

Discovery, Inc.(DISCA)

\$23.09 (As of 06/04/20)

Price Target (6-12 Months): **\$24.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 11/13/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:B

Value: A

Growth: C

Momentum: C

Summary

Discovery is expected to take a hit from sluggish advertising demand and spending. Moreover, cancellation of sporting events is expected to affect its top line. Further, incremental spending on direct-to-consumer initiatives and international business is likely to keep margins under pressure. The company's high indebtedness and an unfavorable forex are other concerns. Shares have underperformed the industry on a year-to-date basis. Nevertheless, burgeoning viewership reflects the company's portfolio strength, which is a key catalyst for the long haul. Further, the increased monetization of digital streaming products and channel launches in several markets are expected to fuel international affiliate growth. Additionally, the growing popularity of the UKTV Lifestyle Business and Food Network are major drivers.

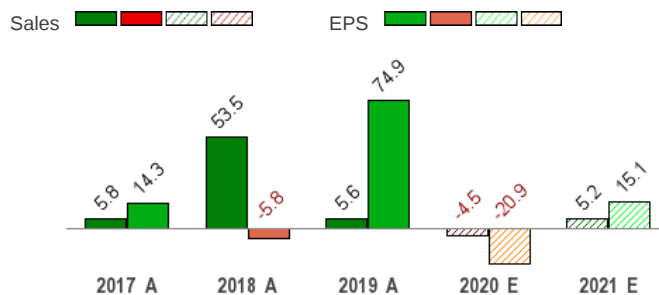
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$33.66 - \$17.12
20 Day Average Volume (sh)	5,150,677
Market Cap	\$12.0 B
YTD Price Change	-29.5%
Beta	1.51
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Broadcast Radio and Television
Zacks Industry Rank	Top 47% (120 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-1.1%
Last Sales Surprise	-1.8%
EPS F1 Est- 4 week change	-5.6%
Expected Report Date	08/04/2020
Earnings ESP	0.0%
P/E TTM	6.2
P/E F1	7.9
PEG F1	0.4
P/S TTM	1.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,651 E	2,753 E	2,893 E	2,854 E	11,190 E
2020	2,683 A	2,515 E	2,454 E	2,726 E	10,641 E
2019	2,707 A	2,885 A	2,678 A	2,874 A	11,144 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.81 E	\$0.97 E	\$0.65 E	\$0.98 E	\$3.36 E
2020	\$0.87 A	\$0.70 E	\$0.60 E	\$0.69 E	\$2.92 E
2019	\$0.87 A	\$0.98 A	\$0.87 A	\$0.98 A	\$3.69 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/04/2020. The reports text is as of 06/05/2020.

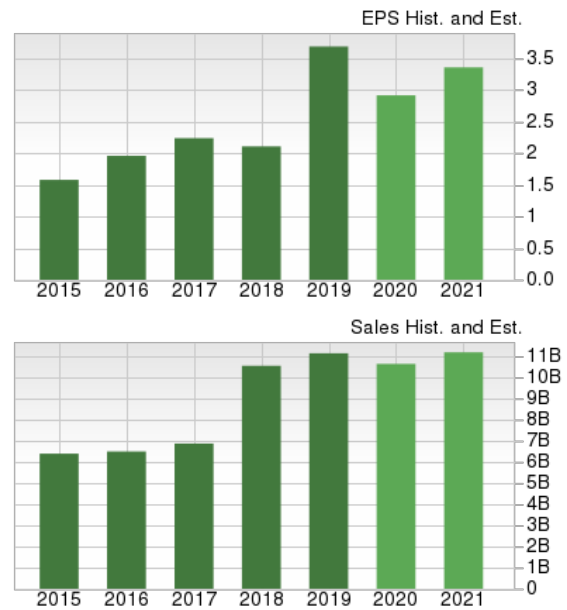
Overview

Discovery Communications is now known as Discovery, Inc. following the completion of the acquisition of Scripps Networks Interactive on Mar 6, 2018. The company offers original and purchased content as well as live events to 3.8 billion cumulative subscribers plus viewers worldwide. Discovery distributes content in the United States and to 220 other countries plus territories in more than 50 languages.

The company's global portfolio of networks includes non-fiction television brands, such as Discovery Channel, HGTV, Food Network, TLC, Animal Planet, Investigation Discovery, Trvl Channel, OWN, Science Channel and MotorTrend (previously known as Velocity, domestically and currently known as Turbo in most international countries).

Moreover, the company's international portfolio constitutes Eurosport, a leading sports entertainment provider and broadcaster of the Olympic Games across Europe, TVN, a Polish media company, as well as Discovery Kids, a leading children's entertainment brand in Latin America.

Discovery also participates in joint ventures including Group Nine Media. The company is a participant in the multi-platform venture with Chip and Joanna Gaines, which plans to launch linear networks, SVOD and TV Everywhere (TVE) products in 2020.



Discovery reported revenues of \$11.14 billion in 2019. It operates through two reportable segments: U.S. Networks and International Networks.

U.S. Networks segment owns and operates 18 national television networks. In 2019, the segment contributed to 63.6% of the company's total revenue base. Moreover, advertising, distribution and other revenues were 60%, 39% and 1%, respectively, of the total segmental revenues.

International Networks segment primarily consists of the national pan-regional TV networks of the company. In 2019, the segment accounted for 36.3% of the company's total revenue stream. Moreover, advertising, distribution and other revenues were 45%, 52% and 3%, respectively, of the total segment revenues.

Other revenues were \$11 million in 2019. On Apr 30, 2018, Discovery sold 88% controlling equity stake in the Education Business to Francisco Partners.



Reasons To Buy:

- ▲ Discovery is one of the world's largest pay-TV programmers, with approximately 4 billion cumulative subscribers. The company is benefiting from content portfolio strength, post the Scripps Networks' buyout. The acquisition also helped the company to expand its international footprint, especially in regions like Europe, Latin America and the Nordics. Cost synergies from the merger drove profitability as adjusted OIBDA grew 12% in 2019.
- ▲ Discovery's expanding market share has been driven by solid viewership of multiple channels including Discovery Channel, Animal Planet, Food Network, HGTV, MotorTrend, Science, TLC, ID, Oprah, Eurosport, the Cooking Channel and UKTV Lifestyle. Notably, Discovery generated more than \$700 million of direct-to-consumer revenues in 2019. Viewership further increased due to the coronavirus outbreak, as more and more people were compelled to stay at home.
- ▲ Moreover, expanding sports coverage based on partnership with the likes of PGA TOUR, Tiger Woods and Olympics is a major growth driver. In Oct 2018, the company entered a 12-year agreement with PGA Tour worth about \$2 billion to manage TV and digital rights for golf events in territories outside the United States. Additionally, GOLFTV inked a partnership with the European Tour to broadcast and stream a number of golf events. Apart from GOLFTV, Discovery's European sports network, EuroSport won European multi-platform broadcast and distribution rights for four Olympic Games between 2018 and 2024. Additionally, the platform has rights to prominent pro leagues in soccer and tennis, among others. This extensive sports coverage enhances Discovery's growth prospect in the long haul.
- ▲ Apart from PGA and European Tour, partnerships with the likes of AT&T, Hulu, Sling TV and Bilibili are helping Discovery rapidly penetrate the online viewing market. Moreover, the company's expanding direct-to-consumer offerings are expected to aid its top line in the long haul. Through the Eurosport Player video streaming service, the company offers premium and localized sports content to fans across 52 markets in Europe. Dplay, the company's real-life entertainment streaming service, is now available in 10 markets including the U.K., Ireland, Spain, the Nordics, Japan and Italy. In Germany, Discovery partnered with ProSiebenSat.1 to launch the streaming service, Joyn. In Poland, it teamed up with Cyfrowy Polsat to create a video streaming platform for disseminating polish content.

Discovery's acquisition of Scripps significantly expands content portfolio and international footprint, which along with an expanding sports coverage and partnerships are key catalysts.

Reasons To Sell:

- ▼ The internal dynamics of the U.S. pay-TV industry has been gradually shifting from cable TV operators to large telecom operators and low-cost over-the-top (OTT) service providers. Online video streaming service providers such as Netflix, Hulu and YouTube, among others, have become a severe threat to legacy pay-TV content providers because of their extremely cheap source of TV programming and solid content. This doesn't bode well for Discovery, as loss of domestic subscribers is a major concern.
- ▼ Coronavirus-led lockdowns and shelter-in-home guidelines resulted in lower advertising demand and spending that hurt Discovery's advertising revenues in first-quarter. The company has witnessed higher cancellations and deferrals in the second quarter. In April Discovery's domestic and international markets are down 20% and 40%, respectively. Moreover, cancellation of gaming events globally due to the coronavirus outbreak is a major headwind to the company. These factors are expected to hurt company's top-line growth in the near term.
- ▼ Forex woes, as U.S. dollar appreciates, are a downside for Discovery. The company expects adverse currency translation to erode revenues by \$130-\$140 million and AOIBDA by \$30 million.
- ▼ Discovery's highly leveraged balance sheet is a significant worry for investors. As of Mar 31, 2020, net debt was \$14.42 billion, higher than \$13.87 billion as of Dec 31, 2019. Notably, on Mar 12, Discovery withdrew \$500 million from its \$2.5 billion revolving credit facility. Moreover, total debt-to-capital increased from 57.2% to 59.2% at the end of the first quarter. The huge debt burden is a headwind as Discovery's advertising revenue stream is expected to get drained by the coronavirus pandemic. Moreover, free cash flow plunged 54% year over year to \$230 million in the March quarter.

Adverse effect of coronavirus on advertising demand and spending, cancellation of gaming events, unfavorable foreign exchange and high leverage are major concerns.

Last Earnings Report

Discovery's Q1 Earnings Miss Mark, Revenues Fall Y/Y

Discovery reported first-quarter 2020 adjusted earnings of 87 cents per share, missing the Zacks Consensus Estimate by 1.4% but increasing 2.4% year over year.

Revenues slid 1% year over year to \$2.68 billion and also lagged the consensus mark by 1.8%.

This year-over-year decline was attributed to a decrease in advertising (52.3% of revenues) and flat distribution (45.7% of revenues) revenues.

Quarter Ending **03/2020**

Report Date	May 06, 2020
Sales Surprise	-1.80%
EPS Surprise	-1.14%
Quarterly EPS	0.87
Annual EPS (TTM)	3.70

Top-Line Details

Advertising revenues dipped 0.9% year over year to \$1.40 billion. Distribution revenues were unchanged at \$1.22 billion. Other revenues were \$58 million, down 14.7% from the year-ago quarter.

U.S. Networks (65.5% of revenues) revenues stayed at \$1.76 billion on a year-over-year basis. Advertising revenues were unchanged while distribution revenues grew 1.6%.

Total portfolio subscribers for March 2020 were 6% lower than the level in March 2019 while subscribers to the fully distributed networks declined 4%.

International Networks revenues (34.5% of revenues) slipped 3% year over year to \$923 million. Advertising and distribution revenues were down 4.3% and 2.3%, respectively.

Solid contributions from the UKTV Lifestyle Business and growth in next-generation initiatives aided advertising revenues. However, discontinuation of certain pay-TV distribution agreements in the Nordics and the impact of coronavirus in key advertising markets hurt top-line growth.

However, excluding the foreign exchange impact, International Networks revenue growth was flat as advertising revenues remained unchanged while distribution revenues inched up 1% on a year-over-year basis.

Distribution increased owing to content licensing arrangements and higher affiliate rates in Latin America as well as monetization of Discovery's next-generation initiatives in Europe and Asia.

Notably, total share of viewing across the international portfolio in the first quarter increased 4%, on average.

Operating Details

In the first quarter, selling, general and administrative (SG&A) expenses increased 3% from the year-ago quarter to \$645 million. This year-over-year growth was due to 9% growth in U.S. Networks SG&A and a 13% increase in International Network SG&A.

Higher marketing expenses related to Discovery's next-generation initiatives escalated SG&A year over year.

Adjusted operating income before depreciation & amortization (OIBDA) decreased 4% from the year-ago quarter to \$1.11 billion. Excluding the foreign exchange impact, OIBDA decreased 3%.

U.S. Networks adjusted OIBDA decreased 4.2% from the year-ago quarter to \$1.02 billion.

Moreover, International Networks adjusted OIBDA declined 5.5% from the year-ago quarter to \$207 million. Excluding the forex impact, adjusted OIBDA was down 2%.

GAAP operating income inched up 0.6% year over year to \$779 million.

Balance Sheet & Cash Flow

As of Mar 31, 2020, cash & cash equivalents were \$1.45 billion compared with \$1.55 billion as of Dec 31, 2019.

Moreover, as of Mar 31, 2020, long-term debt was \$15.27 billion, higher than \$14.81 billion as of Dec 31, 2019.

On Mar 12, 2020, Discovery withdrew \$500 million under its \$2.5 billion revolving credit facility. Additionally, on Apr 30, the company inked a deal with its lender group, led by Bank of America to amend certain provisions of its revolving credit facilities including resetting the Maximum Consolidated Leverage Ratio to 5.5X from the third quarter of 2020 through the first quarter of 2021.

Free cash flow plunged 54% year over year to \$230 million.

Moreover, in February 2020, the company authorized an additional common stock repurchase program worth \$2 billion. Discovery completed its erstwhile \$1-billion repurchase authorization and bought back an additional \$159 million under its new \$2-billion repurchase plan.

Key Development in Q1

Discovery and Amazon announced an expanded collaboration that will provide a complimentary one-year subscription to Food Network Kitchen for all Amazon Fire TV and Fire Tablet customers in the United States.

Recent News

On Apr 23, Discovery-owned Eurosport signed a content partnership contract with Torque Esports. Per the deal, Eurosport will live telecast Torque's The Race All-Star Series - Fully Charged by ROKiT Phones across more than 150 countries and territories via its channels including cable, satellite, IPTV and simulcast over the internet and mobile (including social media), VoD and catch-up programming.

On Apr 13, Discovery announced an expanded content offering across its portfolio of 13 TV-everywhere streaming GO apps and sites. The "Family Favorites" initiative offers full seasons of fan-favorite series and specials from Discovery's collection of family-friendly networks including Discovery Channel, HGTV, Food Network, TLC, Animal Planet, Science Channel, Cooking Channel and DIY. The offering is currently available commercial-free across all Discovery's GO apps and requires no MVPD sign-in.

On Mar 9, Discovery announced that Neil Chugani was appointed chief financial officer and head of strategy and operations of its Direct-to-Consumer business.

Valuation

Discovery shares are down 29.5% in the year-to-date period and 18.6% over the trailing 12-month period. Stocks in the Zacks sub-industry are up 2.8%, while the Zacks Consumer Discretionary sector is down 9.8%. Over the past year, the Zacks sub-industry is up 5.2%, while the sector is down 1.4%.

The S&P 500 Index is down 3.1% in the year-to-date period but up 9.9% in the past year.

The stock is currently trading at 7.43X forward 12-month earnings, which compares to 29.29X for the Zacks sub-industry, 32.15X for the Zacks sector and 22.55X for the S&P 500 index.

Over the past five years, the stock has traded as high as 18.10X and as low as 4.88X, with a 5-year median of 9.92X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$24 price target reflects 7.80X forward 12-month earnings.

The table below shows summary valuation data for DISCA

Valuation Multiples - DISCA					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	7.43	29.29	32.15	22.55
	5-Year High	18.1	34.48	32.15	22.55
	5-Year Low	4.88	20.53	16.21	15.23
	5-Year Median	9.92	25.72	19.91	17.49
P/S F12M	Current	1.11	6.13	2.23	3.51
	5-Year High	2.22	13.45	3.19	3.51
	5-Year Low	0.73	6.13	1.67	2.53
	5-Year Median	1.41	9.52	2.52	3.02
EV/Sales TTM	Current	2.32	8.51	2.94	3.05
	5-Year High	3.94	15.84	4.05	3.46
	5-Year Low	2.06	6.8	2.26	2.13
	5-Year Median	2.79	10.95	3.38	2.83

As of 06/04/2020

Industry Analysis Zacks Industry Rank: Top 47% (120 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Amazon.com, Inc. (AMZN)	Neutral	3
Cable One, Inc. (CABO)	Neutral	3
Comcast Corporation (CMCSA)	Neutral	4
DISH Network Corporation (DISH)	Neutral	3
Fox Corporation (FOXA)	Neutral	3
Netflix, Inc. (NFLX)	Neutral	2
ATT Inc. (T)	Neutral	4
The Walt Disney Company (DIS)	Underperform	5

Industry Comparison Industry: Broadcast Radio And Television				Industry Peers		
	DISCA	X Industry	S&P 500	CMCSA	DIS	NFLX
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Underperform	Neutral
Zacks Rank (Short Term)	4	-	-	4	5	2
VGM Score	B	-	-	C	F	B
Market Cap	12.03 B	572.60 M	22.58 B	187.99 B	223.42 B	182.22 B
# of Analysts	5	2	14	15	6	12
Dividend Yield	0.00%	0.00%	1.87%	2.23%	1.42%	0.00%
Value Score	A	-	-	B	D	C
Cash/Price	0.13	0.24	0.06	0.05	0.07	0.03
EV/EBITDA	3.53	5.77	12.93	8.26	13.20	15.93
PEG Ratio	0.44	0.68	3.06	1.74	14.64	2.15
Price/Book (P/B)	1.10	1.02	3.09	2.27	2.35	21.67
Price/Cash Flow (P/CF)	1.73	2.74	12.17	6.87	15.64	16.25
P/E (F1)	8.45	7.91	22.17	16.40	74.59	64.51
Price/Sales (P/S)	1.08	0.69	2.41	1.73	2.86	8.51
Earnings Yield	12.65%	-0.82%	4.27%	6.10%	1.34%	1.55%
Debt/Equity	1.39	1.39	0.76	1.28	0.45	1.69
Cash Flow (\$/share)	13.33	1.76	7.01	6.01	7.91	25.49
Growth Score	C	-	-	C	D	B
Hist. EPS Growth (3-5 yrs)	15.85%	15.85%	10.87%	17.32%	2.68%	92.67%
Proj. EPS Growth (F1/F0)	-20.92%	-41.38%	-10.79%	-19.55%	-71.26%	55.51%
Curr. Cash Flow Growth	14.01%	-0.84%	5.48%	21.54%	4.37%	26.74%
Hist. Cash Flow Growth (3-5 yrs)	17.30%	13.08%	8.55%	11.76%	7.57%	30.03%
Current Ratio	1.61	1.73	1.29	0.87	0.94	0.82
Debt/Capital	58.90%	58.90%	44.75%	56.39%	35.35%	62.76%
Net Margin	18.54%	5.14%	10.59%	10.72%	6.88%	10.43%
Return on Equity	23.40%	7.67%	16.26%	17.56%	9.09%	30.83%
Sales/Assets	0.33	0.41	0.55	0.42	0.39	0.66
Proj. Sales Growth (F1/F0)	-4.51%	0.00%	-2.61%	-3.91%	-3.66%	22.59%
Momentum Score	C	-	-	F	F	C
Daily Price Chg	3.68%	1.13%	-0.08%	-0.02%	1.24%	-1.81%
1 Week Price Chg	7.17%	3.03%	4.60%	2.22%	-0.61%	-2.23%
4 Week Price Chg	12.47%	11.81%	12.07%	16.05%	17.16%	-5.09%
12 Week Price Chg	3.64%	15.62%	25.17%	18.17%	34.72%	31.43%
52 Week Price Chg	-18.64%	-19.90%	0.34%	0.34%	-9.85%	16.02%
20 Day Average Volume	5,150,677	113,725	2,537,324	19,531,308	18,397,420	5,868,506
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-5.57%	0.00%	-0.08%	-5.16%	-43.25%	-0.23%
(F1) EPS Est 12 week change	-26.38%	-48.48%	-16.19%	-21.69%	-68.96%	7.35%
(Q1) EPS Est Mthly Chg	-9.42%	0.00%	0.00%	-1.77%	-270.31%	-0.08%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	C
Momentum Score	C
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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