


Discovery, Inc . (NASDAQ:DISCA)

 <p>Ishfaq Peerally eToro Elite Popular Investor (Approved Value Investor)</p>	Trading Statistics (USD)					
	Market Cap (bb)	16.1	LTM EPS	1.12	Update Date	18 May 2021
	Current Price	32	LTM P/E	29	Recommendation	BUY
	52 Wk L - H	19 - 78	EV / EBITDA	9.6	Price Target	NONE
Business Description						
<ul style="list-style-type: none"> • Mass media factual television company • Operates under two segments: US Networks and International Networks • US Networks: Discovery Channel, Food Network, HGTV, TLC, Animal Planet, amongst others • International Networks: Eurosport, Dmax, amongst others • Launched streaming service, Discovery+, earlier this year • Exclusive Rights to Olympics and BBC (outside UK, China and Ireland), 						

Financial Summary (GBP)					
	FY16	FY17	FY18	FY19	FY20
Revenue (mm)	6,497	6,873	10,553	11,144	10,671
EBITDA (mm)	4,119	2,578	6,437	7,171	6,691
Margins	63%	38%	61%	64%	63%
Net Income (mm)	1,194	-337	594	2,069	1,219
Margins	18%	-5%	6%	19%	11%

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
- Olympics in 2021 could bring \$175 million to \$200 million in operating income before depreciation and amortization
- Discovery+ ARPU expected to 3-4X US Networks Linear
- 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:

- Revenues of \$10.7 Billion in FY20 down from \$11.1 Billion in FY19
- Operating income of \$2.73 Billion in FY20 vs \$3.19 Billion in FY19
- Net income of \$1.21 Billion in FY20 down from \$2.06 billion in FY19
- Free Cash flow of \$2.33 Billion in FY20 vs \$3.11 million for FY19
- Net income in 2017 and 2018 were unusually lower from impairment of goodwill

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

- Balance Sheet
 - Total assets: \$34.0 Billion ; total liabilities: \$22.0 Billion; book value: \$10.4 Billion
 - Cash: \$2.09 Billion, debts: \$15.4 Billion, current assets: \$6.13 Billion, current liabilities: \$3.08 Billion

Valuations:

- My personal Biases:
 - 5.0% 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

	2015	2016	2017	2018	2019	2020	CAGR	Average
US Advertising	\$ 1,650	\$ 1,690	\$ 4,001	\$ 4,105	\$ 4,245	\$ 4,012	19%	
US Distribution	\$ 1,431	\$ 1,532	\$ 2,586	\$ 2,612	\$ 2,739	\$ 2,852	15%	
US Revenues	\$ 3,131	\$ 3,285	\$ 6,742	\$ 6,869	\$ 7,092	\$ 6,949	17%	
US Operating Income	\$ 1,704	\$ 1,915	\$ 2,320	\$ 2,532	\$ 3,145	\$ 3,031	12%	
US Margin	54%	58%	34%	37%	44%	44%		45%
Int. Avertising	\$ 1,353	\$ 1,279	\$ 1,748	\$ 1,834	\$ 1,799	\$ 1,571	3%	
Int. Distribution	\$ 1,637	\$ 1,681	\$ 1,978	\$ 2,104	\$ 2,096	\$ 2,014	4%	
Int. Revenues	\$ 3,092	\$ 3,040	\$ 3,890	\$ 4,253	\$ 4,041	\$ 3,713	4%	
Int. Operating Income	\$ 676	\$ 597	\$ 127	\$ 434	\$ 563	\$ 191	-22%	
Int. Margin	22%	20%	3%	10%	14%	5%		12%
Warner Media Revenues	\$ 28,118	\$ 29,318	\$ 31,271	\$ 20,585	\$ 35,259	\$ 30,442	2%	
Warner Media Op. Incom	\$ 5,446	\$ 5,195	\$ 5,945	\$ 7,020	\$ 10,659	\$ 8,210	9%	
Margin	19%	18%	19%	34%	30%	27%		25%
Total Revenues	\$ 34,341	\$ 35,643	\$ 41,903	\$ 31,707	\$ 46,392	\$ 41,104	4%	
Total Operating Income	\$ 7,498	\$ 7,248	\$ 8,064	\$ 9,306	\$ 13,849	\$ 10,940	8%	
Operating Margin	22%	20%	19%	29%	30%	27%		25%
Total Net income	\$ 4,829	\$ 5,119	\$ 4,907	\$ 5,578	\$ 9,636	\$ 8,986	13%	
Profit Margin	14%	14%	12%	18%	21%	22%		17%
FCF	\$ 4,611	\$ 5,526	\$ 5,614	\$ 9,036	\$ 12,900	\$ 10,076	17%	
FCF Margin	13%	16%	13%	28%	28%	25%		21%

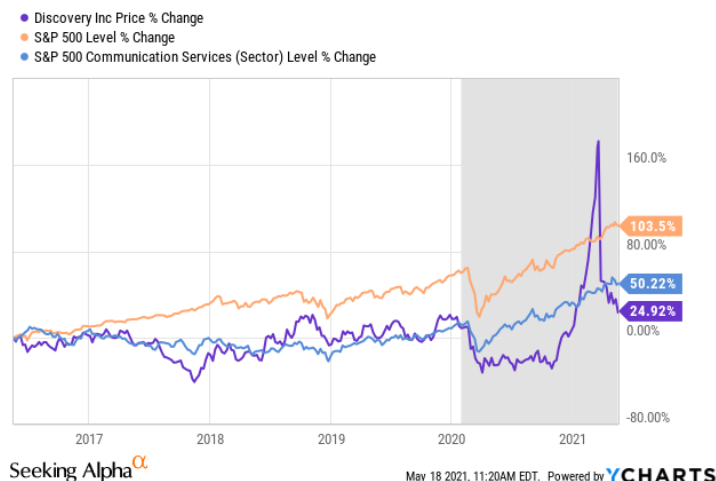
- Revenues in 2021 will return to 2019 level with extra revenues from Olympics and Streaming

- 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
US Revenues	\$ 6,949	\$ 7,092	\$ 7,943	\$ 8,896	\$ 9,964	\$ 11,159
US Operating Income	\$ 3,031	\$ 2,482	\$ 2,780	\$ 3,114	\$ 3,487	\$ 3,906
Int. Revenues	\$ 3,713	\$ 4,041	\$ 4,203	\$ 4,371	\$ 4,546	\$ 4,727
Int. Operating Income	\$ 191	\$ 404	\$ 420	\$ 437	\$ 455	\$ 473
Warner Media Revenues	\$ 28,118	\$ 29,243	\$ 30,412	\$ 31,629	\$ 32,894	\$ 34,210
Warner Media Op. Incom	\$ 5,446	\$ 7,311	\$ 7,603	\$ 7,907	\$ 8,224	\$ 8,552
Total Revenues	\$ 41,104	\$ 40,376	\$ 42,558	\$ 44,896	\$ 47,403	\$ 50,097
Total Operating Income	\$ 10,940	\$ 10,197	\$ 10,803	\$ 11,458	\$ 12,165	\$ 12,931
FCF	\$ 10,076	\$ 8,158	\$ 8,643	\$ 9,166	\$ 9,732	\$ 10,345

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

Year	FCF	Discounted FCF
2020	\$10,076	
2021	\$8,158	\$7,094
2022	\$8,643	\$6,535
2023	\$9,166	\$6,027
2024	\$9,732	\$5,564
2025	\$10,345	\$5,143
Terminal Value		\$42,800
Intrinsic Value		\$73,164



- 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
Bull	\$ 8.27	\$ 41.35	\$ 82.70	\$ 124.05	\$ 165.40	\$ 206.75
Base	\$ 7.19	\$ 35.95	\$ 71.90	\$ 107.85	\$ 143.80	\$ 179.75
Bear	\$ 6.11	\$ 30.55	\$ 61.10	\$ 91.65	\$ 122.20	\$ 152.75
Returns		-20%	89%	184%	278%	444%
CAGR		-4%	14%	23%	30%	40%
Probability		10%	15%	25%	30%	20%
Expectation	25%	0%	2%	6%	9%	8%

Conclusion

- An intrinsic value of \$73 billion for the new company means \$21 billion for Discovery today

- Undervalued with a market cap of \$17 Billion for \$23 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 25% per year with limited downside of 20% and possible reward of over 400% in bull case