

Discovery Holding CO  
Form 10-K  
March 23, 2006

**Table of Contents**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-K**

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

**For the fiscal year ended December 31, 2005  
or**

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

**For the transition period from to**

**Commission File Number 000-51205**

**Discovery Holding Company**

*(Exact name of Registrant as specified in its charter)*

**State of Delaware**

*(State or other jurisdiction of  
incorporation or organization)*

**20-2471174**

*(I.R.S. Employer Identification No.)*

**12300 Liberty Boulevard**

**Englewood, Colorado**

*(Address of principal executive offices)*

**80112**

*(Zip Code)*

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

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

<b>Title of each class</b>	<b>Name of exchange on which registered</b>
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 o No þ

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 o No þ

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 þ No o

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. o

## Edgar Filing: Discovery Holding CO - 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 February 28, 2006, was approximately \$4.1 billion.

The number of shares outstanding of Discovery Holding Company's common stock as of February 28, 2006 was:

Series A Common Stock 268,097,442; and

Series B Common Stock 12,106,093 shares.

### **DOCUMENTS INCORPORATED BY REFERENCE**

The Registrant's definitive proxy statement for its 2006 Annual Meeting of Shareholders is hereby incorporated by reference into Part III of this Annual Report on Form 10-K

---

**DISCOVERY HOLDING COMPANY**  
**2005 ANNUAL REPORT ON FORM 10-K**  
**Table of Contents**

		<b>Page</b>
<b><u>Part I</u></b>		
<u>Item 1.</u>	<u>Business</u>	I-1
<u>Item 1A.</u>	<u>Risk Factors</u>	I-14
<u>Item 1B.</u>	<u>Unresolved Staff Comments</u>	I-21
<u>Item 2.</u>	<u>Properties</u>	I-21
<u>Item 3.</u>	<u>Legal Proceedings</u>	I-22
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>	I-22
<b><u>Part II</u></b>		
<u>Item 5.</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	II-1
<u>Item 6.</u>	<u>Selected Financial Data</u>	II-1
<u>Item 7.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	II-2
<u>Item 7A.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	II-15
<u>Item 8.</u>	<u>Financial Statements and Supplementary Data</u>	II-15
<u>Item 9.</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	II-15
<u>Item 9A.</u>	<u>Controls and Procedures</u>	II-15
<u>Item 9B.</u>	<u>Other Information</u>	II-15
<b><u>Part III</u></b>		
<u>Item 10.</u>	<u>Directors and Executive Officers of the Registrant</u>	III-1
<u>Item 11.</u>	<u>Executive Compensation</u>	III-1
<u>Item 12.</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	III-1
<u>Item 13.</u>	<u>Certain Relationships and Related Transactions</u>	III-1
<u>Item 14.</u>	<u>Principal Accounting Fees and Services</u>	III-1
<b><u>Part IV</u></b>		
<u>Item 15.</u>	<u>Exhibits and Financial Statement Schedules</u>	IV-1
	<u>Subsidiaries</u>	
	<u>Consent of KPMG LLP</u>	
	<u>Consent of PricewaterhouseCoopers LLP</u>	
	<u>Rule 13a-14(a)/15d-14(a) Certification</u>	
	<u>Rule 13a-14(a)/15d-14(a) Certification</u>	
	<u>Rule 13a-14(a)/15d-14(a) Certification</u>	
	<u>Section 1350 Certification</u>	

---

**Table of Contents**

**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, and our 50% owned equity affiliate Discovery Communications, Inc., 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, media management and network services to the media and entertainment industries. Our subsidiaries and affiliates operate in the United States, Europe, Latin America and Asia.

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 160 countries across six continents, with over 1 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 for cash consideration of \$45 million, plus working capital adjustments of \$2.0 million. Accent Health operates an advertising-supported captive audience television network in approximately 11,000 doctor office waiting rooms nationwide.

\* \* \* \* \*

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. To the extent that statements in this Annual Report are not recitations of historical fact, such statements constitute forward-looking statements which, by definition, involve risks and uncertainties. In some cases, you can identify these statements by our use of forward-looking words such as may, should, anticipate, estimate, expect, plan, believe, predict, potential, intend and other words of similar 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

**Table of Contents**

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

I-2

---

**Table of Contents**

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 four reportable segments are our Creative Services Group, Media Management Group and Network Services Group, which are all operating segments of Ascent Media, and Discovery, which is an equity affiliate. Financial information related to our operating segments can be found in note 18 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, media management and network services to the media and entertainment industries. Ascent Media's clients include the 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.

Ascent Media's operations are organized into three main categories: creative services, media management 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.

Ascent Media markets its creative services under various well-known brand names, including *Company 3, Design Music Group (DMG), 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, and Todd-AO*. The creative services client base comprises the major domestic film studios, independent television production companies, broadcast networks, advertising agencies, creative editorial companies and corporate media producers. The principal facilities of the creative services group are in Los Angeles, New York, 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



**Table of Contents**

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, state of the art 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,

I-4

---

## **Table of Contents**

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. The company actively continues to add new, original recordings to its library.

### *Media Management Services*

Ascent Media's media management services group provides owners of content libraries with a full complement of facilities and services necessary to optimize, archive, manage and repurpose media assets for global distribution via freight, satellite, fiber and the Internet. Ascent Media's media facilities are located in Burbank, Hollywood and Santa Monica, California; Northvale, New Jersey; and London, England. The media management services client base includes the major motion picture studios and their international divisions as well as independent owners of television and film libraries and emerging new media distribution channels.

In 2005, Ascent Media completed construction of its 100,000 square foot Digital Media Data Center, or DMDC, in Burbank, California. The DMDC now contains a significant portion of Ascent Media's media management services business in Southern California.

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

*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.* Through its recently-acquired facility, Cinetech, and its other laboratory facilities, 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 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 client's 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  
I-5

---

**Table of Contents**

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.

*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.

*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.

*Network Services*

Ascent Media's network services group provides services to broadcast, cable and satellite programming networks, local television channels, broadcast syndicators, satellite broadcasters, 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. Ascent Media also operates industry-standard encryption and/or compression systems as needed for customer satellite transmission and offers quality control, tape storage and trafficking services. 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. For programming designed for export to other markets, Ascent Media provides language translation, subtitling and voice dubbing. Currently, over two hundred 24/7 programming feeds are supported by Ascent Media's facilities in the United States, London and Singapore.

**Table of Contents**

*Satellite transport.* 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.

*Engineering and systems integration.* Ascent Media designs, builds, installs and services advanced video systems for the broadcast, cable television and other broadband telecommunications industries and other professional and corporate markets. Ascent Media's engineering and systems integration clients include major broadcast networks, numerous cable channels, corporate television networks, a major telecommunications company as well as multiple production and post-production facilities.

*Strategy*

The entertainment services industry has been historically fragmented with numerous providers offering discrete, geographically-limited, non-integrated services. Ascent Media's services, however, span the entirety of the value chain from the creation and management of content to the delivery of content via multiple transmission paths including satellite, fiber and Internet Protocol-based networks. Ascent Media believes the breadth and range of its services uniquely provide it the scale and flexibility necessary to realize significant operating and marketing efficiencies: a global, scalable media services platform integrating preparation, management and transmission services; common best practices operations management across the Ascent Media enterprise; and integration of financial and administrative functions. In Ascent Media's media management and network services businesses, and with large institutional clients that utilize a broad range of its services, Ascent Media intends to build brand awareness on a global basis and promote its integrated suites of services, while continuing to support the identity and customer loyalty associated with Ascent Media's established boutique brands in the creative services industry. Ascent Media intends to optimize its position in the market by pursuing the following strategies:

*Increase scale of operations.* Ascent Media intends to increase the scale of its operations through a combination of internal investment in facilities and capital expenditures plus external investment in companies and joint ventures. Its goal is to attract additional customers in its existing lines of business and expand its business operations geographically.

*Expand scope of services.* Ascent Media intends to expand the scope of its services by applying its core capabilities to new business activities, providing content management and distribution services based on electronic data files rather than physical tapes, participating in emerging high revenue-generating services such as re-formatting content for distribution to new platforms, and gradually attracting new customers with unique service needs that are less susceptible to competitive threats. One growth initiative is to expand Ascent Media's service offerings for a growing number of non-traditional networks, also referred to as captive audience networks. DHC's acquisition of AccentHealth—a health media company with a captive audience network that reaches 19 million consumers per month in over 11,000 physician waiting rooms nationwide—will be managed by Ascent Media and will help enhance Ascent Media's services to captive audience networks.

*Optimize the organization.* In order to reach the first two strategic goals described above, Ascent Media also plans to improve its internal organization. Specifically, Ascent Media intends to re-align its divisional structure to become more compatible with its diversified customer base and the integrated file-based solutions that they seek. Ascent Media also intends to focus on its content security initiative,



**Table of Contents**

creating greater efficiency when it provides parallel tape-based and file-based solutions, invest additional resources in its facilities, develop relationships with other companies and/or form joint ventures.

*Seasonality*

The demand for Ascent Media's core motion picture services, primarily in its creative services group, has historically been seasonal, with higher demand in the spring (second fiscal quarter) and fall (fourth fiscal quarter), and lower in the winter and summer. Similarly, demand for Ascent Media's television program services, primarily in its creative services group, is higher in the first and fourth quarters and lower in the summer, or third quarter. Demand for Ascent Media's commercial services, primarily in its creative services group, are fairly consistent with slightly higher activity in the third quarter. However, recent trends in the demand for television program services may result in increased business for Ascent Media in the summer. In addition, the timing of projects in Ascent Media's media management services group and network services group are beginning to offset the quarters in which there has been historically lower demand for Ascent Media's motion picture and television services. Accordingly, Ascent Media expects to experience less dramatic quarterly fluctuations in its operating performance in the future.

***DISCOVERY***

Discovery Communications, Inc. 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 160 countries across six continents, with over 1 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.

Discovery's relationships and agreements with the distributors of its channels are critical to its business as they provide Discovery's subscription revenue stream and access to an audience for advertising sales purposes. There has been a great deal of consolidation among cable and satellite television operators in the United States in recent years, with over 90% of the pay television households in the country now controlled by the top eight distributors. Discovery also operates in certain overseas markets which have experienced similar industry consolidation. Industry consolidation has generally provided more leverage to the distributors in their relationships with programmers. Accordingly, as its affiliation agreements expire, Discovery may not be able to obtain terms in new affiliation agreements that are comparable to terms in its existing agreements.

Discovery earns revenue from the sale of advertising on its networks, from global delivery of its programming pursuant to affiliation agreements with cable television and direct-to-home satellite operators (which is described as distribution revenue throughout this report), and from product sales in its commerce and education outlets. Distribution revenue includes all components of revenue earned through affiliation agreements. Discovery's affiliation agreements typically have terms of 3 to 10 years and provide for payments based on the number of subscribers that receive Discovery's services. No single distributor represented more than 10% of Discovery's consolidated revenue for the year ended December 31, 2005. Discovery has grown its global network business by securing as broad a subscriber base as possible for each of its channels by entering into affiliation agreements. After obtaining scalable distribution of its networks, Discovery invests in programming and marketing in order to build a viewing audience to support advertising sales. In certain cases, Discovery has made cash payments to distributors in exchange for carriage or has entered into contractual arrangements that allow the distributors to show certain of Discovery's channels for extended free periods. In the United States, Discovery has developed the necessary audience and ratings for its programming such that advertising sales now provide more revenue than channel subscriptions. Distribution revenue still accounts for the majority of the international networks' revenue base, and this is anticipated to be the case for the foreseeable future. As a result, growing the distribution base for existing and newly launched international networks will continue to be the primary focus of the international division.

Discovery's principal operating costs consist of programming expense, sales and marketing expense, personnel expense and general and administrative expenses. Programming is Discovery's largest expense. Costs incurred and capitalized for the direct production of programming content are amortized over varying



**Table of Contents**

periods based on the expected realization of revenue from the underlying programs. Licensed programming is amortized over the contract period based on the expected realization of revenue. Discovery incurs sales and marketing expense to promote brand recognition and to secure quality distribution channels worldwide.

Discovery produces original programming and acquires content from numerous producers worldwide that is tailored to the specific needs of viewers around the globe. Discovery believes it is generally well positioned for continued access to a broad range of high-quality programming for both its U.S. and international networks. It has assembled one of the largest libraries of non-fiction programming and footage in the world, due both to the aggregate purchasing power of its many networks and a policy to own as many rights as possible in the programs aired on its networks. Discovery also has long-term relationships with some of the world's most significant non-fiction program producers, including the British Broadcasting Corporation, which we refer to as the BBC. Discovery believes the broad international appeal of its content combined with its ability to adapt its significant programming library to international markets for relatively low costs is one of its competitive advantages. Discovery is also developing programming applications designed to position the company to take advantage of emerging distribution technologies including video-on-demand, IP-delivered programming, wireless and mobile.

Discovery's other properties consist of Discovery.com and over 100 retail outlets that offer lifestyle, health, science and education oriented products, as well as products related to other programming offered by Discovery. Additionally, Discovery's newest division, Discovery Education, distributes video-based educational materials to schools in the United States and in many countries around the world.

Discovery is a leader in offering solutions to advertisers that allow them to reach a broad range of audience demographics in the face of increasing fragmentation of audience share. The overall industry is facing several issues with regard to its advertising revenue, including (1) audience fragmentation caused by the proliferation of other television networks, video-on-demand offerings from cable and satellite companies and broadband content offerings; (2) the deployment of digital video recording devices (DVRs), allowing consumers to time shift programming and skip or fast-forward through advertisements; and (3) consolidation within the advertising industry, shifting more leverage to the bigger agencies and buying groups.

*Discovery Networks U.S.*

Discovery networks U.S. currently operates 12 channels and provides distribution and advertising sales services for BBC America. The division's channels include Discovery Channel, TLC, Animal Planet, Travel Channel, Discovery Health Channel and the following emerging digital tier networks: The Science Channel, Discovery Kids, The Military Channel, Discovery Home, Discovery Times, Fit TV and Discovery HD Theater, which we refer to collectively as the emerging networks. All of these channels are wholly owned by Discovery other than Animal Planet, in which Discovery has a 60% ownership interest and Discovery Times, in which Discovery has a 50% ownership interest. The division also operates web sites related to its channel businesses and various other new media businesses, including a video-on-demand offering distributed by various cable operators.

*Discovery Networks International*

Discovery networks international, or the international networks, manages a portfolio of channels, led by Discovery Channel and Animal Planet, that are distributed in virtually every pay-television market in the world via an infrastructure that includes major operational centers in London, Singapore, New Delhi and Miami. Discovery networks international currently operates over 97 separate feeds in 33 languages with channel feeds customized according to language needs and advertising sales opportunities. Most of the division's channels are wholly owned by Discovery with the exception of (1) the international Animal Planet channels, which are generally 50-50 joint ventures with the BBC, (2) People + Arts, which operates in Latin America and Iberia as a 50-50 joint venture with the BBC and (3) several channels in Japan and Canada, which operate as joint ventures with strategically important local partners. As with the U.S. networks division, the international networks operate web sites and other new media businesses. In 2004, the group undertook a

**Table of Contents**

major new initiative to re-launch certain existing networks and launch several new networks to create a package of three lifestyle-focused networks for distribution on a global basis.

*Discovery Commerce, Education & Other*

This group includes Discovery commerce, which operates a chain of retail stores in the United States that offer lifestyle, health, science and education-oriented products, as well as products specifically related to programming on Discovery's networks. This division also operates a catalog and electronic commerce business selling products similar to that sold in the Discovery Channel Stores, as well as a licensing business that licenses Discovery trademarks and intellectual property to third parties for the purpose of creating and selling retail merchandise.

This group also includes Discovery education. Since 2003, Discovery has acquired three companies which were involved in the video streaming business. In 2004, the company expanded beyond its traditional education businesses of airing educational programming on its networks and selling hard copies of such programs to schools and began streaming educational video material into schools via the Internet. Discovery education now operates United Streaming, a leading educational broadband streaming service in the United States. This service earns revenue through annual subscription fees paid by schools and school districts which use the service.

*Discovery Stockholders' Agreement*

A subsidiary of ours, together with a subsidiary of Cox Communications, which we refer to as Cox Communications, and Advance/Newhouse Programming Partnership, which we refer to as Advance/Newhouse, and John Hendricks, the founder and Chairman of Discovery, are parties to a Stockholders' Agreement. We own 50%, and Cox Communications and Advance/Newhouse each own 25%, of Discovery. Mr. Hendricks is the record holder of one share of capital stock of Discovery; however, Mr. Hendricks cannot transfer this share, the share is subject to an irrevocable proxy in favor of Advance/Newhouse and the share is subject to a call arrangement pursuant to which Advance/Newhouse can purchase the share. Accordingly, we treat such share as being owned by Advance/Newhouse for purposes of Advance/Newhouse's percentage ownership of Discovery as described in this Annual Report. As a close corporation under Delaware law, the stockholders manage the business of Discovery, rather than a board of directors. The Stockholders' Agreement provides that a number of decisions affecting Discovery, such as, among other things, a decision to effect a fundamental change in its business, a merger or other business combination, issuance of Discovery's equity securities, approval of transactions between Discovery, on the one hand, and any of its stockholders, on the other hand, and adoption of Discovery's annual business plan, must be approved by the holders of 80% of its outstanding capital stock. In addition, other matters, such as the declaration and payment of dividends on its capital stock, require the approval of the holders of a majority of Discovery's outstanding capital stock.

Because we own 50%, Cox Communications owns 25% and Advance/Newhouse owns 25% of the stock of Discovery, any one of us may block Discovery from taking any action that requires 80% approval. In addition, because Cox Communications and Advance/Newhouse, on the one hand, and our company, on the other, each owns 50% of the outstanding stock of Discovery, there is the possibility that the stockholders could deadlock over various other matters, which require the approval of the holders of a majority of its capital stock. To reduce the possibility that this could occur, the stockholders have given John Hendricks, the founder and Chairman of Discovery, the right (but not the obligation), subject to certain limitations, to cast a vote to break a deadlock on certain matters requiring a majority vote for approval.

The Stockholders' Agreement also restricts, subject to certain exceptions, the ability of a stockholder to transfer its shares in Discovery to a third party. Any such proposed transfer is subject to a pro rata right of first refusal in favor of the other stockholders. If all of the offered shares are not purchased by the other stockholders, then the selling stockholder may sell all of the offered shares to the third party that originally offered to purchase such shares at the same price and on the same terms, provided that such third party agrees to be bound by the restrictions contained in the Stockholders' Agreement. In addition, in the event that either Cox Communications or Advance/Newhouse proposes to transfer shares, Cox Communications or Advance/

**Table of Contents**

Newhouse, whichever is not proposing to transfer, would have a preemptive right to buy the other's shares, and if it does not elect to purchase all such shares, then the remaining shares would be subject to the pro rata right of first refusal described above.

The Stockholders' Agreement also prohibits Cox Communications, Advance/ Newhouse and our company from starting, or acquiring a majority of the voting power of, a basic programming service carried in the United States that consists primarily of documentary, science and nature programming, subject to certain exceptions.

In connection with the spin off, Liberty contributed to us 100% of an entity that owns a 10% interest in the Animal Planet limited partnership. Our partners in this entity include Discovery, Cox Communications, Advance/ Newhouse and the BBC. The Stockholders' Agreement prohibits us from selling, transferring or otherwise disposing of either of the subsidiaries that hold the Discovery interest or Animal Planet interest, respectively, unless, after such transaction, such subsidiaries are controlled by the same person or entity.

The foregoing summary of the Discovery Stockholders' Agreement is qualified by reference to the full text of the agreement and amendments.

*Regulatory Matters*

***Ascent Media***

Some of Ascent Media's subsidiary companies hold licenses and authorizations from the Federal Communications Commission, or FCC, required for the conduct of their businesses, including earth station and various classes of wireless licenses and an authorization to provide certain services pursuant to Section 214 of the Communications Act. Most of the FCC licenses held by such subsidiaries are for transmit/receive earth stations, which cannot be operated without individual licenses. The licenses for these stations are granted for a period of fifteen years and, while the FCC generally renews licenses for satellite earth stations, there can be no assurance that these licenses will be renewed at their expiration dates. Registration with the FCC, rather than licensing, is required for receiving transmissions from domestic satellites from points within the United States. Ascent Media relies on third party licenses or authorizations when it and its subsidiaries transmit domestic satellite traffic through earth stations operated by third parties. The FCC establishes technical standards for satellite transmission equipment that change from time to time and requires coordination of earth stations with land-based microwave systems at certain frequencies to assure non-interference. Transmission equipment must also be installed and operated in a manner that avoids exposing humans to harmful levels of radio-frequency radiation. The placement of earth stations or other antennae also is typically subject to regulation under local zoning ordinances.

***Discovery***

In the United States, the FCC regulates the providers of satellite communications services and facilities for the transmission of programming services, the cable television systems that carry such services and, to some extent, the availability of the programming services themselves through its regulation of program licensing. Cable television systems in the United States are also regulated by municipalities or other state and local government authorities and are currently subject to federal rate regulation on the provision of basic service. Continued rate regulation or other franchise conditions could place downward pressure on the fees cable television companies are willing or able to pay for the Discovery networks. Regulatory carriage requirements also could adversely affect the number of channels available to carry the Discovery networks.

The Cable Television Consumer Protection and Competition Act of 1992 (the 1992 Cable Act) directed the FCC to promulgate regulations regarding the sale and acquisition of cable programming between multi-channel video programming distributors (including cable operators) and satellite-delivered programming services in which a cable operator has an attributable interest. Because cable operators have an attributable interest in Discovery, the Discovery networks are subject to these rules. The legislation and the implementing regulations adopted by the FCC preclude virtually all exclusive programming contracts between cable operators and satellite programmers affiliated with any cable operator and the 1992 Cable Act requires that

**Table of Contents**

such affiliated programmers make their programming services available to cable operators and competing multi-channel video programming distributors on terms and conditions that do not unfairly discriminate among distributors. As a result, Discovery has not been, and will not be, able to enter into exclusive distribution agreements, which could provide more favorable terms than non-exclusive agreements.

The 1992 Cable Act required the FCC, among other things, to prescribe rules and regulations establishing reasonable limits on the number of channels on a cable system that will be allowed to carry programming in which the owner of such cable system has an attributable interest. In 1993, the FCC adopted such channel carriage limits. However, in 2001, the United States Court of Appeals for the District of Columbia Circuit found that the FCC had failed to justify adequately the channel carriage limit, vacated the FCC's decision and remanded the rule to the FCC for further consideration. In response to the Court's decision, the FCC issued a further notice of proposed rulemaking in 2001 to consider channel carriage limitations. The FCC issued a Second Further Notice of Proposed Rulemaking on May 17, 2005, requesting comment on these issues. If such channel carriage limitations are implemented, the ability of Cox Communications and Advance/Newhouse to carry the full range of Discovery's networks could be limited.

The 1992 Cable Act granted broadcasters a choice of must carry rights or retransmission consent rights. The rules adopted by the FCC generally provided for mandatory carriage by cable systems of all local full-power commercial television broadcast signals selecting must carry rights and, depending on a cable system's channel capacity, non-commercial television broadcast signals. Such statutorily mandated carriage of broadcast stations coupled with the provisions of the Cable Communications Policy Act of 1984, which require cable television systems with 36 or more activated channels to reserve a percentage of such channels for commercial use by unaffiliated third parties and permit franchise authorities to require the cable operator to provide channel capacity, equipment and facilities for public, educational and government access channels, could adversely affect the Discovery networks by limiting their carriage of such services in cable systems with limited channel capacity. In 2001, the FCC adopted rules relating to the cable carriage of digital television signals. Among other things, the rules clarify that a digital-only television station can assert a right to analog or digital carriage on a cable system. The FCC initiated a further proceeding to determine whether television stations may assert rights to carriage of both analog and digital signals during the transition to digital television and to carriage of all digital signals. On February 10, 2005, the FCC denied mandatory dual carriage of a television station's analog and digital signals during the digital television transition and mandatory carriage of all digital signals, other than its primary signal. Television station owners have petitioned the FCC to reconsider its decision and are seeking legislative change.

In 2004, the FCC's Media Bureau conducted a notice of inquiry proceeding regarding the feasibility of selling video programming services à la carte, i.e. on an individual or small tier basis. The Media Bureau released a report in November 2004, which concluded that a la carte sales of video programming services would not result in lower video programming costs for most consumers and that they would adversely affect video programming networks. On February 9, 2006, the Media Bureau released a new report which stated that the 2004 report was flawed and which concluded that a la carte sales could be in the best interests of consumers. Although the FCC cannot mandate a la carte sales, its endorsement of the concept could encourage Congress to consider proposals to mandate a la carte sales or otherwise seek to impose greater regulatory controls on how a la carte programming is sold. The programming companies that distribute these services in tiers or packages of programming services could experience decreased distribution if a la carte carriage were mandated.

In general, authorization from the FCC must be obtained for the construction and operation of a communications satellite. Satellite orbital slots are finite in number, thus limiting the number of carriers that can provide satellite transponders and the number of transponders available for transmission of programming services. At present, however, there are numerous competing satellite service providers that make transponders available for video services to the cable industry. The FCC also regulates the earth stations uplinking to and/or downlinking from such satellites.

The regulation of programming services is subject to the political process and has been in constant flux over the past decade. Further material changes in the law and regulatory requirements must be anticipated

**Table of Contents**

and there can be no assurance that our business will not be adversely affected by future legislation, new regulation or deregulation.

***International Regulatory Matters***

Video distribution and content businesses are regulated in each of the countries in which we operate. The scope of regulation varies from country to country, although in some significant respects regulation in Western European markets is harmonized under the regulatory structure of the European Union, which we refer to as the EU. Adverse regulatory developments could subject our businesses to a number of risks. Regulations could limit growth, revenue and the number and types of services offered. In addition, regulation may restrict our operations and subject them to further competitive pressure, including restrictions imposed on foreign programming distributors that could limit the content they may carry in ways that affect us adversely. Failure to comply with current or future regulation of our businesses could expose our businesses to various penalties.

**Competition**

The creative media services industry is highly competitive, with much of the competition centered in Los Angeles, California, the largest and most competitive market, particularly for domestic television and feature film production as well as for the management of content libraries. We expect that competition will increase as a result of industry consolidation and alliances, as well as from the emergence of new competitors. In particular, major motion picture studios such as Paramount Pictures, Sony Pictures Corporation, Twentieth Century Fox, Universal Pictures, The Walt Disney Company, Metro-Goldwyn-Mayer and Warner Brothers, while Ascent Media's customers, can perform similar services in-house with substantially greater financial resources than Ascent Media's, and in some cases significant marketing advantages. These studios may also outsource their requirements to other independent providers like us or to other studios. Thomson, a French corporation, is also a major competitor of Ascent Media, particularly under its Technicolor brand, as is Kodak through its Laser Pacific division. Ascent Media also actively competes with certain industry participants that have a unique operating niche or specialty business. There is no assurance that Ascent Media will be able to compete effectively against these competitors.

The business of distributing programming for cable and satellite television is highly competitive, both in the United States and in foreign countries. Discovery competes with other programmers for distribution on a limited number of channels. Increasing concentration in the multichannel video distribution industry could adversely affect Discovery by reducing the number of distributors available to carry Discovery's networks, subjecting more of Discovery's subscriber fees to volume discounts and increasing the distributors' bargaining power in negotiating new affiliation agreements. Once distribution is obtained, Discovery's programming services compete, in varying degrees, for viewers and advertisers with other cable and off-air broadcast television programming services as well as with other entertainment media, including home video, pay-per-view services, online activities, movies and other forms of news, information and entertainment. Discovery also competes, to varying degrees, for creative talent and programming content. Our management believes that important competitive factors include the prices charged for programming, the quantity, quality and variety of the programming offered and the effectiveness of marketing efforts.

**Employees**

We currently have no corporate employees. Liberty provides us with certain management and administrative services pursuant to a services agreement, which includes the services of our executive officers some of whom remain executive officers of Liberty.

As of December 31, 2005, Ascent Media had approximately 3,800 employees, most of which worked on a full-time basis. Approximately 2,400 of Ascent Media's employees were employed in the United States, with the remaining 1,400 employed outside the United States, principally in the United Kingdom and the Republic of Singapore. Approximately 420 of Ascent Media's employees belong to either the International Alliance of Theatrical Stage Employees in the United States or the Broadcasting Entertainment Cinematograph and Theatre Union in the United Kingdom.

**Table of Contents**

As of December 31, 2005, Discovery had approximately 4,000 employees.

**(d) Financial Information About Geographic Areas**

For financial information related to the geographic areas in which we do business, see note 18 to our consolidated financial statements found in Part II of this report.

**(e) Available Information**

All of our filings with the Securities and Exchange Commission (the SEC), including our Form 10-Ks, Form 10-Qs and Form 8-Ks, as well as amendments to such filings are available on our Internet website free of charge generally within 24 hours after we file such material with the SEC. Our website address is [www.discoveryholdingcompany.com](http://www.discoveryholdingcompany.com).

Our corporate governance guidelines, code of ethics, compensation committee charter, and audit committee charter are available on our website. In addition, we will provide a copy of any of these documents, free of charge, to any shareholder who calls or submits a request in writing to Investor Relations, Discovery Holding Company, 12300 Liberty Boulevard, Englewood, Colorado 80112, Tel. No. (866) 876-0461.

The information contained on our website is not incorporated by reference herein.

**Item 1A. Risk Factors.**

An investment in our common stock involves risk. You should carefully consider the risks described below, together with all of the other information included in this annual report in evaluating our company and our common stock. Any of the following risks, if realized, could have a material adverse effect on the value of our common stock.

*We are a holding company, and we could be unable in the future to obtain cash in amounts sufficient to service our financial obligations or meet our other commitments.* Our ability to meet our financial obligations and other contractual commitments depends upon our ability to access cash. We are a holding company, and our sources of cash include our available cash balances, net cash from the operating activities of our subsidiaries, any dividends and interest we may receive from our investments, availability under any credit facilities that we may obtain in the future and proceeds from any asset sales we may undertake in the future. The ability of our operating subsidiaries to pay dividends or to make other payments or advances to us depends on their individual operating results and any statutory, regulatory or contractual restrictions to which they may be or may become subject.

*We do not have access to the cash that Discovery generates from its operating activities.* Discovery generated approximately \$69 million, \$125 million and \$154 million of cash from its operations during the years ended December 31, 2005, 2004 and 2003, respectively. Discovery uses the cash it generates from its operations to fund its investing activities and to service its debt and other financing obligations. We do not have access to the cash that Discovery generates unless Discovery declares a dividend on its capital stock payable in cash, redeems any or all of its outstanding shares of capital stock for cash or otherwise distributes or makes payments to its stockholders, including us. Historically, Discovery has not paid any dividends on its capital stock or, with limited exceptions, otherwise distributed cash to its stockholders and instead has used all of its available cash in the expansion of its business and to service its debt obligations. Covenants in Discovery's existing debt instruments also restrict the payment of dividends and cash distributions to stockholders. We expect that Discovery will continue to apply its available cash to the expansion of its business. We do not have sufficient voting control to cause Discovery to pay dividends or make other payments or advances to its stockholders, or otherwise provide us access to Discovery's cash.

*We have limited operating history as a separate company upon which you can evaluate our performance.* Although our subsidiary Ascent Media was a separate public company prior to June 2003 (when Liberty acquired the outstanding shares of Ascent Media that it did not already own), we have limited operating history as a separate public company. Additionally, the historical financial information included in this annual report for periods prior to our existence may not necessarily be representative of our results as a separate

**Table of Contents**

company. There can be no assurance that our business strategy will be successful on a long-term basis. We may not be able to grow our businesses as planned and may not be profitable.

*We do not have the right to manage Discovery, which means we cannot cause Discovery to operate in a manner that is favorable to us.* Discovery is managed by its stockholders rather than a board of directors. Generally, all actions to be taken by Discovery require the approval of the holders of a majority of Discovery's shares; however, pursuant to a Stockholders' Agreement, the taking of certain actions (including, among other things, a merger of Discovery, or the issuance of additional shares of Discovery capital stock or approval of annual business plans) require the approval of the holders of at least 80% of Discovery's shares. Because we do not own a majority of the outstanding equity interests of Discovery, we do not have the right to manage the businesses or affairs of Discovery. Although our status as a 50% stockholder of Discovery enables us to exercise influence over the management and policies of Discovery, such status does not enable us to cause any actions to be taken. Cox Communications and Advance/ Newhouse each hold a 25% interest in Discovery, which ownership interest enables each such company to prevent Discovery from taking actions requiring 80% approval.

Actions to be taken by Discovery that require the approval of a majority of Discovery's shares may, under certain circumstances, result in a deadlock. Because we own a 50% interest in Discovery and each of Cox Communications and Advance/ Newhouse own a 25% interest in Discovery, a deadlock may occur when the stockholders vote to approve an action that requires majority approval. Accordingly, unless either Cox Communications or Advance/ Newhouse elects to vote with us on items that require majority action, such actions may not be taken. Pursuant to the terms of the Stockholders' Agreement, if an action that requires approval by a majority of Discovery's shares is approved by 50%, but not more than 50%, of the outstanding shares then the proposed action will be submitted to an arbitrator designated by the stockholders. Currently, the arbitrator is John Hendricks, the founder and Chairman of Discovery. Mr. Hendricks, as arbitrator, is entitled to cast the deciding vote on matters where the stockholders have deadlocked because neither side has a majority. Mr. Hendricks, however, is not obligated to take action to break such a deadlock. In addition, Mr. Hendricks may elect to approve actions we have opposed, if such a deadlock exists. In the event of a dispute among the stockholders of Discovery, the possibility of such a deadlock could have a material adverse effect on Discovery's business.

*The liquidity and value of our interest in Discovery may be adversely affected by a Stockholders' Agreement to which we are a party.* Our 50% interest in Discovery is subject to the terms of a Stockholders' Agreement among the holders of Discovery capital stock. Among other things, the Stockholders' Agreement restricts our ability to directly sell or transfer our interest in Discovery or to borrow against its value. These restrictions impair the liquidity of our interest in Discovery and may make it difficult for us to obtain full value for our interest in Discovery should such a need arise. In the event we chose to sell all or a portion of our direct interest in Discovery, we would first have to obtain an offer from an unaffiliated third party and then offer to sell such interest to Cox Communications and Advance/ Newhouse on substantially the same terms as the third party had agreed to pay.

If either Cox Communications or Advance/ Newhouse decided to sell their respective interests in Discovery, then the other of such two stockholders would have a right to acquire such interests on the terms set by a third party offer obtained by the selling stockholder. If the non-selling stockholder elects not to exercise this acquisition right, then, subject to the terms of the Stockholders' Agreement, we would have the opportunity to acquire such interests on substantially the terms set by a third party offer obtained by the selling stockholder. We anticipate that the purchase price to