

## Discovery, Inc.(DISCA)

**\$30.21** (As of 02/14/20)

Price Target (6-12 Months): **\$32.00**

Long Term: 6-12 Months

**Zacks Recommendation:**
**Neutral**

(Since: 11/13/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**3-Hold**

Zacks Style Scores:

VGM:A

Value: A

Growth: B

Momentum: A

## Summary

Discovery is benefiting from strong domestic advertising growth, driven by increase in pricing and continued monetization of digital content offerings and inventory. International advertising is also expected to benefit from the addition of UKTV Lifestyle business, expansion of digital content offerings and increased prices in certain European markets. Expanding sports coverage and the launch of Food Network Kitchen are growth drivers. However, incremental spending on direct-to-consumer initiatives is expected to keep margins under pressure. Moreover, volatility in international markets like Mexico and Argentina is a headwind. Further, unfavorable foreign exchange and intense competition in the pay-TV market are expected to hurt overall growth. Shares have underperformed the industry in the past year.

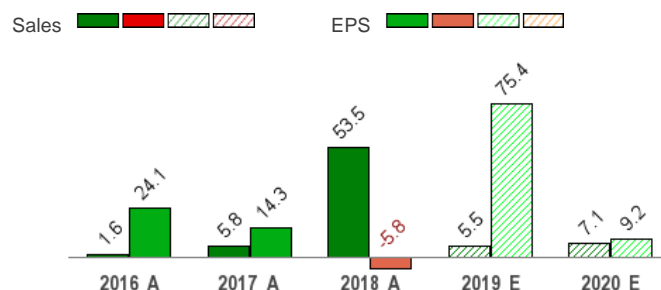
## Price, Consensus & Surprise



## Data Overview

52 Week High-Low	<b>\$33.66 - \$25.90</b>
20 Day Average Volume (sh)	<b>3,802,973</b>
Market Cap	<b>\$15.9 B</b>
YTD Price Change	<b>-7.7%</b>
Beta	<b>1.57</b>
Dividend / Div Yld	<b>\$0.00 / 0.0%</b>
Industry	<b>Broadcast Radio and Television</b>
Zacks Industry Rank	<b>Top 26% (66 out of 255)</b>

## Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	<b>4.8%</b>
Last Sales Surprise	<b>0.1%</b>
EPS F1 Est- 4 week change	<b>4.6%</b>
Expected Report Date	<b>02/27/2020</b>
Earnings ESP	<b>6.5%</b>
P/E TTM	<b>8.7</b>
P/E F1	<b>7.5</b>
PEG F1	<b>0.4</b>
P/S TTM	<b>1.4</b>

## Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	2,828 E	3,020 E	3,032 E	2,998 E	11,925 E
2019	2,707 A	2,885 A	2,678 A	2,871 E	11,137 E
2018	2,307 A	2,845 A	2,592 A	2,809 A	10,553 A

## EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.92 E	\$1.09 E	\$0.75 E	\$1.04 E	\$4.04 E
2019	\$0.87 A	\$0.98 A	\$0.87 A	\$0.95 E	\$3.70 E
2018	\$0.53 A	\$0.66 A	\$0.52 A	\$0.74 A	\$2.11 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 02/14/2020. The reports text is as of 02/17/2020.

## Overview

Discovery Communications is now known as Discovery, Inc. following the completion of the acquisition of Scripps Networks Interactive in March 2018. The company offers original and purchased programming in the United States as well as 220 other countries and territories in more than 50 languages.

The company's global portfolio of networks includes non-fiction television brands such as Discovery Channel, TLC, Animal Planet, Investigation Discovery (ID), Science Channel (SCI), and MotorTrend & Turbo. As a result of the acquisition of Scripps Networks, the company also added Food Network, HGTV, Travel Channel and TVN.

Moreover, Eurosport is a leading sports entertainment provider and broadcaster of the Olympic Games across Europe. Further, Discovery Kids is a leading children's entertainment brand in Latin America.

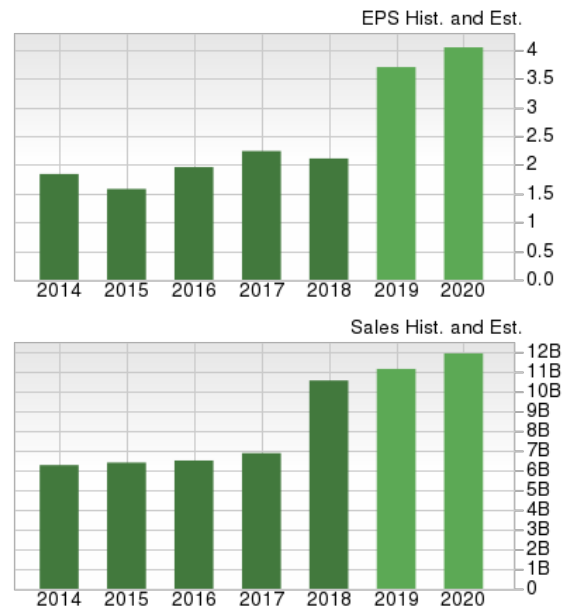
Discovery also participates in joint ventures, including Group Nine Media. Moreover, the company operates OWN, Discovery Family, AHC, Destination America, Discovery Life, DIY Network, Cooking Channel and Great American Country networks in the United States.

Discovery reported revenues of \$10.55 billion in 2018. The company operates through two reportable segments: U.S. Networks and International Networks.

U.S. Networks segment owns and operates 18 national television networks. In 2018, the segment contributed 60% to the company's total revenues. The U.S. Network segment generates revenues from affiliate fees & distribution (39% to segment revenues), advertising (59%) and Other (2%). Distribution, advertising and other revenues contributed 39%, 59% and 7%, respectively, to revenues.

International Networks segment primarily consists of the national pan- regional TV networks of the company. These TV networks are distributed throughout the world (excluding the United States) from London, Singapore and Miami. In 2018, the segment accounted for 40% of the company's total revenues. Revenue streams are similar to that of the U.S. Networks segment. Distribution, advertising and other revenues were 50%, 43% and 7%, respectively, of revenues in this segment.

Education and Other revenues were \$54 million in 2018, which represented 1% of revenues. On Apr 30, 2018, Discovery sold 88% controlling equity stake in the Education Business to Francisco Partners.



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## 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 in expanding its international footprint, especially in regions like Europe, Latin America and the Nordics. Cost synergies from the merger drove profitability as adjusted OIBDA grew by 8%. Moreover, Discovery expects to achieve additional margin expansion in 2019.
- ▲ Discovery is a dominant name in the pay-TV market. The company's expanding market share driven by solid viewership of multiple channels including Discovery Channel, Animal Planet, Food, HDTV MotorTrend, Science, TLC, ID, Oprah, and Eurosport is a key catalyst. The company's expanding content portfolio is expected to boost top-line growth.
- ▲ 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.
- ▲ 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. The company inked a joint venture with The Enthusiast Network (TEN) for automotive media, which marks Discovery's entry into the direct-to-consumer offerings space.
- ▲ Discovery's strong free cash flow generation capability makes it an attractive stock. The company ended 2018 with \$2.4 billion of free cash flow against its targeted \$2.3 billion, which represented a free cash flow conversion of more than 55% of adjusted OIBDA. Moreover, management expects to generate healthy free cash flow in 2019 courtesy adjusted OIBDA growth and continued margin expansion.

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

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## 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 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.
- ▼ Discovery's top-line growth has also been negatively impacted by softness in certain international markets including the United Kingdom (due to Brexit), Italy and Mexico (due to economic and political challenges). Moreover, unfavorable foreign exchange is expected to hurt top-line and bottom-line in 2019.
- ▼ High costs continue to limit Discovery's bottom-line growth. Discovery expects to spend an additional \$200-\$300 million on direct-to-consumer initiatives. This is expected to hurt OIBDA by \$300-\$400 million in 2019.
- ▼ Discovery is a highly leveraged company. This is indicated by the fact that the ratio of its long-term debt-to-equity currently stands at 132.6% much higher than S&P 500's 83.4%.

The continuing loss of U.S. subscribers due to competition, sluggishness in International Networks, unfavorable foreign exchange and high leverage are major concerns.

## Last Earnings Report

### Discovery Q3 Earnings Beat Estimates, Revenues Up Y/Y

Discovery reported third-quarter 2019 adjusted earnings of 87 cents per share that beat the Zacks Consensus Estimate by 4.8% and increased 10.1% year over year.

Revenues increased 3.3% year over year to \$2.68 billion and beat the consensus mark by 0.1%. Excluding foreign exchange impact, revenues increased 5%.

The year-over-year growth was driven by an increase in advertising (52.8% of revenues) and distribution (44.8% of revenues) revenues.

Quarter Ending **09/2019**

Report Date	Nov 07, 2019
Sales Surprise	0.09%
EPS Surprise	4.82%
Quarterly EPS	0.87
Annual EPS (TTM)	3.46

### Top-Line Details

Advertising revenues grew 3.5% year over year to \$1.41 billion. Distribution revenues increased 4.3% from the year-ago quarter to \$1.20 billion.

Other revenues were \$64 million, down 14.7% from the year-ago quarter.

U.S. Networks (64.4% of revenues) revenues rose 3% from the year-ago quarter to \$1.73 billion. Advertising and distribution revenues were up 2.8% and 5.7%, respectively.

The advertising growth was driven by increases in pricing and continued monetization of digital content offerings and inventory. The growth in distribution revenues was driven by increased contractual affiliate rates and additional carriage on streaming platforms.

Per Nielsen, Discovery had the #1 most watch TV portfolio for "women 25-54" in the United States for the past six months.

Moreover, TLC was the #1 ad-supported cable network in primetime among "women 25-54" and "women 18-49," with delivery up 16% and 10%, respectively.

Notably, Discovery launched Food Network Kitchen in collaboration with Amazon in the United States.

International Networks revenues (35.5% of revenues) rose 3.7% year over year to \$950 million. Advertising and distribution revenues were up 5.3% and 2.4%, respectively.

However, excluding foreign exchange impact, International Networks revenues grew 9%, as advertising revenues increased 10% and distribution revenues 8% on a year-over-year basis.

The advertising growth was driven by contribution from the UKTV Lifestyle Business, expansion of digital content offerings and increased prices in certain European markets.

Moreover, the growth in distribution revenues was driven by contractual price increases and new channel launches in the Latin America region. Additionally, higher digital licensing revenues and growth in Europe owing to increases in pricing and monetization of digital content offerings drove the top line in the reported quarter.

### Operating Details

In the third quarter, selling, general and administrative (SG&A) expenses decreased 1% from the year-ago quarter to \$660 million.

Adjusted operating income before depreciation & amortization (OIBDA) increased 6.2% from the year-ago quarter to \$1.13 billion. Excluding foreign exchange impact, OIBDA grew 9%.

U.S. Networks adjusted OIBDA rose 11.5% from the year-ago quarter to \$1 billion. However, International Networks adjusted OIBDA declined 6.7% from the year-ago quarter to \$237 million. Excluding foreign exchange impact, adjusted OIBDA increased 5%.

GAAP operating income surged 67.8% year over year to \$619 million.

### Balance Sheet

As of Sep 30, 2019, cash & cash equivalents were \$813 million compared with \$1.32 billion as of Jun 30, 2019. Moreover, as of Sep 30, long-term debt was \$14.76 billion, lower than \$14.82 billion as of Jun 30.

Free cash flow was \$884 million, up from \$596 million reported in the previous quarter.

Discovery repurchased nearly 12 million shares for \$300 million in the reported quarter.

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## Recent News

On Oct 28, Discovery and Comscore announced a number of multi-year strategic agreements for the use of the latter's audience measurement and consumer insights tools.

On Sep 25, Discovery announced the launch of Food Network Kitchen, a first-of-its-kind direct-to-consumer product, in late October 2019 in the United States. It will also be available across iOS (iPhone and iPad) and Android mobile devices. Food Network Kitchen will be rolled out across additional platforms and devices in 2020. Moreover, Discovery and Amazon have collaborated to offer Food Network Kitchen through Amazon Alexa and Echo Show, Fire Tablets, Fire TV streaming media devices and Fire TV Edition smart TVs.

On Aug 14, 2019, Cox Media division and premium OTT advertising provider Gamut announced a partnership with Discovery for local market OTT inventory ad sales efforts in the United States.

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## Valuation

Discovery shares are up 6.3% in the past six-month period and 3.1% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Discretionary sector are up 13.1% and 11.9% in the past six-month period, respectively. Over the past year, the Zacks sub-industry and the sector are up 7.8% and 13.4%, respectively.

The S&P 500 index is up 16.2% in the past six-month period and 20.9% in the past year.

The stock is currently trading at 7.44X forward 12-month earnings, which compares to 23.92X for the Zacks sub-industry, 20.31X for the Zacks sector and 19.36X for the S&P 500 index.

Over the past five years, the stock has traded as high as 18.10X and as low as 6.58X, with a 5-year median of 10.6X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$32 price target reflects 7.88X 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	7.44	23.92	20.31	19.36
	5-Year High	18.1	34.44	23.35	19.36
	5-Year Low	6.58	20.5	16.16	15.18
	5-Year Median	10.6	25.9	20.07	17.47
P/S F12M	Current	1.33	7.34	2.32	3.58
	5-Year High	2.22	13.42	3.19	3.58
	5-Year Low	0.73	6.61	1.81	2.54
	5-Year Median	1.45	9.73	2.54	3
EV/Sales TTM	Current	2.69	9.71	3.32	3.11
	5-Year High	3.94	15.82	4.04	3.27
	5-Year Low	2.07	7.94	2.7	2.15
	5-Year Median	2.83	11.19	3.43	2.77

As of 02/14/2020

## Industry Analysis Zacks Industry Rank: Top 26% (66 out of 255)



## Top Peers

Cable One, Inc. (CABO)	Outperform
DISH Network Corporation (DISH)	Outperform
Amazon.com, Inc. (AMZN)	Neutral
Comcast Corporation (CMCSA)	Neutral
The Walt Disney Company (DIS)	Neutral
Fox Corporation (FOXA)	Neutral
Netflix, Inc. (NFLX)	Neutral
AT&T Inc. (T)	Neutral

Industry Comparison Industry: Broadcast Radio And Television				Industry Peers		
	DISCA Neutral	X Industry	S&P 500	CMCSA Neutral	DIS Neutral	NFLX Neutral
<b>VGM Score</b>	<b>A</b>	-	-	<b>B</b>	<b>F</b>	<b>F</b>
Market Cap	15.87 B	714.57 M	24.61 B	209.85 B	251.93 B	166.92 B
# of Analysts	3	2	13	14	6	13
Dividend Yield	0.00%	0.00%	1.78%	1.82%	1.26%	0.00%
<b>Value Score</b>	<b>A</b>	-	-	<b>B</b>	<b>D</b>	<b>F</b>
Cash/Price	0.05	0.15	0.04	0.03	0.03	0.03
EV/EBITDA	4.63	5.58	14.06	8.90	14.84	14.71
PEG Ratio	0.39	0.75	2.09	1.27	5.08	2.09
Price/Book (P/B)	1.43	1.25	3.29	2.50	2.66	22.02
Price/Cash Flow (P/CF)	2.58	4.39	13.65	7.67	17.64	14.92
P/E (F1)	7.48	9.21	19.21	14.21	25.87	62.80
Price/Sales (P/S)	1.43	0.95	2.70	1.93	3.35	8.28
Earnings Yield	13.37%	8.36%	5.19%	7.03%	3.86%	1.59%
Debt/Equity	1.33	1.33	0.71	1.23	0.40	1.95
Cash Flow (\$/share)	11.72	2.13	6.92	6.01	7.91	25.49
<b>Growth Score</b>	<b>B</b>	-	-	<b>A</b>	<b>F</b>	<b>F</b>
Hist. EPS Growth (3-5 yrs)	6.99%	6.99%	10.85%	16.77%	5.67%	82.45%
Proj. EPS Growth (F1/F0)	9.28%	22.22%	7.17%	3.63%	-6.53%	46.66%
Curr. Cash Flow Growth	26.26%	8.86%	8.56%	21.54%	4.37%	26.74%
Hist. Cash Flow Growth (3-5 yrs)	18.37%	15.14%	8.36%	11.76%	7.57%	30.03%
Current Ratio	1.52	1.80	1.23	0.84	0.80	0.90
Debt/Capital	57.73%	57.73%	42.91%	55.43%	33.19%	66.06%
Net Margin	16.81%	8.83%	11.81%	11.98%	13.81%	9.26%
Return on Equity	23.29%	8.23%	16.86%	18.25%	10.23%	28.45%
Sales/Assets	0.34	0.38	0.54	0.42	0.37	0.66
Proj. Sales Growth (F1/F0)	7.08%	5.99%	3.85%	4.80%	17.12%	20.90%
<b>Momentum Score</b>	<b>A</b>	-	-	<b>D</b>	<b>C</b>	<b>A</b>
Daily Price Chg	-0.40%	0.00%	0.06%	0.04%	-0.97%	-0.26%
1 Week Price Chg	1.81%	1.81%	2.47%	3.59%	1.96%	6.28%
4 Week Price Chg	-7.81%	-2.58%	0.59%	-1.66%	-3.85%	12.34%
12 Week Price Chg	-6.00%	-1.16%	6.98%	3.90%	-5.01%	22.04%
52 Week Price Chg	5.01%	-9.06%	16.62%	23.70%	26.10%	5.94%
20 Day Average Volume	3,802,973	62,052	2,020,569	21,241,226	11,362,844	7,938,394
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.31%	0.23%
(F1) EPS Est 4 week change	4.57%	0.00%	-0.05%	-1.73%	0.78%	11.18%
(F1) EPS Est 12 week change	4.57%	0.00%	-0.17%	-5.29%	-3.96%	10.08%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	-0.24%	-5.85%	-6.91%	44.19%

## 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	B
Momentum Score	A
VGM Score	A

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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