


## Discovery, Inc . (NASDAQ:DISCA)

 <p><b>Ishfaq Peerally</b> eToro Elite Popular Investor (Approved Value Investor)</p>	Trading Statistics (USD)					
	<b>Market Cap (bb)</b>	13.2	<b>LTM EPS</b>	1.88	<b>Update Date</b>	8 Nov 2021
	<b>Current Price</b>	26	<b>LTM P/E</b>	13.8	<b>Recommendation</b>	BUY
	<b>52 Wk L - H</b>	21 - 78	<b>EV / EBITDA</b>	3.4	<b>Price Target</b>	NONE
<b>Business Description</b>						
<ul style="list-style-type: none"> <li>• Mass media factual television company</li> <li>• Operates under two segments: US Networks and International Networks</li> <li>• US Networks: Discovery Channel, Food Network, HGTV, TLC, Animal Planet, amongst others</li> <li>• International Networks: Eurosport, Dmax, amongst others</li> <li>• Launched streaming service, Discovery+, earlier this year</li> <li>• Exclusive Rights to Olympics and BBC (outside UK, China and Ireland),</li> </ul>						

Financial Summary (GBP)					
	FY17	FY18	FY19	FY20	TTM
<b>Revenue (mm)</b>	6,873	10,553	11,144	10,671	11,890
<b>EBITDA (mm)</b>	2,578	6,437	7,171	6,691	7,282
<b>Margins</b>	38%	61%	64%	63%	61%
<b>Net Income (mm)</b>	-337	594	2,069	1,219	1,239
<b>Margins</b>	-5%	6%	19%	11%	10%

### Investment Thesis

#### Business Description:

- 800 million monthly unique viewers globally
- 250 million hours viewed daily
- Operates under 2 segments: US Networks and International Networks, each divided into advertising and distribution subsegments
- 65% of revenues in 2020 came from US Networks, 38% Advertising and 27% Distribution
- 35% of revenues in 2020 came from International Networks, 15% Advertising and 19% Distribution
- Since shows are factual, expenses are limited compared to competitors with 2020 operating margins of 25% vs 18% for Viacom and Netflix and 2% for Disney (20% in 2019)
- Stock crashed by 60% after a margin call from Archegos Capital

#### Merger with AT&T's (NYSE:T) WarnerMedia

- Structured as Reverse Morris Trust Transaction, whereby AT&T will spin off Warner Media which will then merge with Discovery
- Discovery shareholders will own 29% of the new company
- AT&T will receive \$43 billion in a combination of cash, debt securities, and Warner's retention of certain debt

#### Catalysts:

- Recovery from pandemic
- Content creation/acquisition is less expensive compared to competitors
- Discovery+ ARPU expected to 3-4X US Networks Linear
- Deal will make Discovery more competitive with non-factual networks

#### Risks:

- Streaming business is very competitive with Netflix, Disney+, Amazon Prime, Apple TV+ and others
- Streaming business might be a cash flow drain in initial years
- Cable Networks businesses are in decline
- Concentrated business
- Will no longer be a fully factual network
- Synergy costs might be bigger than expected
- Will take some of the debt of AT&T on balance sheet

- AT&T shareholders unhappy about the dividend cut from the company

### Financial Analysis:

(mm USD)	3Q21	3Q20	% change		2Q21	2Q20	% change
<b>Revenues</b>	\$ 3,150	\$ 2,561	23%	<b>Net income</b>	\$ 156	\$ 300	-48%
<b>Operating Income</b>	\$ 329	\$ 531	-38%	<b>FCF</b>	\$ 705	\$ 787	-10%
<b>Total Assets</b>	<b>Total Liabilities</b>	<b>Book Value</b>	<b>Cash</b>	<b>Debt</b>	<b>Current Assets</b>	<b>Current Liabilities</b>	
\$ 34,318	\$ 20,920	\$ 11,611	\$ 3,116	\$ 14,785	\$ 6,656	\$ 3,335	

	2015	2016	2017	2018	2019	2020	CAGR	Average
<b>US Advertising</b>	\$ 1,650	\$ 1,690	\$ 4,001	\$ 4,105	\$ 4,245	\$ 4,012	19%	
<b>US Distribution</b>	\$ 1,431	\$ 1,532	\$ 2,586	\$ 2,612	\$ 2,739	\$ 2,852	15%	
<b>US Revenues</b>	\$ 3,131	\$ 3,285	\$ 6,742	\$ 6,869	\$ 7,092	\$ 6,949	17%	
<b>US Operating Income</b>	\$ 1,704	\$ 1,915	\$ 2,320	\$ 2,532	\$ 3,145	\$ 3,031	12%	
<b>US Margin</b>	54%	58%	34%	37%	44%	44%		45%
<b>Int. Advertising</b>	\$ 1,353	\$ 1,279	\$ 1,748	\$ 1,834	\$ 1,799	\$ 1,571	3%	
<b>Int. Distribution</b>	\$ 1,637	\$ 1,681	\$ 1,978	\$ 2,104	\$ 2,096	\$ 2,014	4%	
<b>Int. Revenues</b>	\$ 3,092	\$ 3,040	\$ 3,890	\$ 4,253	\$ 4,041	\$ 3,713	4%	
<b>Int. Operating Income</b>	\$ 676	\$ 597	\$ 127	\$ 434	\$ 563	\$ 191	-22%	
<b>Int. Margin</b>	22%	20%	3%	10%	14%	5%		12%
<b>Total Revenues</b>	\$ 6,394	\$ 6,497	\$ 10,790	\$ 11,176	\$ 11,144	\$ 10,671	11%	
<b>Total Operating Income</b>	\$ 2,052	\$ 2,053	\$ 2,119	\$ 2,286	\$ 3,190	\$ 2,730	6%	
<b>Operating Margin</b>	32%	32%	20%	20%	29%	26%		26%
<b>Total Net income</b>	\$ 1,034	\$ 1,194	\$ (337)	\$ 594	\$ 2,069	\$ 1,219	3%	
<b>Profit Margin</b>	16%	18%	-3%	5%	19%	11%		11%
<b>FCF</b>	\$ 1,191	\$ 1,292	\$ 1,494	\$ 2,429	\$ 3,110	\$ 2,337	14%	
<b>FCF Margin</b>	19%	20%	14%	22%	28%	22%		21%

### Valuations:

- My personal Biases:
  - 4.0% of my portfolio
- Assumptions for base case:
  - WarnerMedia was acquired by AT&T in 2018 for \$85 billion
  - Below are the pro-forma financial estimates of WarnerMedia+Discovery for the last five years

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<b>Int. Margin</b>	22%	20%	3%	10%	14%	5%		12%
<b>Warner Media Revenues</b>	\$ 28,118	\$ 29,318	\$ 31,271	\$ 20,585	\$ 35,259	\$ 30,442	2%	
<b>Warner Media Op. Incom</b>	\$ 5,446	\$ 5,195	\$ 5,945	\$ 7,020	\$ 10,659	\$ 8,210	9%	
<b>Margin</b>	19%	18%	19%	34%	30%	27%		25%
<b>Total Revenues</b>	\$ 34,341	\$ 35,643	\$ 41,903	\$ 31,707	\$ 46,392	\$ 41,104	4%	
<b>Total Operating Income</b>	\$ 7,498	\$ 7,248	\$ 8,064	\$ 9,306	\$ 13,849	\$ 10,940	8%	
<b>Operating Margin</b>	22%	20%	19%	29%	30%	27%		25%
<b>Total Net income</b>	\$ 4,829	\$ 5,119	\$ 4,907	\$ 5,578	\$ 9,636	\$ 8,986	13%	
<b>Profit Margin</b>	14%	14%	12%	18%	21%	22%		17%
<b>FCF</b>	\$ 4,611	\$ 5,526	\$ 5,614	\$ 9,036	\$ 12,900	\$ 10,076	17%	
<b>FCF Margin</b>	13%	16%	13%	28%	28%	25%		21%

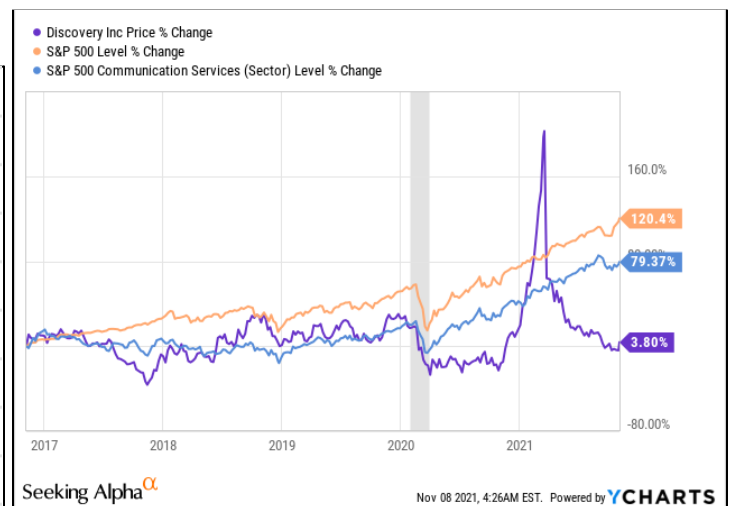
- Revenues in 2021 will slightly exceed 2019 level
- US Network Revenues will grow by 12% annually from 2021-2025 (17% in the last five years) with operating margins of 35% (average of 45% in last five years)

- International Network Revenues will grow by 4% annually from 2021-2025 (4% in the last five years) with operating margins of 10% (average of 12% in last five years)
- 4% of annual growth of WarnerMedia revenues
- Operating margin of 25% for WarnerMedia
- 80% of operating income conversion in FCF

	2020	2021	2022	2023	2024	2025
<b>US Revenues</b>	\$ 6,949	\$ 7,200	\$ 8,064	\$ 9,032	\$ 10,115	\$ 11,329
<b>US Operating Income</b>	\$ 3,031	\$ 2,520	\$ 2,822	\$ 3,161	\$ 3,540	\$ 3,965
<b>Int. Revenues</b>	\$ 3,713	\$ 4,200	\$ 4,368	\$ 4,543	\$ 4,724	\$ 4,913
<b>Int. Operating Income</b>	\$ 191	\$ 420	\$ 437	\$ 454	\$ 472	\$ 491
<b>Warner Media Revenues</b>	\$ 28,118	\$ 32,000	\$ 33,280	\$ 34,611	\$ 35,996	\$ 37,435
<b>Warner Media Op. Incom</b>	\$ 5,446	\$ 8,000	\$ 8,320	\$ 8,653	\$ 8,999	\$ 9,359
<b>Total Revenues</b>	\$ 41,104	\$ 43,400	\$ 45,712	\$ 48,186	\$ 50,836	\$ 53,678
<b>Total Operating Income</b>	\$ 10,940	\$ 10,940	\$ 11,579	\$ 12,268	\$ 13,012	\$ 13,815
<b>FCF</b>	\$ 10,076	\$ 8,752	\$ 9,263	\$ 9,815	\$ 10,409	\$ 11,052

- Discount rate of 15%
- Terminal growth rate of 3%

Year	FCF	Discounted FCF
<b>2020</b>	\$10,076	
<b>Year 1</b>	\$8,752	\$7,610
<b>Year 2</b>	\$9,263	\$7,004
<b>Year 3</b>	\$9,815	\$6,454
<b>Year 4</b>	\$10,409	\$5,951
<b>Year 5</b>	\$11,052	\$5,495
<b>Terminal Value</b>		\$45,791
<b>Intrinsic Value</b>		<b>\$78,305</b>



- Use P/FCF as exit multiples for 2025 (range of 5-33 in last 5 years)
- Bull case 15% more than in base case and bear case 15% less
- Shares outstanding doesn't change
- We will consider only prices for shares of Discovery, ignoring the new company (since we don't know anything about pricing yet)

2025 FCF/share		2025 Price to FCF Ratio				
		5	10	15	20	25
<b>Bull</b>	\$ 5.55	\$ 27.75	\$ 55.50	\$ 83.25	\$ 111.00	\$ 138.75
<b>Base</b>	\$ 4.83	\$ 24.15	\$ 48.30	\$ 72.45	\$ 96.60	\$ 120.75
<b>Bear</b>	\$ 4.10	\$ 20.50	\$ 41.00	\$ 61.50	\$ 82.00	\$ 102.50
<b>Returns</b>		-21%	86%	179%	272%	434%
<b>CAGR</b>		-5%	13%	23%	30%	40%
<b>Probability</b>		10%	15%	25%	30%	20%
<b>Expectation</b>	<b>24%</b>	0%	2%	6%	9%	8%

## Conclusion

- An intrinsic value of \$78.3 billion for the new company means \$22.7 billion for Discovery today
- Undervalued with a market cap of \$13.2 Billion for \$22.7 Billion in intrinsic value in a conservative analysis

- With a margin of safety, a fair value would be \$20 billion
- Exit multiples analysis shows an expected returns of 24% per year with limited downside of 20% and possible reward of over 400% in bull case