	<u>Ending Balance</u>
		<u>amounts in thousands</u>		
Excess facility costs December 31, 2004	<u>\$3,377</u>	<u>—</u>	<u>(788)</u>	<u>2,589</u>
Excess facility costs December 31, 2005	<u>\$2,589</u>	<u>4,112</u>	<u>(2,718)</u>	<u>3,983</u>
Severance	155	9,005	(2,896)	6,264
Excess facility costs	<u>3,828</u>	<u>3,087</u>	<u>(2,251)</u>	<u>4,664</u>
December 31, 2006	<u>\$3,983</u>	<u>12,092</u>	<u>(5,147)</u>	<u>10,928</u>

(9) Acquisitions

AccentHealth

Effective January 27, 2006, one of DHC's subsidiaries acquired substantially all of the assets of AccentHealth, LLC's ("AccentHealth") healthcare media business for cash consideration of \$46,793,000. AccentHealth operates an advertising-supported captive audience television network in doctor office waiting rooms nationwide. The Company recorded goodwill of \$32,224,000 and other intangible assets of \$9,800,000 in connection with this acquisition. Other intangible assets are included in Other assets, net on the consolidated balance sheets. The excess purchase price over the fair value of assets acquired is attributable to the growth potential of AccentHealth and expected compatibility with Ascent Media's existing network services group.

For financial reporting purposes, the acquisition is deemed to have occurred on February 1, 2006, and the results of operations of AccentHealth have been included in DHC's consolidated results as a part of the network services group since the date of acquisition. On a pro forma basis, the results of operations of AccentHealth are not significant to those of DHC.

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements — (Continued)

London Payout Centre

On March 12, 2004, pursuant to an Agreement for the Sale and Purchase, Ascent Media acquired all of the issued share capital of London Payout Centre Limited ("LPC") from an independent third party for a purchase price of \$36,573,000 paid at closing. LPC is a UK-based television channel origination facility. The purchase was funded, in part, by proceeds from Liberty. The financial position and results of operations of LPC have been consolidated since the date of acquisition.

(10) Income Taxes

Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future. Such deferred income tax asset and liability computations are based on enacted tax laws and rates applicable to periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities. Income tax benefit (expense) is as follows:

	<u>Years Ended December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
	amounts in thousands		
Current:			
Federal	\$ (1,015)	—	—
State	(1,340)	(637)	502
Foreign	<u>528</u>	<u>2,164</u>	<u>(3,780)</u>
Current	<u>(1,827)</u>	<u>1,527</u>	<u>(3,278)</u>
Deferred:			
Federal	(33,711)	(26,402)	(25,221)
State	(7,250)	(20,743)	(7,774)
Foreign	<u>(1,154)</u>	<u>(3,218)</u>	<u>1,303</u>
Deferred	<u>(42,115)</u>	<u>(50,363)</u>	<u>(31,692)</u>
Total tax expense	<u>\$(43,942)</u>	<u>(48,836)</u>	<u>(34,970)</u>

Components of pretax income (loss) are as follows:

	<u>Years Ended December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
	amounts in thousands		
Domestic	\$ 16,761	76,907	96,470
Foreign	<u>(18,829)</u>	<u>5,205</u>	<u>4,608</u>
	<u>\$ (2,068)</u>	<u>82,112</u>	<u>101,078</u>

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES
Notes to Consolidated Financial Statements — (Continued)

Income tax benefit (expense) differs from the amounts computed by applying the U.S. federal income tax rate of 35% as a result of the following:

	2006	2005	2004
	amounts in thousands		
	2006	2005	2004
Computed expected tax benefit (expense)	\$ 724	(\$ 28,739)	(\$ 35,377)
State and local income taxes, net of federal income taxes	(4,477)	(3,976)	(5,311)
Change in valuation allowance affecting tax expense	(8,711)	1,630	3,575
Goodwill impairment not deductible for tax purposes	(26,655)	—	—
Non-deductible expenses	(2,273)	(2,361)	(476)
Change in estimated state tax rate	—	(15,263)	—
Other, net	(2,550)	(127)	2,619
Income tax expense	\$(43,942)	(\$ 48,836)	(\$ 34,970)

Components of deferred tax assets and liabilities as of December 31 are as follows:

	2006	2005
	amounts in thousands	
	2006	2005
Current assets:		
Accounts receivable reserves	\$ 3,572	2,350
Accrued liabilities	12,821	14,676
	<u>16,393</u>	<u>17,026</u>
Noncurrent assets:		
Net operating loss carryforwards	61,956	59,064
Property and equipment	2,743	4,771
Intangible assets	9,497	8,249
Other	5,784	5,506
	<u>79,980</u>	<u>77,590</u>
Total deferred tax assets, gross	96,373	94,616
Valuation allowance	(96,223)	(91,235)
	<u>150</u>	<u>3,381</u>
Current liabilities:		
Prepaid expenses	(139)	(818)
Other	(1,622)	(3,010)
	<u>(1,761)</u>	<u>(3,828)</u>
Noncurrent liabilities:		
Investments	(1,174,744)	(1,131,058)
Total deferred tax liabilities	(1,176,505)	(1,134,886)
Net deferred tax liability	\$(1,176,355)	(1,131,505)

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements — (Continued)

The Company's deferred tax assets and liabilities are reported in the accompanying consolidated balance sheets as follows:

	December 31,	
	2006	2005
	amounts in thousands	
Current deferred tax liabilities	\$ 1,761	3,828
Long-term deferred tax liabilities, net of deferred tax assets	1,174,594	1,127,677
Net deferred tax liabilities	\$1,176,355	1,131,505

At December 31, 2006, the Company has \$76,080,000 and \$482,579,000 in net operating loss carryforwards for federal and state tax purposes, respectively. These net operating losses expire, for federal purposes, as follows: \$6,836,000 in 2021; \$61,542,000 in 2022 and \$7,702,000 in 2025. The state net operating losses expire at various times from 2013 through 2025. In addition, the Company has \$751,000 of federal income tax credits, which may be carried forward indefinitely. The Company has \$2,584,000 of state income tax credits, of which \$2,342,000 will expire in the year 2012.

During the current year, management has determined that it is more likely than not that the Company will not realize the tax benefits associated with certain cumulative net operating loss carryforwards and other deferred tax assets. As such, the Company continues to maintain a valuation allowance of \$96,223,000. The total valuation allowance increased \$4,988,000 during the year ended December 31, 2006 as a result of an increase in deferred tax assets related to acquisitions of \$733,000, an increase of current year deferred tax assets of \$8,711,000 which affected tax expense, and a decrease of prior year deferred tax assets of \$4,456,000 which did not affect tax expense.

During 2006, 2005 and 2004, the Company provided (\$776,000), (\$34,000) and \$1,636,000, respectively, of U.S. tax expense for future repatriation of cash from its Asia operations pursuant to APB 23. This charge represents all undistributed earnings from Asia not previously taxed in the United States.

The Company has deficits from its United Kingdom and Mexican operations and therefore does not have any undistributed earnings subject to United States taxation.

(11) Stockholders' Equity

Preferred Stock

DHC's preferred stock is issuable, from time to time, with such designations, preferences and relative participating, optional or other rights, qualifications, limitations or restrictions thereof, as shall be stated and expressed in a resolution or resolutions providing for the issue of such preferred stock adopted by DHC's Board of Directors. As of December 31, 2006, no shares of preferred stock were issued.

Common Stock

Holders of DHC Series A common stock are entitled to one vote for each share held, and holders of DHC Series B common stock are entitled to 10 votes for each share held. Holders of DHC Series C common stock are not entitled to any voting powers, except as required by Delaware law. As of December 31, 2006, no shares of DHC Series C common stock were issued. Each share of the Series B common stock is convertible, at the option of the holder, into one share of Series A common stock.

As of December 31, 2006, there were 1,943,804 shares of DHC Series A common stock and 2,996,525 shares of DHC Series B common stock reserved for issuance under exercise privileges of outstanding stock options.

(12) Stock Options and Other Long-Term Incentive Compensation

Stock Options

On May 4, 2006, each of the non-employee directors of DHC was granted 10,000 options to purchase DHC Series A common stock with an exercise price of \$14.48. Such options vest one year from the date of grant, terminate 10 years from the date of grant and had a grant-date fair value of \$4.47 per share, as determined by the Black-Scholes Model.

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements — (Continued)

The following table presents the number and weighted average exercise price ("WAEP") of options to purchase DHC Series A and Series B common stock.

	<u>DHC Series A Common Stock</u>	<u>WAEP</u>	<u>DHC Series B Common Stock</u>	<u>WAEP</u>
Outstanding at January 1, 2006	1,937,616	\$15.43	2,996,525	18.87
Granted	30,000	\$14.48	—	
Exercises	(22,382)	\$12.46	—	
Cancellations	(1,430)	\$12.10	—	
Outstanding at December 31, 2006	<u>1,943,804</u>	\$15.45	<u>2,996,525</u>	18.87
Exercisable at December 31, 2006	<u>1,460,415</u>	\$16.18	<u>2,876,525</u>	18.99

As of December 31, 2006, the total compensation cost related to unvested equity awards was \$1.1 million. Such amount will be recognized in DHC's consolidated statements of operations through 2009.

2006 Ascent Media Long-Term Incentive Plan

Effective August 3, 2006, Ascent Media adopted its 2006 Long-Term Incentive Plan (the "2006 Plan"). The 2006 Plan provides the terms and conditions for the grant of, and payment with respect to, Phantom Appreciation Rights ("PARs") granted to certain officers and other key personnel of Ascent Media. The value of a single PAR ("Value") is calculated as the sum of (i) 6% of cumulative free cash flow (as defined in the 2006 Plan) over a period of up to six years, divided by 500,000 plus (ii) 5% of the increase in the calculated value of Ascent Media over a baseline value determined at the time of grant, divided by 10,000,000. The 2006 Plan is administered by a committee that consists of two individuals appointed by DHC. Grants are determined by the committee, with the first grant occurring on August 3, 2006. The maximum number of PARs that may be granted under the 2006 Plan is 500,000, and there were 398,500 granted PARs as of December 31, 2006. The PARs vest quarterly over a three year period, and are payable on March 31, 2012 (or, if earlier, on the six-month anniversary of a grantee's termination of employment without cause). Ascent Media will record a liability and a charge to expense based on the Value and percent vested at each reporting period. As of December 31, 2006, the Value of the PARs was \$0.

(13) Other Comprehensive Earnings (Loss)

Accumulated other comprehensive earnings (loss) included in DHC's consolidated balance sheets and consolidated statements of stockholders' equity reflect the aggregate of foreign currency translation adjustments and unrealized holding gains and losses on available-for-sale securities.

The change in the components of accumulated other comprehensive earnings (loss), net of taxes, is summarized as follows:

	<u>Foreign Currency Translation Adjustments</u>	<u>Unrealized Holding Gains (losses) on Securities</u>	<u>Accumulated Other Comprehensive Earnings (loss), Net of Taxes</u>
	amounts in thousands		
Balance at January 1, 2004	\$ 5,236	1,439	6,675
Other comprehensive earnings	<u>6,797</u>	<u>(1,162)</u>	<u>5,635</u>
Balance at December 31, 2004	12,033	277	12,310
Other comprehensive loss	<u>(14,821)</u>	<u>651</u>	<u>(14,170)</u>
Balance at December 31, 2005	(2,788)	928	(1,860)
Other comprehensive earnings	<u>17,922</u>	<u>(148)</u>	<u>17,774</u>
Balance at December 31, 2006	<u>\$ 15,134</u>	<u>780</u>	<u>15,914</u>

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements — (Continued)

The components of other comprehensive earnings (loss) are reflected in DHC's consolidated statements of comprehensive earnings (loss) net of taxes. The following table summarizes the tax effects related to each component of other comprehensive earnings (loss).

	<u>Before-Tax Amount</u>	<u>Tax (Expense) Benefit</u>	<u>Net-of-Tax Amount</u>
	<u>amounts in thousands</u>		
Year ended December 31, 2006:			
Foreign currency translation adjustments	\$ 29,648	(11,726)	17,922
Unrealized holding gains on securities arising during period	<u>(245)</u>	<u>97</u>	<u>(148)</u>
Other comprehensive earnings	<u>\$ 29,403</u>	<u>(11,629)</u>	<u>17,774</u>
Year ended December 31, 2005:			
Foreign currency translation adjustments	\$(24,518)	9,697	(14,821)
Unrealized holding gains on securities arising during period	<u>1,077</u>	<u>(426)</u>	<u>651</u>
Other comprehensive loss	<u>\$(23,441)</u>	<u>9,271</u>	<u>(14,170)</u>
Year ended December 31, 2004:			
Foreign currency translation adjustments	\$ 11,143	(4,346)	6,797
Unrealized holding losses on securities arising during period	<u>(1,905)</u>	<u>743</u>	<u>(1,162)</u>
Other comprehensive earnings	<u>\$ 9,238</u>	<u>(3,603)</u>	<u>5,635</u>

(14) Employee Benefit Plans

Ascent Media offers a 401(k) defined contribution plan covering most of its full-time domestic employees not eligible to participate in the Motion Picture Industry Pension and Health Plan (MPIPHP), a multi-employer defined benefit pension plan. Contributions to the MPIPHP are determined in accordance with the provisions of negotiated labor contracts and generally are based on the number of hours worked. Ascent Media also sponsors a pension plan for eligible employees of its foreign subsidiaries. Employer contributions are determined by Ascent Media's board of directors. The plans are funded by employee and employer contributions. Total pension plan expenses for the years ended December 31, 2006, 2005 and 2004 were \$7,868,000, \$7,109,000 and \$6,485,000, respectively.

(15) Commitments and Contingencies

Future minimum lease payments under scheduled operating leases, which are primarily for buildings, equipment and real estate, having initial or remaining noncancelable terms in excess of one year are as follows (in thousands):

Year ended December 31:	
2007	\$32,058
2008	\$29,156
2009	\$27,645
2010	\$24,590
2011	\$19,436
Thereafter	\$59,144

Rent expense for noncancelable operating leases for real property and equipment was \$31,355,000, \$31,643,000 and \$26,487,000 for the years ended December 31, 2006, 2005 and 2004, respectively. Various lease arrangements contain options to extend terms and are subject to escalation clauses.

At December 31, 2006, the Company is committed to compensation under long-term employment agreements with its certain executive officers of Ascent Media as follows: 2007, \$1,815,000; 2008, \$1,760,000; and 2009, \$1,565,000.

On December 31, 2003, Ascent Media acquired the operations of Sony Electronic's systems integration center business and related assets, which we refer to as SIC. In exchange, Sony received the right to be paid in 2008 an amount equal to 20% of the value of the combined business of Ascent Media's wholly owned subsidiary, AF Associates, Inc. and

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements — (Continued)

SIC. The value of 20% of the combined business of AF Associates and SIC is estimated at \$6,100,000. SIC is included in Ascent Media's network services group.

The Company is involved in litigation and similar claims incidental to the conduct of its business. In management's opinion, none of the pending actions is likely to have a material adverse impact on the Company's financial position or results of operations.

(16) Related Party Transactions

Certain third-party general and administrative and spin off related costs were paid by Liberty on behalf of the Company prior to the Spin Off and reflected as expenses in the accompanying consolidated statements of operations. In addition, certain general and administrative expenses are charged by Liberty to DHC pursuant to the Services Agreement. Such expenses aggregated \$2,260,000 and \$5,948,000 for the years ended December 31, 2006 and 2005, respectively.

Ascent Media provides services, such as satellite uplink, systems integration, origination, and post-production, to Discovery. Revenue recorded by Ascent Media for these services for the years ended December 31, 2006, 2005 and 2004 aggregated \$33,741,000, \$34,189,000 and \$41,785,000, respectively.

(17) Information About Operating Segments

The Company's chief operating decision maker, or his designee (the "CODM"), has identified the Company's reportable segments based on (i) financial information reviewed by the CODM and (ii) those operating segments that represent more than 10% of the Company's combined revenue or earnings before taxes. In addition, those equity investments whose share of earnings represent more than 10% of the Company's earnings before taxes are considered reportable segments.

Based on the foregoing criteria, the Company's business units have been aggregated into three reportable segments: the creative services group and the network services group, which are operating segments of Ascent Media, and Discovery, which is an equity affiliate. Corporate related items and unallocated income and expenses are reflected in the Corporate and other column listed below. As a product of our segment restructuring, the segment presentation for prior periods has been conformed to the current period segment presentation.

The 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. The network services group provides broadcast services, which are comprised of services necessary to assemble and distribute programming for cable and broadcast networks via fiber and satellite to viewers in North America, Europe, Asia and Latin America. Additionally, the networks services group provides systems integration, design, consulting, engineering and project management services.

The accounting policies of the segments that are consolidated entities are the same as those described in the summary of significant accounting policies and are consistent with GAAP.

The Company evaluates the performance of these operating segments based on financial measures such as revenue and operating cash flow. The Company defines operating cash flow as revenue less cost of services and selling, general and administrative expenses (excluding stock and other equity-based compensation and accretion expense on asset retirement obligations). The Company believes this is an important indicator of the operational strength and performance of its businesses, including the businesses' ability to service debt and capital expenditures. In addition, this measure allows management to view operating results and perform analytical comparisons and identify strategies to improve performance. This measure of performance excludes depreciation and amortization, stock and other equity-based compensation, accretion expense on asset retirement obligations and restructuring and impairment charges that are included in the measurement of operating income pursuant to GAAP. Accordingly, operating cash flow should be considered in addition to, but not as a substitute for, operating income, cash flow provided by operating activities and other measures of financial performance prepared in accordance with GAAP.

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements — (Continued)

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each segment requires different technologies, distribution channels and marketing strategies.

Summarized financial information concerning the Company's reportable segments is presented in the following tables:

	Consolidated Reportable Segments				Equity Affiliate- Discovery
	Creative Services Group	Network Services Group(1)	Corporate and Other	Consolidated Total	
	amounts in thousands				
Year ended December 31, 2006					
Revenue from external customers	\$417,876	270,211	—	688,087	3,012,988
Operating cash flow	\$ 52,554	49,522	(43,347)	58,729	722,424
Capital expenditures	\$ 27,126	44,331	6,084	77,541	90,138
Depreciation and amortization	\$ 38,661	23,055	6,213	67,929	133,634
Total assets	\$410,313	382,848	5,077,821	5,870,982	3,376,553
Year ended December 31, 2005					
Revenue from external customers	\$421,797	272,712	—	694,509	2,671,754
Operating cash flow	\$ 70,708	55,877	(47,960)	78,625	686,638
Capital expenditures	\$ 47,179	38,476	4,871	90,526	99,684
Depreciation and amortization	\$ 38,644	27,046	10,687	76,377	123,209
Total assets	\$470,213	323,558	5,025,465	5,819,236	3,174,620
Year ended December 31, 2004					
Revenue from external customers	\$405,026	226,189	—	631,215	2,365,346
Operating cash flow	\$ 72,903	62,537	(37,645)	97,795	662,690
Capital expenditures	\$ 22,810	23,123	3,359	49,292	88,100
Depreciation and amortization	\$ 38,776	27,074	11,755	77,605	129,011
Total assets	\$469,930	294,599	4,800,299	5,564,828	3,235,686

(1) Included in Network Services Group revenue is broadcast services revenue of \$158,151,000, \$149,568,000 and \$136,680,000 and systems integration revenue of \$112,060,000, \$123,144,000 and \$89,509,000 in 2006, 2005 and 2004, respectively.

The following table provides a reconciliation of segment operating cash flow to earnings (loss) before income taxes.

	Years Ended December 31,		
	2006	2005	2004
	amounts in thousands		
Segment operating cash flow	\$ 58,729	78,625	97,795
Stock-based compensation	(1,817)	(4,383)	(2,775)
Restructuring and other charges	(12,092)	(4,112)	—
Depreciation and amortization	(67,929)	(76,377)	(77,605)
Impairment of goodwill	(93,402)	—	(51)
Share of earnings of Discovery	103,588	79,810	84,011
Other, net	10,855	8,549	(297)
Earnings (loss) before income taxes	\$ (2,068)	82,112	101,078

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements — (Continued)

Information as to the Company's operations in different geographic areas is as follows:

	<u>Years Ended December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
	<u>amounts in thousands</u>		
Revenue			
United States	\$535,792	525,288	460,070
United Kingdom	129,540	149,928	148,002
Other countries	<u>22,755</u>	<u>19,293</u>	<u>23,143</u>
	<u>\$688,087</u>	<u>694,509</u>	<u>631,215</u>
Property and equipment, net			
United States	\$184,052	163,073	
United Kingdom	70,363	65,017	
Other countries	<u>26,360</u>	<u>28,155</u>	
	<u>\$280,775</u>	<u>256,245</u>	

(18) Quarterly Financial Information (Unaudited)

	<u>1st</u>	<u>2nd</u>	<u>3rd</u>	<u>4th</u>
	<u>Quarter</u>	<u>Quarter</u>	<u>Quarter</u>	<u>Quarter</u>
	<u>amounts in thousands, except per share amounts</u>			
<u>2006:</u>				
Revenue	<u>\$153,568</u>	<u>165,789</u>	<u>169,876</u>	<u>198,854</u>
Operating loss	<u>\$ (2,857)</u>	<u>(6,252)</u>	<u>(97,350)</u>	<u>(8,678)</u>
Net earnings (loss)	<u>\$ 11,615</u>	<u>13,734</u>	<u>(76,633)</u>	<u>5,274</u>
Basic and diluted net earnings (loss) per common share ..	<u>\$.04</u>	<u>.05</u>	<u>(.27)</u>	<u>.02</u>
<u>2005:</u>				
Revenue	<u>\$174,290</u>	<u>178,019</u>	<u>167,934</u>	<u>174,266</u>
Operating income (loss)	<u>\$ 2,877</u>	<u>(4,982)</u>	<u>(1,403)</u>	<u>2,106</u>
Net earnings	<u>\$ 16,825</u>	<u>4,027</u>	<u>1,189</u>	<u>11,235</u>
Basic and diluted net earnings per common share	<u>\$.06</u>	<u>.01</u>	<u>—</u>	<u>.04</u>

PART III.

The following required information is incorporated by reference to our definitive proxy statement for our 2007 Annual Meeting of Stockholders presently scheduled to be held in the second quarter of 2007:

Item 10. Directors, Executive Officers and Corporate Governance

Item 11. Executive Compensation

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Item 13. Certain Relationships and Related Transactions, and Director Independence

Item 14. Principal Accounting Fees and Services

We will file our definitive proxy statement for our 2007 Annual Meeting of stockholders with the Securities and Exchange Commission on or before April 30, 2007.

PART IV.

Item 15. Exhibits and Financial Statement Schedules.

(a) (1) **Financial Statements**

Included in Part II of this Report:

	<u>Page No.</u>
Discovery Holding Company:	
Management's Report on Internal Control over Financial Reporting	II-15
Report of Independent Registered Public Accounting Firm.	II-16
Report of Independent Registered Public Accounting Firm.	II-17
Consolidated Balance Sheets, December 31, 2006 and 2005.	II-18
Consolidated Statements of Operations and Comprehensive Earnings (Loss), Years ended December 31, 2006, 2005 and 2004	II-19
Consolidated Statements of Cash Flows, Years Ended December 31, 2006, 2005 and 2004	II-20
Consolidated Statements of Stockholders' Equity, Years ended December 31, 2006, 2005 and 2004	II-21
Notes to Consolidated Financial Statements, December 31, 2006, 2005 and 2004	II-22

(a) (2) **Financial Statement Schedules**

Included in Part IV of this Report:

(i) All schedules have been omitted because they are not applicable, not material or the required information is set forth in the financial statements or notes thereto.

(ii) Separate financial statements for Discovery Communications, Inc.:

Report of Independent Registered Public Accounting Firm	IV-3
Consolidated Balance Sheets, December 31, 2006 and 2005	IV-4
Consolidated Statements of Operations, Years ended December 31, 2006, 2005 and 2004	IV-5
Consolidated Statements of Cash Flows, Years ended December 31, 2006, 2005 and 2004	IV-6
Consolidated Statements of Changes in Stockholders' Deficit, Years ended December 31, 2006, 2005 and 2004	IV-7
Notes to Consolidated Financial Statements	IV-8

(a) (3) **Exhibits**

Listed below are the exhibits which are filed as a part of this Report (according to the number assigned to them in Item 601 of Regulation S-K):

2 — Plan of Acquisition, Reorganization, Arrangement, Liquidation or Succession:

2.1 Reorganization Agreement among Liberty Media Corporation, Discovery Holding Company ("DHC") and Ascent Media Group, Inc. (incorporated by reference to Exhibit 2.1 to DHC's Registration Statement on Form 10, dated July 15, 2005 (File No. 000-51205) (the "Form 10")).

3 — Articles of Incorporation and Bylaws:

3.1 Restated Certificate of Incorporation of DHC (incorporated by reference to Exhibit 3.1 to the Form 10).

3.2 Bylaws of DHC (incorporated by reference to Exhibit 3.2 to the Form 10).

4 — Instruments Defining the Rights of Securities Holders, including Indentures:

4.1 Specimen Certificate for shares of the Series A common stock, par value \$.01 per share, of DHC (incorporated by reference to Exhibit 4.1 to the Form 10).

4.2 Specimen Certificate for shares of the Series B common stock, par value \$.01 per share, of DHC (incorporated by reference to Exhibit 4.2 to the Form 10).

4.3 Rights Agreement between DHC and EquiServe Trust Company, N.A., as Rights Agent (incorporated by reference to Exhibit 4.3 to the Form 10).