

Discovery Holding CO
Form 10-K
February 15, 2008

Table of Contents

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

Form 10-K

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2007**
- OR**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the transition period from to**

Commission File Number 000-51205

DISCOVERY HOLDING COMPANY
(Exact name of Registrant as specified in its charter)

State of Delaware
*(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:

Title of Each Class	Name of Exchange on Which Registered
Series A Common Stock, par value \$.01 per share	Nasdaq Global Select Market
Series B Common Stock, par value \$.01 per share	Nasdaq Global Select Market

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

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

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

The aggregate market value of the voting stock held by nonaffiliates of Discovery Holding Company computed by reference to the last sales price of such stock, as of the closing of trading on June 30, 2007, was approximately \$6.1 billion.

The number of shares outstanding of Discovery Holding Company's common stock as of January 31, 2008 was:

Series A Common Stock 269,179,015; and
Series B Common Stock 11,869,696 shares.

DOCUMENTS INCORPORATED BY REFERENCE

The Registrant's definitive proxy statement for its 2008 Annual Meeting of Stockholders is hereby incorporated by reference into Part III of this Annual Report on Form 10-K

DISCOVERY HOLDING COMPANY
2007 ANNUAL REPORT ON FORM 10-K

Table of Contents

	Page
<u>PART I</u>	
<u>Item 1.</u> <u>Business</u>	I-1
<u>Item 1A.</u> <u>Risk Factors</u>	I-27
<u>Item 1B.</u> <u>Unresolved Staff Comments</u>	I-37
<u>Item 2.</u> <u>Properties</u>	I-37
<u>Item 3.</u> <u>Legal Proceedings</u>	I-37
<u>Item 4.</u> <u>Submission of Matters to a Vote of Security Holders</u>	I-37
<u>PART II</u>	
<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-2
<u>Item 7.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	II-3
<u>Item 7A.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	II-25
<u>Item 8.</u> <u>Financial Statements and Supplementary Data</u>	II-25
<u>Item 9.</u> <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	II-25
<u>Item 9A.</u> <u>Controls and Procedures</u>	II-25
<u>Item 9B.</u> <u>Other Information</u>	II-25
<u>PART III</u>	
<u>Item 10.</u> <u>Directors, Executive Officers and Corporate Governance</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, and Director Independence</u>	III-1
<u>Item 14.</u> <u>Principal Accounting Fees and Services</u>	III-1
<u>PART IV</u>	
<u>Item 15.</u> <u>Exhibits and Financial Statement Schedules</u>	IV-1
<u>Amended and Restated Limited Liability Company Agreement</u>	
<u>Subsidiaries of Discovery Holding Company</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 was intended to qualify as a tax-free transaction.

We are a holding company. Through our two wholly-owned operating subsidiaries, Ascent Media Group, LLC (Ascent Media) and Ascent Media CANS, LLC (dba AccentHealth) (AccentHealth), and through our 662/3% owned equity affiliate Discovery Communications Holding, LLC (Discovery), we are engaged primarily in (1) the provision of creative and network services to the media and entertainment industries and (2) the production, acquisition and distribution of entertainment, educational and informational programming and software. Our subsidiaries and affiliates operate in the United States, Europe, Latin America, Asia, Africa and Australia.

The assets and operations of Ascent Media are composed primarily of the assets and operations of 13 companies acquired by Liberty from 2000 through 2004, including The Todd-AO Corporation, Four Media Company, certain assets of SounDelux Entertainment Group, Video Services Corporation, Group W Network Services, London Playout Centre and the systems integration business of Sony Electronics. The combination and integration of these and other acquired entities allows 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.

AccentHealth, which we acquired in January 2006, operates an advertising-supported captive audience television network in doctor office waiting rooms nationwide.

Discovery is a leading global media and entertainment company that provides original and purchased programming across multiple distribution platforms in the United States and more than 170 other countries, including television networks offering customized programming in 35 languages. Discovery also develops and sells consumer and educational products and services in the United States and internationally, and owns and operates a diversified portfolio of website properties and other digital services. Discovery operates through three divisions: (1) Discovery networks U.S., (2) Discovery networks international, and (3) Discovery commerce and education.

Discovery was formed in the second quarter of 2007 as part of a restructuring (the DCI Restructuring) completed by Discovery Communications, Inc. (DCI). In the DCI Restructuring, DCI was converted into a limited liability company and became a wholly-owned subsidiary of Discovery, and the former shareholders of DCI, including us, became members of Discovery. Subsequent to the DCI Restructuring, each of the members of Discovery held the same membership interests in Discovery as they previously held in DCI. Discovery is the successor reporting entity to DCI.

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On May 14, 2007, Discovery and Cox Communications Holdings, Inc. (Cox) completed an exchange of Cox's 25% membership interest in Discovery for all of the capital stock of a subsidiary of Discovery that held Travel Channel, travelchannel.com and approximately \$1.3 billion in cash (the Cox Transaction). Discovery raised the cash component through additional debt financing, and retired the membership interest previously owned by Cox. Upon completion of this transaction, we own a 66²/₃% interest in Discovery and Advance/Newhouse Programming Partnership (Advance/Newhouse) owns a 33¹/₃% interest. We continue to account for our investment in Discovery using the equity method of accounting due to governance rights possessed by Advance/Newhouse which restrict our ability to control Discovery.

I-1

Table of Contents

In December 2007, we announced that we had signed a non-binding letter of intent with Advance/Newhouse to combine our respective stakes in Discovery. As currently contemplated by the non-binding letter of intent, the transaction, if completed, would involve the following steps:

We will spin-off to our shareholders a wholly-owned subsidiary holding cash and Ascent Media, except for those businesses of Ascent Media that provide sound, music, mixing, sound effects and other related services;

Immediately following the spin-off, we will combine with a new holding company (New DHC), and our existing stockholders will receive shares of common stock of New DHC;

As part of this transaction, Advance/Newhouse will contribute its interests in Discovery and Animal Planet to New DHC in exchange for preferred stock of New DHC that, immediately after the closing of the transactions, will be convertible at any time into shares initially representing one-third of the outstanding shares of common stock of New DHC. The preferred stock held by Advance/Newhouse will entitle it to elect two members to New DHC 's board of directors and to exercise approval rights with respect to the taking of specified actions by New DHC and Discovery.

Although no assurance can be given, consummation of this transaction (the Newhouse Transaction and Ascent Spin Off) is expected to close in the second quarter of 2008 and would result in the consolidation of the results of Discovery within New DHC.

* * * * *

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

general economic and business conditions and industry trends including the timing of, and spending on, feature film, television and television commercial 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 of new business lines and business strategies;

integration of acquired operations;

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uncertainties associated with product and service development and market acceptance, including the development and provision of programming for new television and telecommunications technologies;

changes in the distribution and viewing of television programming, including the expanded deployment of personal video recorders, video on demand and IP television and their impact on television advertising revenue;

rapid technological changes;

future financial performance, including availability, terms and deployment of capital;

I-2

Table of Contents

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, or the duration of any existing strike or job action;

changes in, or failure or inability to comply with, government regulations, including, without limitation, regulations of the Federal Communications Commission, and adverse outcomes from regulatory proceedings;

changes in the nature of key strategic relationships with partners and joint venturers;

competitor responses to our products and services, and the products and services of the entities in which we have interests; and

threatened terrorists attacks and ongoing military action in the Middle East and other parts of the world.

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

(b) **Financial Information About Operating Segments**

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

Based on the foregoing criteria, our three reportable segments are our Creative Services group and Network Services group, which are operating segments of Ascent Media, and Discovery, which is an equity affiliate. 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 and network services to the media and entertainment industries in the United States, the United Kingdom (UK) and Singapore. Ascent Media provides effective solutions for the creation, management and distribution of content to major motion picture studios, independent producers, broadcast

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networks, programming networks, advertising agencies and other companies that produce, own and/or distribute entertainment, news, sports, corporate, educational, industrial and advertising content. Services are marketed to target industry segments through Ascent Media's internal sales force and may be sold on a bundled or individual basis.

Ascent Media's operations are organized into two main categories: creative services and network services.

I-3

Table of Contents

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 and TV spots, documentaries, independent films, scripted and reality television, TV movies and mini-series, television commercials, internet and new media advertising, 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 reformat and repurpose completed media assets for global distribution via freight, satellite, fiber and the Internet.

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

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

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

Dailies. Clients that are in production require daily screening of their previous day's footage captured on film, video or data in order to evaluate technical and aesthetic qualities of the production and to facilitate the creative editorial process. Ascent Media provides the services necessary for clients to view principal photography on a daily basis, also known as dailies, including film processing and digital transfer, which is the transfer of film negatives to video or digital data. Dailies may be delivered to customers in a variety of videotape or file based formats. The Company also provides dailies viewing environments at client locations and in editorial cutting rooms for their clients' productions.

Digital intermediates. Ascent Media's digital intermediate 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. The digital intermediate process provides filmmakers and commercial producers with greater creative control through enhanced visual manipulation options and the ability to see their creative decisions applied in real time.

Color Correction. The color correction process allows for the development of a creative look and feel for media content, which can then be applied to different source elements that are assembled in sequence to allow for consistency of visual presentation, notwithstanding variations in the original source material and the differing color spectrums of film and other media. Ascent Media employs highly-skilled creative talent who utilize creative colorizing techniques, equipment and processes to enable its clients to achieve desired results for creative content including television commercials, music videos, feature films and television shows.

Creative editorial. After principal photography of advertising content has been completed, Ascent Media's editors assemble various elements into a cohesive story consistent with the messaging, branding and creative direction of Ascent Media's advertising clients. Ascent Media provides the tools and talent required through all stages of the finishing process necessary for creation, and primary and secondary distributions, of completed advertising content.

Ascent Media also provides the rental of editorial equipment for use in the creation of feature film and episodic television content.

Visual effects. Visual effects can be used to create images that cannot be created physically through a more cost-effective means, to digitally remove elements captured in principal photography, and to enhance or supplement original visual images by integrating computer generated images with images captured during

Table of Contents

principal photography. Ascent Media provides its visual effects services with teams of artists utilizing an array of graphics and animation workstations and using a variety of software to accomplish unique effects.

Assembly, formatting and master creation 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 certain entertainment media content to meet specific production and distribution requirements, including time compression and commercial breaks. Finally, Ascent Media creates and delivers multiple master copies of the applicable final product for distribution, broadcast, archival and other purposes designated by the customer.

Digital media management services. Ascent Media's Digital Media Data Center provides services that enable content owners to digitize content once, then store, manage, re-purpose and distribute such content globally in multiple formats and languages to numerous providers. These file-based services can help Ascent Media's clients exploit existing and emerging global revenue streams, including broadband, mobile and other digital outlets and devices, reducing time-to-market while providing increased security, flexibility and database functionality. Such services can be implemented as a fully outsourced platform or individual managed services. As used in the media services industry, the term "element" refers to a unit of created content of any length, such as a feature film, television episode, commercial spot, movie trailer, promotional clip or other unique product, such as a foreign language version or alternate format of any of the foregoing.

Advertising distribution. Once a television commercial has been completed, Ascent Media provides support services required to manufacture and deliver commercials to specific television broadcasters or radio stations, including format conversion, video and audio duplication, distribution, and storage and asset management, for advertising agencies, corporate advertisers and other content owners. Ascent Media uses satellite, fiber-optic and Integrated Services Digital Network, or ISDN, Internet access, terrestrial broadband, and conventional air freight for the delivery of television and radio spots to broadcasters and radio stations. Ascent Media's commercial television distribution facilities in Los Angeles and San Francisco, California enable Ascent Media to service any regional or national client.

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

Transferring film to video or digital media masters. 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 a video or digital file format. Each frame must be color corrected and adapted to the desired aspect ratio to meet the required distribution specifications and 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, have contributed to the growth of Ascent Media's film transfer business. Ascent Media also digitally removes dirt and scratches from a damaged film master that is transferred to a digital file format.

Professional duplication and standards conversion. Ascent Media provides professional duplication, which is the process of creating broadcast quality and resolution independent sub-masters for distribution to professional end users. Ascent Media uses master elements to make sub-masters in numerous domestic and international broadcast standards

as well as up to 22 different tape formats. Ascent Media also provides standards conversion, which is the process of changing the frame rate of a video signal from one video standard, such as the United States standard (NTSC), to another, such as a European standard (PAL or

Table of Contents

SECAM). Content is regularly copied, converted and checked by quality control for use in intermediate processes, such as editing, on-air backup and screening and for final delivery to cable and pay-per-view programmers, broadcast networks, television stations, airlines, home video duplicators and foreign distributors. Ascent Media's duplication and standards conversion facilities are technically advanced with unique characteristics that significantly increase equipment capacity while reducing error rates and labor cost.

DVD compression and authoring and menu design. Ascent Media provides all stages of DVD production, including creative menu design, special feature production, interactive features, compression, authoring, multi channel audio mixing, and quality control. Ascent Media supports DVD production in traditional DVD formats as well as Blu Ray and HD DVD formats. Ascent Media also prepares and optimizes content for evolving formats of digital distribution, such as video-on-demand and interactive television.

Storage of elements and working masters. Ascent Media's physical 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. Ascent Media also provides file-based digital archive services, as discussed under the heading *Digital media management services* above.

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.

Sound supervision, sound design and sound editorial. Ascent Media provides creative talent, facilities and support services to enhance, modify or 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 have prepared the elements that will make up the finished product, the final process in the creative sound post production process is the mix (or re-recording). Mixing a film involves the process of combining multiple elements, such as tracks of sound effects, dialogue and music, to complete the final product. Ascent Media maintains a significant number of mixing stages, purpose-built and provisioned with advanced recording equipment, capable of handling any type of project, from major motion pictures to smaller independent films.

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

and multimedia games. Ascent Media actively continues to add new, original recordings to its library.

Table of Contents

Network Services

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

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

Network origination and master control. The network services group provides outsourced network origination services 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 via fiber and satellite. Currently, over two hundred programming feeds running 24 hours a day, seven days a week are supported by Ascent Media's facilities in the United States, London and Singapore. Network origination services are provided from large-scale technical platforms with integrated asset management, hierarchical storage management (a data storage technique which automatically moves data between high-cost and low-cost storage media), and broadcast automation capabilities. These platforms, which are designed, built, owned and operated by Ascent Media, require Ascent Media to incorporate and integrate hardware and software from multiple third-party suppliers into a coordinated service solution. Associated services include cut-to-clock and compliance editing, tape library management, ingest & quality control, format conversion, and tape duplication. For multi-language television services, Ascent Media facilitates the collection, aggregation, and playout of languaging materials, including subtitles and foreign language dubs. On-air graphics and other secondary events are also integrated with the content by Ascent Media. In conjunction with network origination services, Ascent Media operates television production studios and provides complete post-production services for on-air promotions for some clients.

Transport and connectivity. Ascent Media operates satellite earth station facilities in Singapore, California, New York, New Jersey, Minnesota and Connecticut. 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 operates a global fiber network to carry real-time video and data services between its various locations in the US, London, and Singapore. This network is used to provide full-time program feeds and ad hoc services to clients and to transport files and real-time signals between Ascent Media locations. Ascent Media also operates industry-standard encryption and/or compression systems as needed for customer satellite transmission.

Engineering and systems integration. Ascent Media designs, builds, installs and services advanced technical systems for production, management and delivery of rich media content to the worldwide broadcast, cable television, broadband, government and telecommunications industries. Ascent Media's engineering and systems integration business operates out of facilities in New Jersey, California, Florida, and London, and services global clients including major broadcasters, cable and satellite networks, telecommunications providers, and corporate television networks, as well as numerous production and post-production facilities. Services offered include program management, engineering design, equipment procurement, software integration, construction, installation, service and support. Ascent Media also designs and constructs satellite earth stations and related facilities.

Consulting Services. Ascent Media provides strategic, technology and business consulting services to the media and entertainment industry. Key practice areas include: digital migration; content delivery strategies; workflow analysis and design; emerging delivery platforms (such as Internet-protocol television, mobile and broadband); technology assessment; and technology-enabled business strategies.

Table of Contents

Network Operations, Field Service and Call Center. The network services group provides field service operations 24 hours a day, seven days a week through an on-staff network of approximately 50 field engineers located throughout the United States. Services include preventative and reactive maintenance of satellite earth stations, satellite networks, fiber-based digital transmission facilities, cable and telecommunications stations (also called head ends), and other technical facilities for the distribution of video content. The group operates a call center 24 hours a day, seven days a week out of its Palm Bay, Florida facility, providing outsourced services for technology manufacturing companies, networks and telecoms. In addition, the group operates a network operations center, providing outsourced services relating to monitoring and management of satellite and terrestrial distribution networks and remote monitoring and control of technical facilities. End users for field service, call center and network operation center services include major US broadcast and cable networks, telecommunications providers, digital equipment manufacturers, and government and corporate operations.

AccentHealth

AccentHealth provides advertising-supported health education programming for distribution in doctor office waiting rooms via three AccentHealth Waiting Room TV Networks: the General Health Network, the Young Family Network and the Silver Network. The General Health Network targets general practice and family practice patients, and provides news and health information applicable to the general needs of that demographic. The Young Family Network targets pediatric and Ob-Gyn patients, and provides baby, child and parenting related programming. The Silver Network targets internal medicine, general practice and cardiology patients, and provides programming tailored to appeal to the specific interests of patients over the age of 50. Programming on the AccentHealth Waiting Room TV Networks is produced monthly by CNN and features customized content relating to a variety of topics, including medical breakthroughs, parenting issues, nutrition, fitness, safety and wellness.

AccentHealth's programming content airs on television monitors installed in doctor office waiting rooms, and is provided at no cost to the practice. AccentHealth offers its advertising clients a number of products and services, including:

- selected commercial time slots on the AccentHealth Waiting Room TV Networks;

- print-display advertising space (traditionally used for product brochures, information pamphlets or coupons) alongside the Health Panels, AccentHealth's wall-mounted educational print displays;

- turn-key literature distribution services; and

- certain services related to the production of commercial advertising spots or the customization of certain advertising services.

We believe that AccentHealth is the largest point-of-care media supplier in the U.S., with the AccentHealth Waiting Room TV networks reaching 11.7 million viewers per month in 11,200 waiting rooms nationwide.

Strategy

Ascent Media's goal is to be the premier end-to-end digital media supply chain services provider to the media and entertainment industry creating, managing and distributing rich media content across all distribution channels on a global basis. Ascent Media believes it can optimize its position in the market by pursuing the following strategies:

Provide a broad range of media services. The entertainment services industry has historically been fragmented, with numerous providers offering discrete, geographically-limited, non-integrated services. Ascent Media spans the value

chain with a broad range of services from the creation and management of media content to the distribution of content via multiple transmission paths, including satellite, fiber and Internet Protocol-based networks on a global basis. Ascent Media believes its range of service offerings and in-depth knowledge of media workflows provide it with a strategic advantage over less-diversified service providers in developing deep, long-term relationships with creators, owners and distributors of creative content. In addition, Ascent Media believes that the reputations of its highly-respected creative boutiques, which operate under their own well-known brand names, help distinguish Ascent Media from commodity suppliers.

Table of Contents

Grow digital media management business. Ascent Media seeks to increase business with major media and entertainment clients by creating, storing, managing, repurposing and distributing their digital media content through traditional channels as well as emerging new media outlets on a global basis. Ascent Media believes that the technical complexity and scale issues associated with providing these services will make outsourcing of activities more attractive to Ascent Media's client base, creating opportunities for increased market share. In 2007, Ascent Media extended the geographical reach of its proprietary digital media management system, adding capabilities in the New York metropolitan area and the United Kingdom to the original center in Los Angeles. Ascent Media currently plans to deploy its proprietary digital media management system in Singapore during 2008.

Deploy an interconnected global media network. Ascent Media plans to provide clients access to a fiber-based network integrated with its creative and management services. The network will provide global connectivity and file transport capabilities, which will make client workflows more efficient and enhance Ascent's end-to-end portfolio of services.

Invest in core business operations. Ascent Media intends to increase its capabilities through internal investments to improve the capacity, utilization and throughput of its existing facilities. Ascent Media will also consider opportunities that may arise to add scale or service offerings, or to increase market share, through strategic acquisitions or joint ventures. Consistent with this strategy, Ascent Media will also seek opportunities to divest non-core assets, when appropriate.

Seek opportunities to offer new services within core competencies. Ascent Media intends to expand its market share by applying its core capabilities to develop new value-added service offerings, participating in emerging high revenue-generating services such as re-versioning content for distribution to new platforms. In that regard, Ascent Media will endeavor to develop service offerings that meet unique needs of its customers.

For a description of the risks associated with the foregoing strategies, and with Ascent Media's business in general, see Risk Factors beginning on page I-27.

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 demand 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 lowest 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, changes in the timing of the demand for television program services may result in increased business for Ascent Media in the summer. In addition, the timing of long-term projects in Ascent Media's creative 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 is a leading global media and entertainment company that provides original and purchased programming across multiple distribution platforms in the United States and more than 170 other countries, with over 100 television networks offering customized programming in 35 languages. As one of the world's largest providers of non-fiction television programming, Discovery's strategy is to optimize the distribution, ratings and profit potential of each of its branded channels. Discovery also develops and sells consumer and educational products and services in the United States and internationally, and owns and operates a diversified portfolio of website properties and other digital

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services. Discovery operates through three divisions: (1) Discovery networks U.S., (2) Discovery networks international, and (3) Discovery commerce and education.

Discovery's media content spans non-fiction genres including science, exploration, survival, natural history, sustainability of the environment, technology, anthropology, health and wellness, engineering, adventure, lifestyles and current events. This type of programming tends to be culturally neutral and maintains its relevance for an extended period of time, referred to as long-tail. As a result, Discovery's content translates well across

Table of Contents

international borders and is made even more accessible through extensive use of dubbing and subtitles in local languages as well as the creation of local programming tailored to individual market preferences.

Discovery's content is designed to target key audience demographics, and the popularity of its programming offers a compelling reason for advertisers to purchase time on its channels. Discovery's audience ratings are a key driver in generating advertising revenue and create demand on the part of cable television operators, direct-to-home or DTH satellite operators, telephone and communications companies and other content distributors to deliver its programming to their customers.

Discovery has an extensive library of over 100,000 hours of programming and footage that provides a high-quality source of content for creating new services and launching into new markets and onto new platforms. Discovery generally owns most or all rights to the majority of this programming and footage which enables Discovery to exploit its library to launch new brands and services into new markets quickly without significant incremental spending. Programming can be re-edited and updated to provide topical versions of subject matter in a cost-effective manner and utilized around the world.

In addition to growing distribution and advertising revenue for its branded channels, Discovery is focused on growing revenue across new distribution platforms, including brand-aligned web properties, mobile devices, video-on-demand and broadband channels, which serve as additional outlets for advertising and affiliate sales, and provide promotional platforms for its programming. Discovery currently operates Internet sites providing news, information and entertainment content that are aligned with its television programming. In December 2007, Discovery completed the acquisition of HowStuffWorks.com, an award-winning online source of high-quality, unbiased and easy-to-understand explanations of how the world actually works. This acquisition provides an additional platform for Discovery's extensive library of video content and positions its brand as a hub for satisfying curiosity on a variety of topics on both television and online.

Discovery is also exploiting its programming assets to take advantage of the growing demand for high definition (HD) programming in the U.S. and throughout the world. In 2007, Discovery launched HD simulcasts of four of its networks (Discovery Channel, TLC, Animal Planet and Science Channel) in addition to its existing HD Theater service, which was launched in 2002. Discovery also operates HD channels in 15 countries outside of the U.S., making it the number-one programming provider of HD channels outside of the U.S. based on the number of HD channels that it operates. Discovery believes it is well positioned to take advantage of the accelerating growth in sales of HD televisions and Blu-Ray and HD DVD players, and the expanding distribution of HD channels around the world. Where Discovery operates HD simulcasts of its networks, Discovery also benefits from the ability to aggregate audiences for advertising sales purposes.

Strategy

Discovery's strategy is to develop high quality media brands that build consumer viewership, optimize distribution growth and capture advertising sales. In addition, Discovery is focused on maximizing the overall efficiency and effectiveness of its global operations through collaboration and innovation across operating units and regions around the world and across all television and digital platforms.

In line with this strategy, Discovery's specific priorities include:

Maintaining Discovery's focus on creative excellence in non-fiction programming and expanding the portfolio's brand entitlement by developing compelling content that increases audience growth, builds advertising relationships and supports continued distribution revenue on all platforms.

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Exploiting Discovery's distribution strength in the U.S. with three channels reaching more than 90 million U.S. subscribers and six channels reaching approximately 50 million to 70 million U.S. subscribers to build additional branded channels and businesses that can sustain long-term growth and profitability. For example, Discovery recently announced the repositioning of several emerging television networks to build stronger consumer brands through specific category ownership that supports more passionate audience loyalty and increased advertiser and affiliate interest and integration.

I-10

Table of Contents

Maintaining a leadership position in non-fiction entertainment in international markets, and continuing to grow and improve the performance of the international operations. This will be achieved through expanding local advertising sales capabilities, creating licensing and digital growth opportunities, and improving operating efficiencies by strengthening development and promotional collaboration between U.S. and international network groups.

Developing and growing compelling and profitable content experiences on new platforms that are aligned with its core branded channels. Specifically, extending ownership of non-fiction entertainment to all digital media devices around the world to enhance the consumer entertainment experience, further monetize Discovery's extensive programming library, and create additional vehicles on which to offer new products and services that deliver new revenue streams.

Recent Developments

In support of its strategy and priorities, in January 2007, Discovery re-evaluated its operations to identify and implement strategic initiatives designed to improve operational and financial performance and allocate capital in a more disciplined and efficient manner. The following actions are representative of these initiatives:

Business Restructuring: Improved margins through revenue growth and cost efficiencies across Discovery's divisions. Management implemented a growth strategy to address underperforming assets, closed all of its 103 retail stores and shifted the focus of its commerce business to e-commerce and licensing in order to broaden the reach of Discovery-branded products. Discovery also streamlined its education business to focus on direct-to-school products including *Discovery Education streaming* and significantly reduced the investment in direct-to-consumer services. These actions, coupled with an overall focus on improved efficiency, resulted in an approximate 25% reduction in global personnel in 2007. As a result of these restructurings, Discovery improved the operating cash flow margins from the properties that it continues to use and operate.

Global Content Sharing: Strengthened development and promotional collaboration between U.S. and international networks to improve operating margins, promote content sharing and build global brand strength.

Television Network Rebrands: In January 2008, Discovery Times Channel was rebranded as Investigation Discovery as a means to exploit Discovery's extensive library of fact-based investigation and current affairs programming. In June 2008, Discovery expects to rebrand Discovery Home as Planet Green, the only 24-hour eco-lifestyle television network committed to documenting, preserving and celebrating the planet. In January 2008, Discovery announced a proposed 50-50 joint venture with Oprah Winfrey and Harpo, Inc. to rebrand Discovery Health as OWN: The Oprah Winfrey Network, a new multi-platform venture designed to entertain, inform and inspire people to live their best lives through the OWN Channel and the Oprah.com website. It is expected that Discovery Health Channel will be rebranded as OWN in the second half of 2009.

Digital Media Acquisitions and Website Relaunch: Expanded internal web operations while acquiring HowStuffWorks.com and TreeHugger.com, to create a portfolio of brand-aligned digital properties that expand Discovery's cross-platform sales and promotional opportunities and realize economies through programs that can be produced once and used often in both long- and short-form across multiple platforms. In December 2007, Discovery completed the acquisition of HowStuffWorks.com, an award-winning online source of high-quality, unbiased and easy-to-understand explanations of how the world actually works, and in August 2007, Discovery acquired Treehugger.com, an eco-lifestyle website. Discovery relaunched its flagship website, Discovery.com, and is in the process of expanding and deepening the content of all of its channel websites (e.g., TLC.com, AnimalPlanet.com) to move beyond being television promotion vehicles and to focus on

audience growth, engagement and improved monetization. Together with these recent acquisitions, Discovery now has approximately 25 million unique visitors per month to all of its wholly owned websites (source: Omniture, Inc.).

Table of Contents

Dispositions - In May 2007, Discovery and Cox completed an exchange of Cox's 25% interest in Discovery for all of the capital stock of a subsidiary of Discovery that held Discovery's entire interest in Travel Channel, travelchannel.com and approximately \$1.3 billion in cash.

Business Operations

Discovery operates through the three divisions discussed below. A discussion of the financial performance of each of these divisions can be found in Management's Discussion and Analysis of Financial Condition and Results of Operations.

Discovery Networks U.S.

Reaching approximately 675 million cumulative subscribers (as defined below) in the United States as of December 31, 2007 and having one of the industry's most widely distributed portfolio of brands, Discovery networks U.S. delivers 11 cable and satellite television channels in the U.S. The portfolio includes three channels that each reach over 90 million U.S. subscribers (as defined below) and four channels that each reach over 50 million U.S. subscribers. Discovery networks U.S. also provides distribution and advertising sales services for Travel Channel and BBC America and distribution services for BBC World Service.

Domestic subscriber numbers set forth in this document are according to The Nielsen Company. As used herein, a U.S. subscriber is a single household that receives the applicable Discovery channel from its cable, satellite or other television provider, including those who receive Discovery networks from pay-television providers without charge pursuant to various pricing plans that include free periods and/or free carriage. The term cumulative subscribers in the U.S. refers to the collective sum of the total number of U.S. subscribers to each of Discovery's U.S. channels. By way of example, two U.S. households that each receive five Discovery networks from their cable provider represent 10 cumulative subscribers in the U.S. The term cumulative subscribers in the U.S. also includes seven million cumulative subscribers in Canada who receive direct feeds of TLC and Military Channel from Discovery networks U.S.

Discovery Channel