


## 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>	17.2	<b>LTM EPS</b>	1.42	<b>Update Date</b>	22 Apr 2021
	<b>Current Price</b>	38	<b>LTM P/E</b>	27	<b>Recommendation</b>	BUY
	<b>52 Wk L - H</b>	18 - 78	<b>EV / EBITDA</b>	9.7	<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)					
	FY16	FY17	FY18	FY19	FY20
<b>Revenue (mm)</b>	6,497	6,873	10,553	11,144	10,671
<b>EBITDA (mm)</b>	4,119	2,578	6,437	7,171	6,691
<b>Margins</b>	63%	38%	61%	64%	63%
<b>Net Income (mm)</b>	1,194	-337	594	2,069	1,219
<b>Margins</b>	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

#### 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
- Possible share buybacks

#### 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

#### 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. Advertising	\$ 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

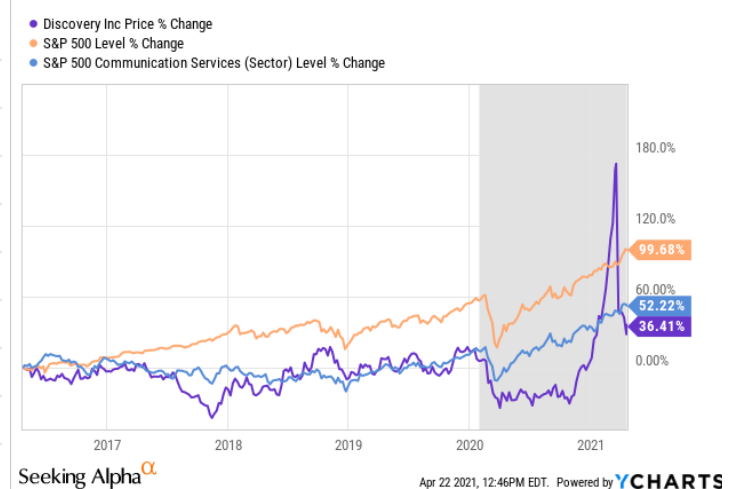
- Total assets: \$34.0 Billion ; total liabilities: \$22.0 Billion; book value: \$10.4 Billion
  - Cash: \$2.09 Billion, debts: \$15.4 Billion, current assets: \$6.13 Billion, current liabilities: \$3.08 Billion

### Valuations:

- My personal Biases:
  - Transition to streaming more challenging that company anticipates because of concentration of programming, making customer acquisition slow
- Assumptions for base case:
  - 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)
  - 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
Total Revenues	\$ 10,671	\$ 11,133	\$ 12,146	\$ 13,267	\$ 14,509	\$ 15,887
Total Operating Income	\$ 2,730	\$ 2,886	\$ 3,200	\$ 3,551	\$ 3,942	\$ 4,379
FCF	\$ 2,337	\$ 2,309	\$ 2,560	\$ 2,841	\$ 3,153	\$ 3,503

Year	FCF	Discounted FCF
TTM	\$2,337	
2021	\$2,309	\$2,008
2022	\$2,560	\$1,936
2023	\$2,841	\$1,868
2024	\$3,153	\$1,803
2025	\$3,503	\$1,742
Terminal Value		\$14,516
<b>Intrinsic Value</b>		<b>\$23,872</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

2025 FCF/share		2025 Price to FCF Ratio				
		5	10	15	20	25
<b>Bull</b>	\$ 8.27	\$ 41.35	\$ 82.70	\$ 124.05	\$ 165.40	\$ 206.75
<b>Base</b>	\$ 7.19	\$ 35.95	\$ 71.90	\$ 107.85	\$ 143.80	\$ 179.75
<b>Bear</b>	\$ 6.11	\$ 30.55	\$ 61.10	\$ 91.65	\$ 122.20	\$ 152.75
<b>Returns</b>		-20%	89%	184%	278%	444%
<b>CAGR</b>		-4%	14%	23%	30%	40%
<b>Probability</b>		10%	15%	25%	30%	20%
<b>Expectation</b>	<b>25%</b>	0%	2%	6%	9%	8%

### Conclusion

- 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