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Hallmark Channel's Profits in the Cards

By ELLIOT GOLAN *Staff Reporter*

The Hallmark Channel is best known for programs where the wholesome and honest guy gets the girl and the family ends up happy and smiling.

In a television landscape where most networks are trying to produce content rife with the danger and sex appeal that attracts younger viewers, and in turn, advertisers, Hallmark has its niche. The channel's audience, mostly women ages 25 to 44, has become a highly profitable segment of the TV market.

In the last three years, Crown Media Holdings, Inc. of Studio City, which manages the Hallmark Channel and its 2008 spinoff, Hallmark Movie Channel, has produced a return on equity of more than 95 percent, topping the Business Journal's list of most profitable companies in the San Fernando Valley.

That number is significantly higher than other successful Valley companies, such as apparel brand licensing company Cherokee Inc. and biotech giant Amgen Inc., which produced about 60 and 20 percent returns, respectively.

Moreover, Crown reported a net income of about $450 million in that same three-year period.

"We've got a strong business and a lot of momentum," said Bill Abbott, chief executive of Crown Media. "We've really turned the corner in the last couple years."

Abbott

Crown Media Holdings Inc. (Nasdaq: CRWN)

Studio City

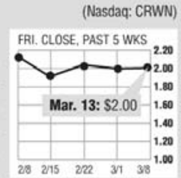
CEO: Bill Abbott

Employees: 175

Market Cap: $716 million

P/E: 6.71

EPS: $0.30



Source: Yahoo Finance

Return on equity is calculated by dividing the net income of a company by its shareholders equity, or the value of a company's assets after all liabilities are deducted.

Lloyd Greif, chief executive of Los Angeles investment banking firm Greif & Co., said return on equity is a simple and straightforward way to gauge whether a company is heading in the right direction. Though a company's return on equity can be artificially inflated by accruing large-scale debt, thereby proportionately reducing shareholder equity, Greif said the positive outlook at Crown is not a numbers mirage, despite its more than $475 million in debt. Cable television is a lower-cost business than industries that require production of hard goods or maintenance of manufacturing plants and though Greif said the company is still using debt as its primary source for growth capital, it is a healthier company today than it was in the last few years.

What's more, he said, a high return on equity is usually a sign that management is competent and creating good value for the business.

"They're deleveraging and that's what you want to be doing," he said. "They're solidifying their balance sheet."

And this year, the channel will premiere its first scripted television series. "Cedar Grove," based on books by romance novelist Debbie Macomber, will star Andie MacDowell and is expected to debut in June.

But business did not look nearly as promising at Crown for much of the last decade. Between its founding by the Hall family of Hallmark Cards Inc. fame in 1991 and 2008, Crown amassed more than $1 billion in debt. Much of that debt came from acquisitions, according to Greif.

In 1994, the company paid $365 million to purchase RHI Entertainment Inc., a producer of long-form television programming, including made-for-television movies and miniseries. In 2001, it struck a deal for 700 titles from the film library of Hallmark Entertainment Distribution, a wholly owned subsidiary of Hallmark Entertainment Inc., adding $220 million to its debt load.

Abbott said the debt was amassed due to "creating a foundation."

In 2010 the company underwent a major shift, which included a recapitalization. The Hall family purchased a large amount of the company's debt. In addition, the number of outstanding shares grew from 104 million in 2008 to almost 360 million three years later. As a result, the Hall family now owns more than 90 percent of the public company's stock.

"The path to profitability was not easy," Abbot said. "Our loans were expiring and that was our only route."

Revenue stream

Originally launched in 1984, the Hallmark channel has gone through several identity shifts, including several years of airing primarily religious content. In 2001, the network was renamed the Hallmark Channel and went away from religious programming to family fare.

Since then, it has aired classic shows such as "I love Lucy," original movies and past segments from its parent company's Hallmark Hall of Fame anthology series, which features made-for-television movies and mini-series. Demand for the programming is high. According to ratings agency Nielsen Co., Hallmark Channel ranked 38 out of 96 in subscribers among the advertising supported cable networks in the U.S. last year. Hallmark Movie Channel ranked 90, though the cannel reaches 50 million homes after only five years in existence.

Salvatore Muoio, founder of New York money management firm S. Muoio & Co. LLC., said the two channels have a more loyal viewing base than many other cable networks, making Crown a very stable business. Moreover, since much of the daily lineup is licensed, programming costs for the channels remains small.

"A large part of the incremental dollar of revenue falls to the bottom line," he said. "They have good profitability."

Much of that revenue comes from advertising. Of the more than $960 million in total revenue Crown Media has reported to the Securities and Exchange Commission in the last three years, more than 75 percent of that, or about $740 million, comes from advertising. While Muoio said the advertising base is strong, he said the company is not taking full advantage of its other main source of revenue: cable subscriber fees.

At a mere 7 cents per subscriber, he said the Hallmark Channel is charging well-below industry standards.

But with subscriber fees amounting to less than one-quarter of the revenue stream for the company, Abbott said the priority is to remain a a good value proposition to cable system operators.

"We've got high ratings and good advertising," he said. "We're in a sweet spot right now."

Muoio thinks the low subscriber fee doesn't come from a sense of maintaining value, but from a lack of bargaining power. As a result, he said the company should reconsider selling to a bigger player in the cable industry, which may increase its leverage when negotiating rates.

After all, the Hallmark Channel and Hallmark Movie Channel were removed from AT&T Inc.'s U-verse cable system in 2010 after the two companies failed to reach a new carriage agreement. Crown was able to renew its contract with industry juggernaut Time Warner Cable Inc. near the end of last year.

And with the talk swirling about the pending sale of the Outdoor Channel to Kroenke Sports & Entertainment LLC of Denver for $225 million, the time may be right to sell.

Abbott said the company has no plans to consider selling. "Cable is a strong and stable business," he said. "Hallmark will not be for sale."

Lawrence Stern, president of New York private investment firm Stern Capital LLC, said the company has shown strong improvement in its bottom line over the last few years and he expects further growth.

"They've created tremendous enterprise value," he said. "There are only a handful of independent cable channels that remain. This one hits a loyal audience and will be around for quite a while."