Needham

December 21, 2010

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**Entertainment, Cable & Media / Consumer**

# Discovery Communications, Inc. (DISCA) – Hold

## DISCA: Initiating Coverage with a HOLD Rating

We initiate coverage of Discovery Communications, Inc. (DISCA) with a HOLD rating based on the following analytical building blocks:
**DISCA** is a pure-play cable network company. DISCA's US cable networks (63% of 2010E revenue) reach nearly 800mm subscribers through 13 US cable networks including Discovery Channel, Animal Planet, TLC, etc. DISCA's international cable networks (33% of 2010E revenue) reach over 1B subscribers in more than 180 countries led by the Discovery Channel, which distributes 23 international television brands.

**Great Company.** DISCA is a great company with strong fundamentals and an excellent management team. DISCA's unique high-quality programming, strong strategic position in both the US and offshore, its strong brands, and balance sheet strength all make it one of the highest quality companies in the media space.

**Valuation.** DISCA is priced for perfection. DISCA is valued on the forward year (2011E) at a P/E of 20x, an EV/EBITDA of 11x, an EVFCF of 19x and a 6% FCF yield. DISCA trades at more than a 50% premium to the other companies we follow on most metrics (Table 8 includes comparative valuation statistics). **ROIC Issues:** Simply adding one datapoint, DISCA, to our media regression analysis lowers the $R^2$ from 83% to 76% because DISCA's valuation is so far above the regression line. We estimate that DISCA's ROIC will grow by about 250 basis points in FY11 (from 12.3% to 14.8%). DISCA's WACC (weighted average cost of capital) should remain at about 9.1%. Since ROIC>WACC, this implies that DISCA is creating value in FY11, but because it is valued so far above the (typically >80% correlated regression) line we worry that the market is already discounting all of this improvement in today's share price implying anemic share price upside over the next 12 months.

We initiate coverage of DISCA with a HOLD rating.

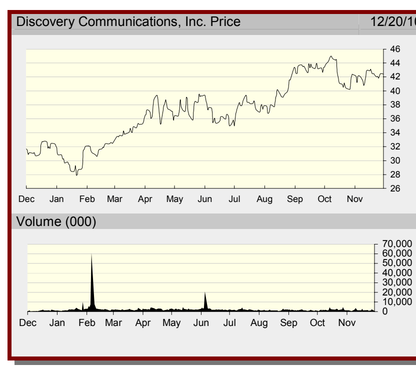
| | FY 12/31/09 A | FY 12/31/10 E | | FY 12/31/11 E | |
|---|---|---|---|---|---|
| | | Old | New | Old | New |
| **Rev. (MM)** | $3,516.0 | | $3,808.3 | | $4,084.9 |
| ***Growth*** | *2.1%* | *0.0%* | *8.3%* | *0.0%* | *7.3%* |
| **Op. Mar.** | *35.5%* | | 35.6% | | *41.1%* |
| **EPS: 1Q** | 0.28 | | 0.39A | | |
| **EPS: 2Q** | 0.42 | | 0.25A | | |
| **EPS: 3Q** | 0.22 | | 0.37A | | |
| **EPS: 4Q** | 0.41 | | 0.50 | | |
| **EPS: Year** | 1.33 | | 1.51 | | 2.10 |
| ***Growth*** | *56.3%* | *0.0%* | *13.5%* | *0.0%* | *39.0%* |
| **P/E Ratio** | 17.2x | nm | 28.1x | nm | 20.2x |

Note: Pro forma earnings estimates displayed above do not include one-time items or any stock compensation expenses.

**Coverage Initiation**

| Market Data | |
|---|---|
| Price (12/20/10) | $42.42 |
| 12-Month Price Target | N/A |
| 52-Week range | $44.97-27.88 |
| Shares Out. (MM) | 429.8 |
| Market cap (MM) | $18,230.0 |
| Avg. daily volume (000) | 1,665.3 |
| **Financial Data** | |
| Total Debt/Cap. | 35.1% |
| Price/LTM Rev. | 4.9x |
| Tangible BVPS | ($0.85) |
| Net Cash Per Share | ($6.03) |

*DISCA is the world's largest nonfiction media company reaching more than 1.5 billion cumulative subscribers in over 180 countries*




**Disclosures applicable to this security: B, G.**
**Disclosure explanation on the inside back cover of this report.**

## INVESTMENT POSITIVES

1. **Unique High-Quality Programming.** Discovery is the largest and most prestigious producer of TV non-fiction programming in the world.
   - The Discovery Channel is DISCA's core channel. It reaches over 100 million subscribers in the U.S. and nearly 300mm in over 100 other countries. The advertising revenue at The Discovery Channel is DISCA's single largest revenue stream, accounting for 24% of DISCA's US revenue.
   - DISCA has 3 fully distributed channels in the US: Discovery Channel, TLC and Animal Planet. We estimate that these 3 networks will account for about 50% of DISCA total revenue and nearly 70% of DISCA's EBITDA in FY10.
   - DISCA's other large cable networks in the US are Science Channel, and Investigation Discovery (ID). DISCA also has two 50%/50% cable channel JVs: the HUB is with Hasbro and the Oprah Winfrey Channel is a JV with Oprah's company. These JVs are not included in the consolidated financial statements of DISCA.
2. **Strategic Position.** With over 95% of its revenue coming from cable networks, DISCA is one of the few pure-play public cable network companies. DISCA has a strong strategic position both in the US and offshore. Advertising revenue represents about half of DISCA's revenue and the premium programming aired by DISCA attracts the largest and highest quality advertisers and on Earth.
3. **Global Footprint**. DISCA generates about 65% of revenue and 70% of its EBITDA from inside the US, with the balance coming from outside the US. This type of global footprint should provide stability from economic weakness occurring in any one region of the world. We are optimistic about the potential of several DISCA channels to add to their global footprint over the next several years, including Investigation Discovery and TLC.
4. **Brand Value.** Brands are more valuable in a fragmenting audience world. Three of DISCA's channels are fully distributed in the US with nearly 100mn homes. Worldwide, two of DISCA's channels are in more than 700mn homes. This broad reach makes some of DISCA's brands the most valuable in the world in the TV space.
5. **Balance Sheet Strength.** We expect DISCA to end FY10 with a net debt/EBITDA ratio of about 2.0x. In addition, DISCA has no debt maturities until 2015 and generates strong FCF. DISCA is committed to retaining an investment grade rating with debt levels in the 2-3x Debt/EBITDA range.
6. **Affiliate Fees.** DISCA generates about 50% of its revenues from affiliate agreements, which are largely locked up contractually through 2012. DISCA's business model lends stability and visibility to the income statement. Post 2012 years, we expect DISCA to have faster affiliate fee revenue growth as it renews its affiliate fee contracts with more successful networks in its negotiating group (like the HUB and Oprah Winfrey Channel).
7. **Cyclical Advertising Upside.** Advertising continues to strengthen in the US with scatter rates up 10-15% year to date. We expect pricing strength to continue into FY11 and think that there is upside ratings potential to the DISCA empire if either the HUB or the Oprah Winfrey Network JVs succeed.

8. **Advance/Newhouse Ownership.** On Dec 13, 2010 DISCA agreed to repurchase 13,732,491 shares of Series C preferred stock at $36.41 per share (approximately $500 million), from Advance/Newhouse, representing about 10% of their ownership interest. Advance/Newhouse's retains veto power over DISCA's other large equity holder, John Malone. Advance/Newhouse and John Malone control 26% and 23% of the vote, respectively.

## INVESTMENT NEGATIVES

1. **Valuation.** Priced for perfection. Discovery has been publicly traded in its current manifestation since September of 2008. It's current P/E is over 20x FY11 and DISCA trades at more than a 50% premium to the other companies we follow.
2. **M&A Risk.** On the 3Q10 earnings call, Brad Singer, CFO stated that "Our primary focus on utilizing our capital is to invest in our businesses." Since DISCA is at the low end of their leverage targets but are *not* talking about share repurchases or dividend increases (unlikely to happen owing to John Malone's aversion to the tax-disadvantages of dividends) this implies to us further investments in offshore content and cable channels. Acquisions are often dilutive, and offshore acquisitions are often risky.
3. **Content Discount Rates.** We are thinking a lot about how discount rates should differ in a world where cord cutting or cord slicing may become more prevalent. We think the lowest risk group of content creators is companies that own copywrites with high production value and broad distribution. We wonder weather the types of content the DISCA creates are more substitutable with premium Internet content.
4. **Rising Risk Profile.** DISCA produces about 70% of the content it airs, up from about 55% in 2004. This is great in the sense that DISCA owns the copywrites for all these shows. But higher levels of owned content typically mean more risk in a hit-driven business. It often means lower ratings as well since owned "lesser" shows are sometimes picked above better shows owned by third parties.
5. **Margin Pressure from International Expansion.** Margins in the US cable networks business are about 50% higher than offshore margins. That is, in the US, we estimate that operating margins are 45%, significantly higher than the 30% margins offshore. As DISCA expands its international presence, this may put downward pressure on overall margins.
6. **Risks in the US.** In the US, DISCA's biggest market, housing starts remain essentially zero, growth of multichannel households is minimal or negative (a la cord cutting) and pricing power on the video product is under siege from triple-play bundles. If consumers begin cutting or slicing the cord, DISCA's top 3 networks would feel the pain immediately because they are each fully distributed networks.
7. **Ratings Risks.** DISCA's ratings are down 1% season to date. The strongest profit driver at DISCA is The Discovery Channel as it represents about 50% of DISCA's US advertising revenue, which in turn is based on ratings momentum. The 5% decline in October was driven by a 13% y/y decline at the Discovery Channel. In November, Discovery Channel's ratings rebounded, up 2% y/y which aided overall ratings at DISCA being up 4% in November.
8. **Ownership Structure.** Some media companies have two classes of stock but DISCA is the only company we cover that has *three* classes of stock. The Class A shares are entitled to one vote per share (about 208 million shares outstanding). Class B shares (6.6mm outstanding) are mostly held by John Malone and are entitled to 10 votes per share. Class C shares total 198 million *after* Discovery

repurchased 13.7 million of these shares for approximately $500 million from Advance/Newhouse. This repurchase reduced the Advance Newhouse ownership of DISCA from 33% to 31%.

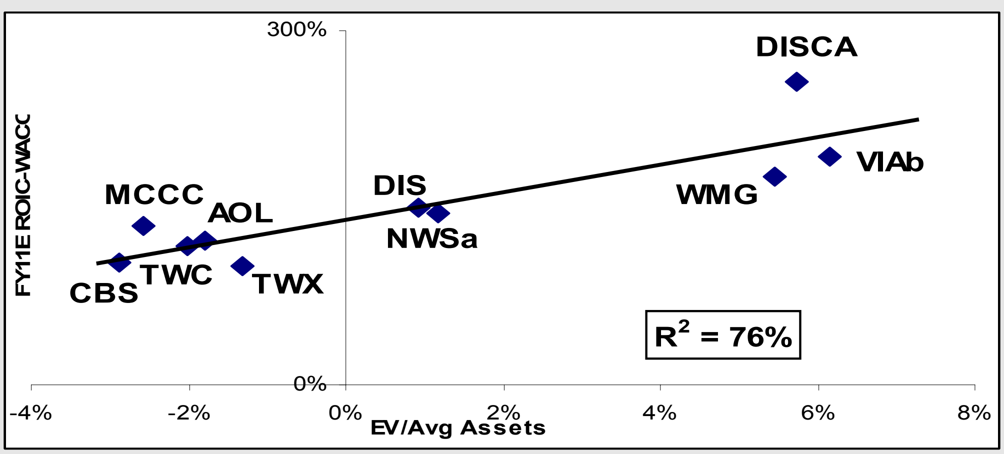
9. **Cost Increases.** Launch support fees fell by about 10% each year for the five years ending in 2009. But when DISCA renewed its agreement with BSkyB in 2007, it agreed to pay about $200 million in launch fees over a five year period representing an additional expense of about $40mm/year suggesting rising expenses in this category. Additionally, programming commitments may increase owing to the JV's (where revenue and profits are not consolidated).

## Why ROIC Matters in Media

Returns on invested capital (ROIC) in the media space are closely related to share price performance. In fact, there is typically a 70-90% statistical correlation between U.S. entertainment company valuations and their year-forward estimated ROICs. Recently, the correlation hit 76%. This high statistical correlation implies that shifts in ROIC are predictive of changes in total valuation and share prices. An important valuation implication of this high correlation is that a company is likely to stay on the line (ie, valuations should move up or down) as its ROIC outlook changes.

We estimate that DISCA's ROIC will grow by about 250 basis points in FY11 (from 12.3% to 14.8%). DISCA's WACC (weighted average cost of capital) will remain at about 9.1%, according to our estimates. Since ROIC>WACC, this implies that DISCA is creating value in FY11. The problem with DISCA is valuation. Adding DISCA to our media regression analysis lowers the $R^2$ from 83% to 76%.
Importantly, the slope of the entertainment regression line is typically very steep. Therefore, it is important to accurately assess ROIC trends for entertainment companies. Making mistakes is expensive for investors in cases where an entertainment company under-delivers expected ROICs and a boon to investors who accurately predict ROIC improvements. Figure 1 includes a recent statistical correlation between of FY11 forward-year returns on invested capital compared with valuations for the media stocks under our coverage.

***Entertainment Companies: Correlation of Valuation to ROIC*** *Figure 1*




Source: Yahoo finance prices as of 12/21/10, Needham & Company, LLC estimates.

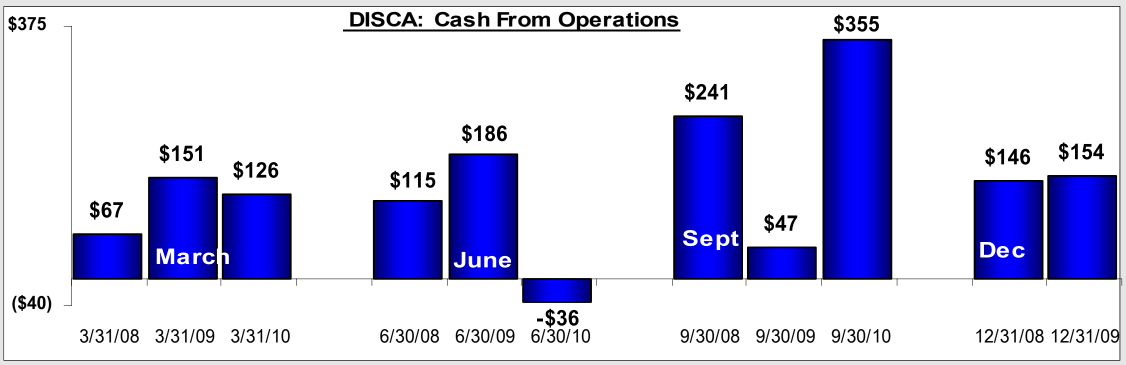
## DISCA: ROIC Summary & Conclusions

The clearest signposts of improving ROICs are rising FCF and deleveraging.

**Cash From Operations Analysis:**

- **9/30/10:** DISCA's Cash from Operations showed a large increase in the most recent quarter ended 9/30/10 after two quarters of declines. Results in the quarter compared well with year ago results due in large part to an improved advertising market as well as lower taxes paid in the current quarter.
- **LT Trends.** DISCA's Cash from Operations has been positive in 11 of the past 12 quarters, despite the worst advertising recession in 30 years. FCF trends have remained positive coming out of the recession.
- **Seasonality:** Seasonal with March and December typically the weakest FCF quarters of the year and September the biggest positive FCF quarter.

***DISCA: Cash from Operations ($ in MMs)*** *Figure 2*

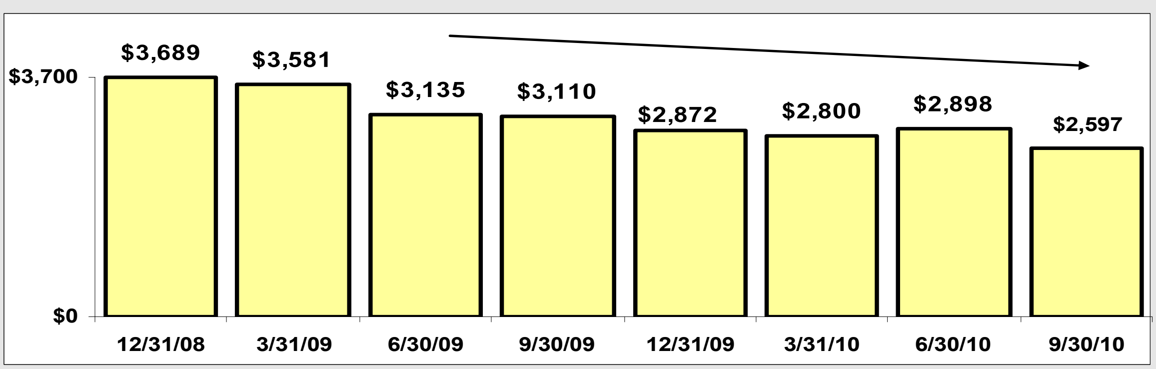



**Source: Company reports, Needham & Company, LLC. research.**

**Net Debt Analysis:**

- **9/30/10:** Strong deleveraging trends. Net debt fell $301M in the 3 months ended 9/30/10, after being up slightly in the prior quarter.
- **LT Trends:** Over the past 3 years, debt has declined steadily. DISCA's net debt has fallen by $1,092M since 12/31/2008 and by $500mm over the past year (since 9/30/09)
- **Seasonality:** Debt repayment has typically NOT been seasonal. Analysis shows that DISCA has had lower net debt in most quarters since 12/31/08.

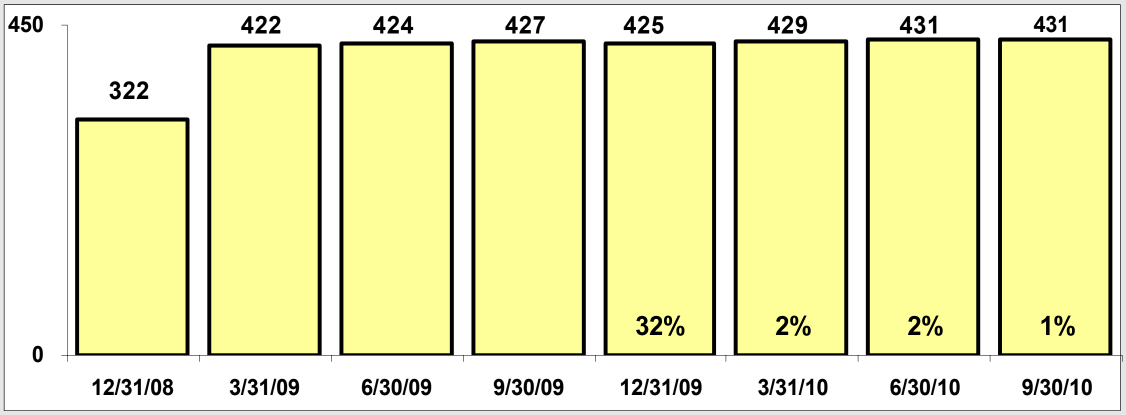
***DISCA: Net Debt ($ in MMs)*** *Figure 3*




**Source: Company reports, Needham & Company, LLC research.**

**DISCA Average Shares Outstanding:**
DISCA's diluted share count had been relatively stable over the past 7 quarters, with most quarters reporting around 431M average diluted shares outstanding. Owing to DISCA's recently announced repurchase of the Advance/Newhouse shares and the current outstanding authorization, we expect this number to fall in FY11, which implies a shrinking asset base (better for ROIC trends).

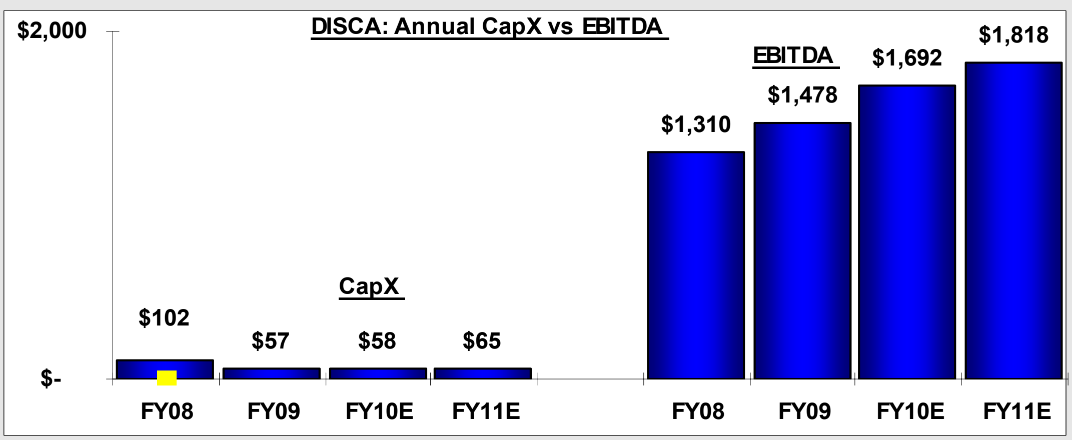
***DISCA Average Diluted Shares Outstanding** (MMs)* *Figure 4*




**Source: Company reports, Needham & Company, LLC research.**

**CapX vs EBITDA Trends:**
In FY10, we estimate that EBITDA will rise by $214M (to $1.7B), up 14.5% y/y while CapX will remain flat at about $65mm, implying improving ROAs. We are projecting a small increase in CapX spending in FY 2011E. In FY11E, this trend remains positive with $65M of total CapX driving an increase of about $126M of EBITDA, implying a marginal return on incremental invested capital of approximately 94%.

***DISCA: CapX vs EBITDA, FY08-FY11E** ($ in MMs)* *Figure 5*

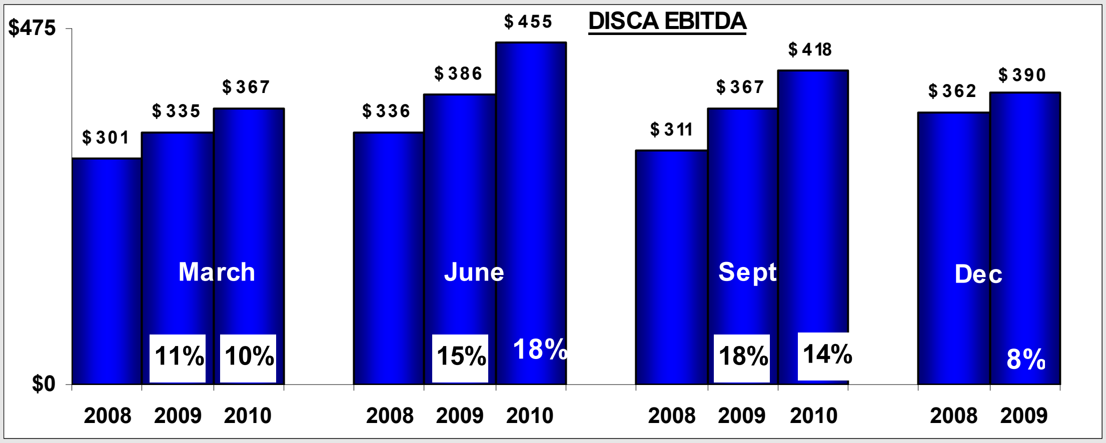



**Source: Company reports, Needham & Company, LLC research.**

**DISCA's EBITDA Trends**

Figure 6 includes DISCA's recent trends in EBITDA. The most recent quarter reported continued y/y growth in EBITDA, up 14% y/y but down 4% q/q. EBITDA growth is being driven entirely by growth in the US business. The International channels reported lower EBITDA in the most recent quarter.

***DISCA: EBITDA Trends** ($ in MMs)* *Figure 6*

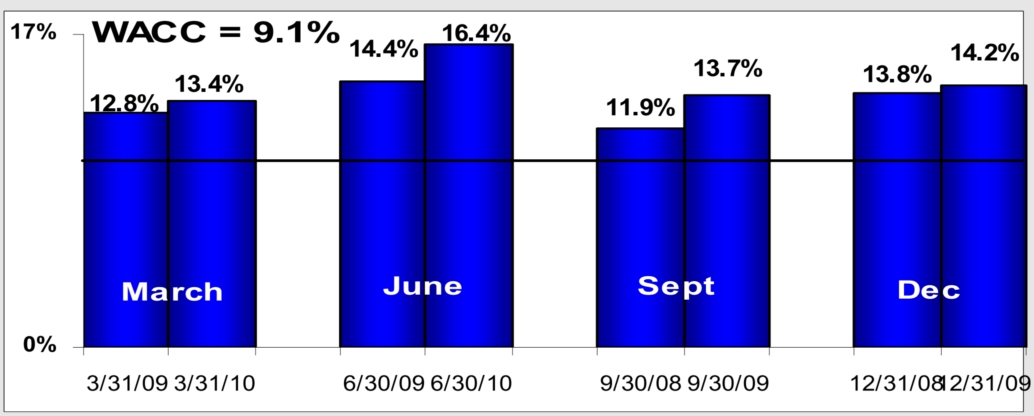



*Source: Company reports, Needham & Company, LLC research.*

**DISCA ROA Trends:**

DISCA's ROA's (defined as EBITDA/Assets) in the first 9 months of FY 2010 are higher than the same period one year ago. ROAs have performed solidly over the past 8 quarters ranging from a low of 11.9% to a high of 16.4%. DISCA's WACC is approximately 9.1% and its ROAs have surpassed that level in each of the past 8 quarters. We note that share prices tie closely to *trends in ROIC,* not the actual level of ROICs.

***DISCA ROA Trends*** *Figure 7*




**Source: Company reports, Needham & Company, LLC research.**

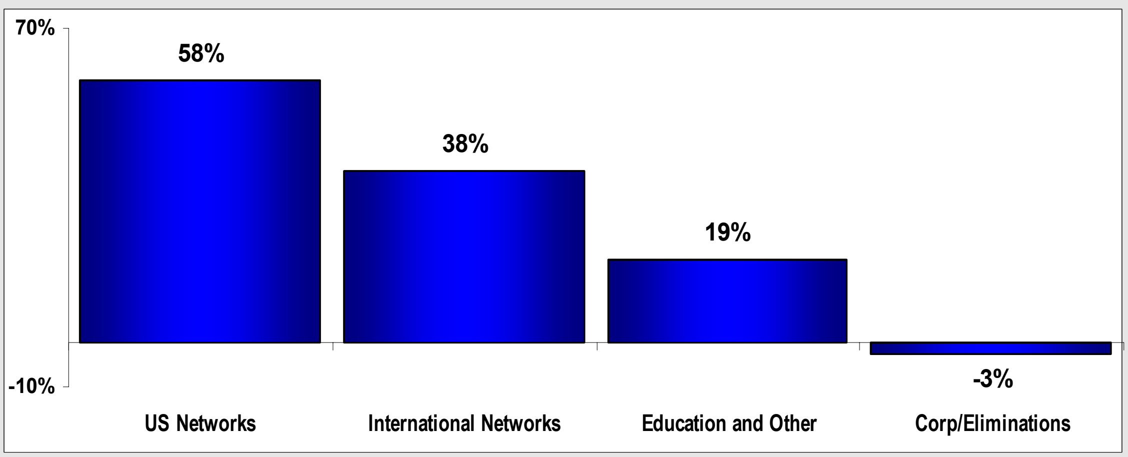
## Segment Information and Analysis

**Segment ROA Analysis:**
DISCA operates its business in three segments:

- The **US Networks** reach approximately 785M subscribers through 13 US cable and satellite networks including, Discovery Channel, Animal Planet, TLC, Discovery Health, etc.
- The **International Networks** reaches over 1 B subscribers in more than 180 countries led by the Discovery Channel, which distributes 23 international television brands.
- The **Education & Other** groupcombines scientifically proven, standards-based digital media and a dynamic user community to empower teachers to improve student achievement.
- The **"Corporate"** segment includes corporate overhead expense, net of income on cash balances.

For the fiscal year ended 12/31/09, DISCA's three operating segments had ROAs as follows: 58% for US Networks; 38% for International Networks; and 19% for Education and Other.

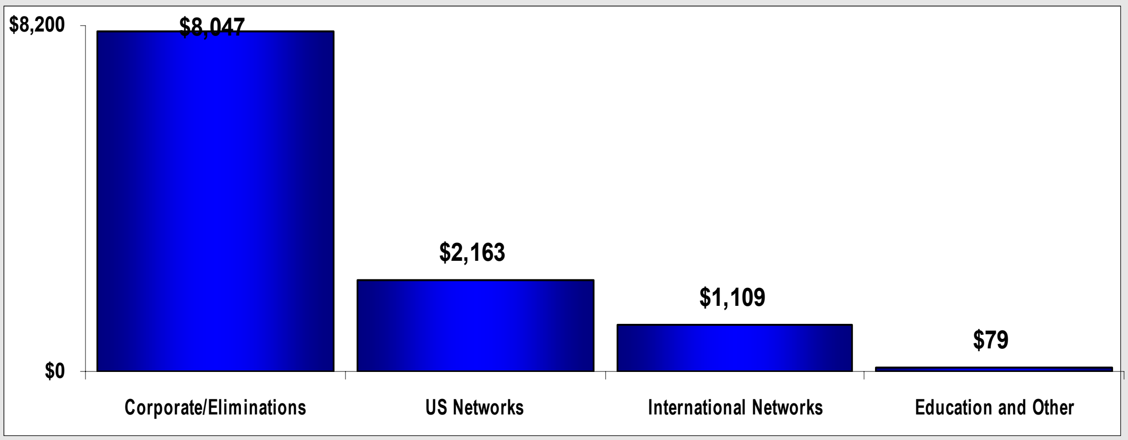
***DISCA: Comparative Operating Segment ROAs,** FY09A* *Figure 8*




**Source: Company reports, Needham & Company, LLC research.**

**Segment Asset Analysis:**
DISCA's asset allocation is unlike its competitors. Corporate has the largest asset base of DISCA at $8.05B. Of this, $6.4B represents goodwill, so none of the operating divisions have any goodwill included in them. The US Networks have the largest asset base of the operating divisions, at $2.2B, followed by International Networks at $1.1B and Education & Other at $79M.

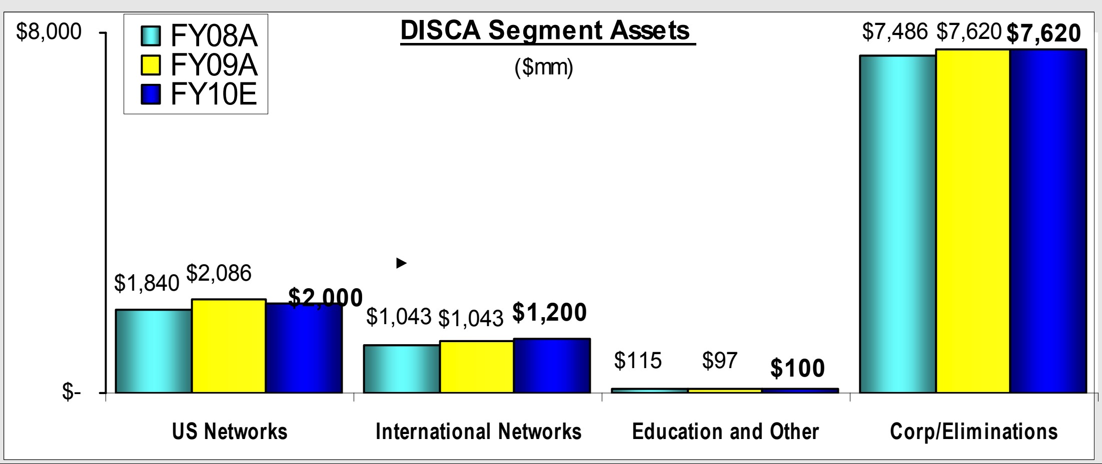
***Total Assets by Segment at 9/30/10*** *($ in MMs)* *Figure 9*




**Source: Company reports, Needham & Company, LLC research.**

**Segment Assets Trends:**
Assets have been relatively stable over the past two years, and we expect this to continue into FY11. This is positive for ROICs as this stability, coupled with rising EBITDA, drives higher ROICs. We project that current asset levels will remain steady into FY11E, absent a significant acquisition.

***Asset Trends by Segment*** *($ in MMs)* *Figure 10*



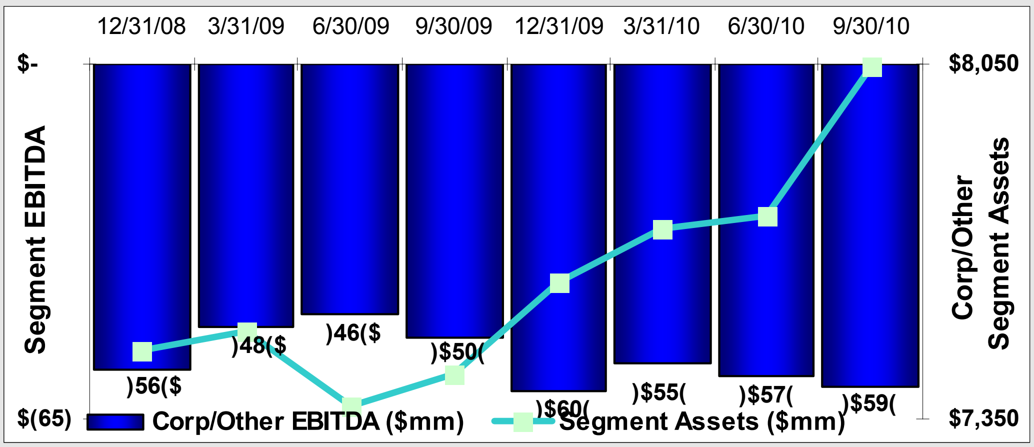

**Source: Company reports, Needham & Company, LLC research.**

## Segment Capital Efficiency Trends

**Corporate ROA Analysis:**

- **Assets:** Corporate segment assets are the highest of DISCA's four divisions at over $8B (including about $6.4B of goodwill) at 9/30/10. Assets in this division have been on the rise for the past 5 quarters. Since all acquisitions have their goodwill added to this segment, asset growth implies international cable networks are being acquired.
- **EBITDA** in this segment is negative because corporate is a cost center. We do believe that income on cash balances is included in this segment's EBITDA, which partly masks the true cost of the corporate center. EBITDA losses in this division have been relatively constant, albeit growing, over the past 2 years.

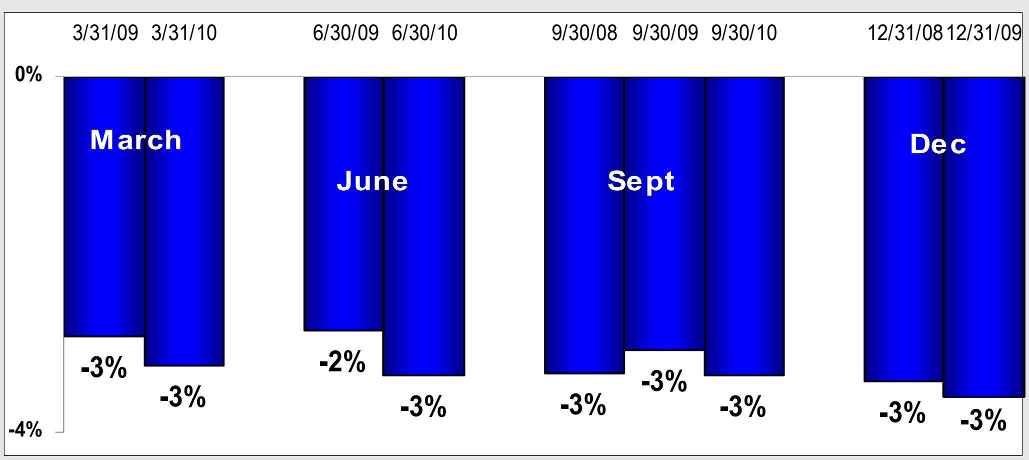
***Corporate: EBITDA vs Asset Trends ($ in MMs)*** *Figure 11*




**Source: Company reports, Needham & Company, LLC research.**

Corporate results are generally steady and always negative throughout the year. There is little seasonality in this number.

*Corporate: ROA Trends* *Figure 12*

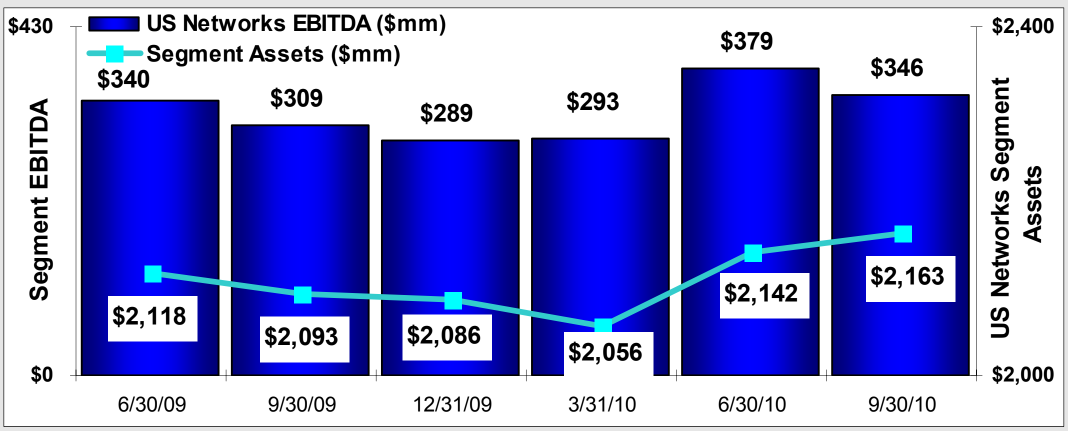



Source: Company reports, Needham & Company, LLC research.

**US Networks ROA Analysis:**

- **Assets.** This segment has the second largest asset base in the DISCA empire at $2.2B. US Network segment assets have remained relatively constant over the past 6 quarters in the range of $2.06B and $2.16B. We expect assets in this division to remain relatively constant for the remainder of FY10E.
- **EBITDA.** DISCA weathered the miserable US advertising recession of 2009 because >50% of its revenue is affiliate fees. FY 2010 so far shows solid y/y performance and we expect this to continue as we head into the final 3 months of FY2010.

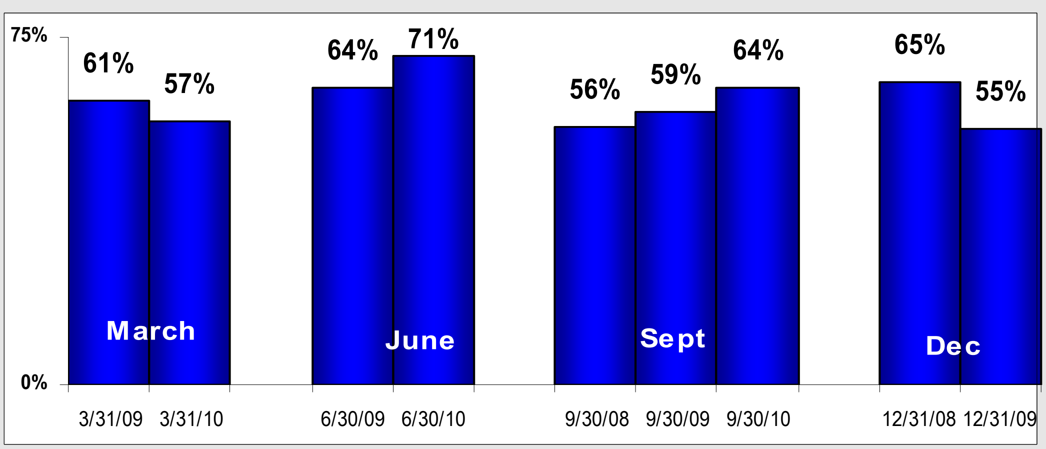
*US Networks: EBITDA vs Asset Trends ($ in MMs)* *Figure 13*




**Source: Company reports, Needham & Company, LLC research.**

The US Networks division has had spectacular ROAs for the past 9 quarters, ranging from a low of 55% to a high of 71%. The absolute level of ROAs are somewhat overstated because all goodwill at DISCA is reported in the "corporate" segment, but trends are valid. These returns do not appear to be seasonal.

*US Networks: ROA Trends* *Figure 14*

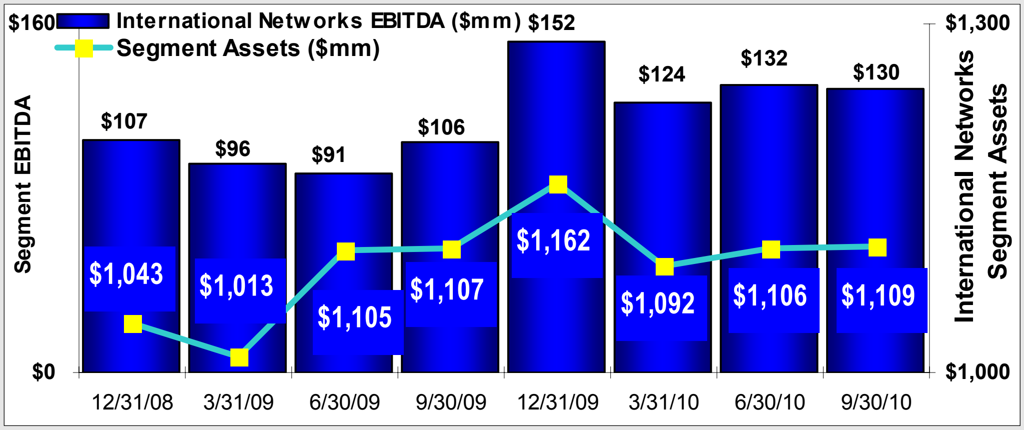



**Source: Company reports, Needham & Company, LLC research.**

**International Networks ROA Analysis:**

- **Assets:** This segment has the third largest asset base at DISCA. Assets have stayed in the $1.0B to $1.1B range over the past 2 years, but acquisitions offshore are largely accounted for by adding the goodwill to the "corporate" group.
- **EBITDA** in this segment has performed at a solid level for the past 8 quarters, reporting strong y/y growth in FY10. We expect this to continue in FY11E.

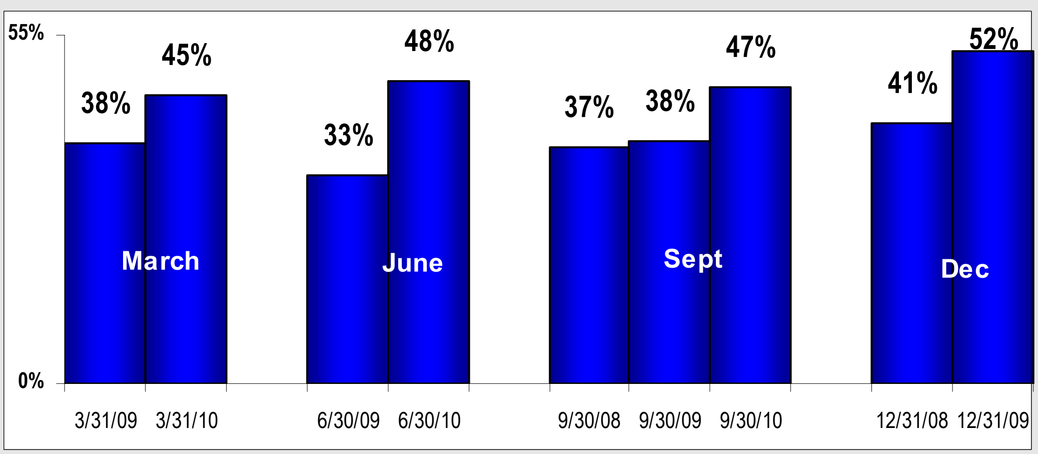
***International Networks: EBITDA vs Asset Trends** ($ in MMs)* *Figure 15*




**Source: Company reports, Needham & Company, LLC research.**

Seasonally, DISCA's ROAs perform steadily throughout the year, although the most recent four quarters have been impressively higher than the prior year period. The absolute level of ROAs are somewhat overstated because all goodwill at DISCA is reported in the "corporate" segment, but trends are valid. These returns do not appear to be seasonal.

***International Networks: ROA Trends*** *Figure 16*

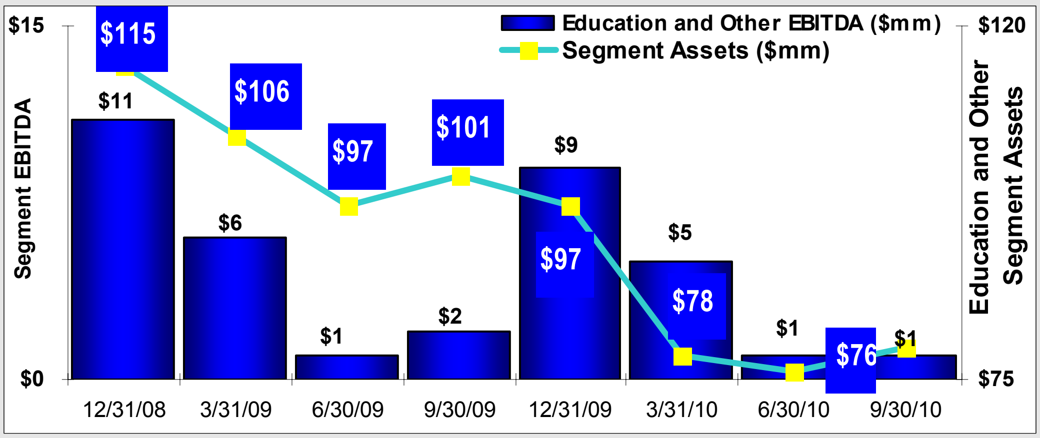



**Source: Company reports, Needham & Company, LLC research.**

**Education and Other ROA Analysis:**

- **<u>Assets:</u>** This segment has by far the smallest asset base of DISCA's three operating segments. Assets have fallen by about a third to $80M in the most recent 3 quarters, presumably owing to write-offs.
- **<u>EBITDA</u>** in this segment has been small, but positive, for the past 8 quarters. This business is seasonal with the June and Sept quarters barely able to eek out a profit in each year shown.

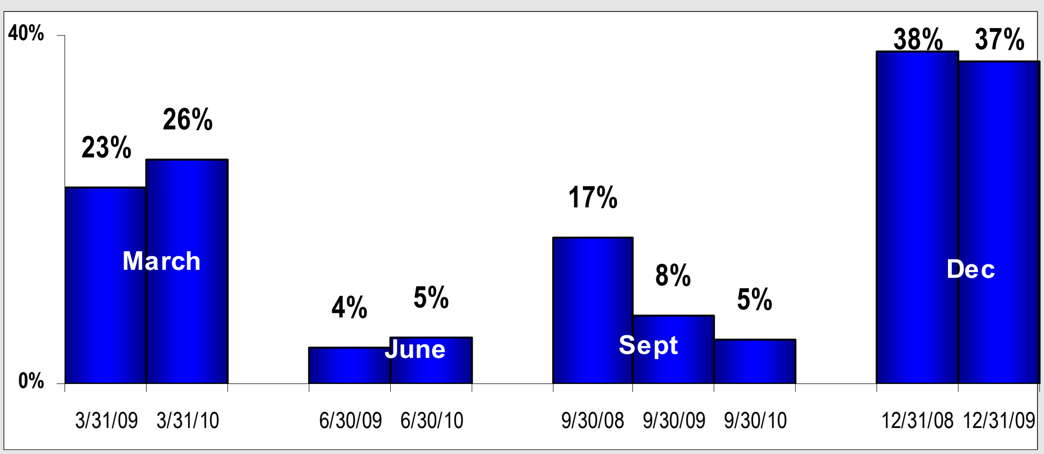
***Education and Other: EBITDA vs Asset Trends** (\$ in MMs)* *Figure 17*




**Source: Company reports, Needham & Company, LLC research.**

Seasonally, DISCA's ROAs in this division have performed better in the December quarter with June being the lowest performing quarter of the year.

***Education and Other: ROA Trends*** *Figure 18*




**Source: Company reports, Needham & Company, LLC research.**

## EPS ESTIMATES

Figure A below shows our revenue and EPS estimates compared to consensus estimates.

| FYE Dec. 31: | 4Q10E | 2010E | 2011E |
|---|---|---|---|
| **Rev Current ($mm)** | **$1,040** | **$3,808** | **$4,085** |
| Previous ($mm) | - | - | - |
| Consensus ($mm) | $1,030 | $3,790 | $4,040 |
| **Operating EPS** | **$0.50** | **$1.51** | **$2.10** |
| Previous | - | - | - |
| Consensus | $0.52 | $1.53 | $2.11 |
| P/E | | 28.1 | 20.2 |
| Sources: Needham & Company estimates, Yahoo Finance | | | |

## VALUATION

Our HOLD rating is based on several forms of valuation, summarized in Table 1:

*DISCA: Valuation Summary & Conclusions* *Table 1*

**Table 1: DISCA: Valuation Summary & Conclusions**

| 2011E Valuation Multiples | | | Embedded Expectations Metrics | |
|---|---|---|---|---|
| 1 | EV/Sales | 4.9 | 7 **Breakeven DCF** (Calculated as the 10-Yr EBITDA CAGR required to justify current share price) | 2.1% |
| 2 | EV/OIBDA | 11.0 | | |
| 3 | P/E | 20.2 | | |
| 4 | FCF/Share | $2.45 | | |
| 5 | EV/FCF | 19.4 | | |
| 6 | FCF Yield | 6% | | |

Source: Needham & Company estimates.

Source: Needham & Company, LLC research.

1. The **"Breakeven DCF"** valuation methodology uses the current share price to calculate the market's growth expectations for the enterprise, including capital efficiency trends. This valuation methodology concludes that DISCA must achieve a 10-year OIBDA compound annual growth rate of approximately 2.1% to justify its current share price.
2. DISCA's EV/OIBDA trading multiple is approximately 11x 2011E, one of the highest that we cover.
3. Our Free Cash Flow analysis shows that DISCA is currently valued at about 19.4x 2011E Free Cash flow and has a 6% free cash flow yield, making it one of the most expensive companies we cover.

## Management

**David M. Zaslav, Chief Executive Officer**

Mr Zaslav became the CEO of DISCA in January of 2007. Mr. Zaslav previously worked at NBC Universal as President of Cable, US TV, and New Media Distribution.

**Brad Singer, CFO**
Mr. Singer joined Discovery in July 2008 from American Tower Corporation. Prior to that he worked as an investment banker with Goldman Sachs & Co., focusing on the telecommunications, media and entertainment industries.

**Peter Liguori, Chief Operating Officer**
Mr. Liguori joined Discovery in 2009. Mr. Liguori was previously President of entertainment for Fox Broadcasting Company.

## COMPANY DESCRIPTION

DISCA is a pure-play cable networks company. We believe that DISCA is the world's largest nonfiction media company reaching more than 1.5 billion cumulative subscribers in over 180 countries. Discovery reaches its audience through 100-plus worldwide networks, led by Discovery Channel, TLC, Animal Planet, Science Channel, Investigation Discovery, Planet Green and HD Theater, as well as leading consumer and educational products and services.

Table 2

**Discovery Communications, Inc: Quarterly Income Statement Projections, 2010E**

$ and shares in millions, except per share data

| | 3/31/10A | 6/30/10A | 9/30/10A | 12/31/10E | 2010E | Year/Year Change Q1 | Q2 | Q3 | Q4 | 2010E |
|---|---|---|---|---|---|---|---|---|---|---|
| **Revenue** | | | | | | | | | | |
| US Networks | | | | | | | | | | |
| Distribution | $259 | $263 | $264 | $272 | $1,058 | 4% | 6% | 9% | 11% | 8% |
| Advertising | $266 | $329 | $304 | $334 | $1,233 | 9% | 13% | 16% | 17% | 14% |
| Other | $21 | $28 | $17 | $26 | $92 | -9% | 56% | 13% | 16% | 17% |
| Total US Networks | $546 | $620 | $585 | $632 | $2,383 | 6% | 12% | 13% | 14% | 11% |
| International Networks | | | | | | | | | | |
| Distribution | $186 | $186 | $188 | $193 | $753 | 4% | 4% | 3% | 1% | 3% |
| Advertising | $82 | $106 | $98 | $143 | $429 | 41% | 39% | 21% | 10% | 24% |
| Other | $25 | $14 | $18 | $26 | $83 | -14% | -36% | -28% | -30% | -27% |
| Total International Networks | $293 | $306 | $304 | $362 | $1,265 | 11% | 10% | 5% | 1% | 6% |
| Education and Other | $37 | $33 | $38 | $43 | $151 | -14% | -21% | -10% | -13% | -14% |
| Corporate and Eliminations | $3 | $4 | ($1) | $4 | $10 | -25% | 300% | -200% | 33% | 11% |
| **Total Revenue** | **$879** | **$963** | **$926** | **$1,040** | **$3,808** | 6% | 10% | 9% | 8% | 8% |
| **OIBDA** | | | | | | | | | | |
| US Networks | $293 | $379 | $346 | $351 | $1,369 | 4% | 11% | 12% | 21% | 12% |
| International Networks | $124 | $132 | $130 | $165 | $551 | 29% | 45% | 23% | 8% | 24% |
| Education and Other | $5 | $1 | $1 | $4 | $11 | -17% | 0% | -50% | -61% | -42% |
| Corporate and Eliminations | ($55) | ($57) | ($59) | ($60) | ($231.0) | 15% | 24% | 18% | 0% | 13% |
| **Total OIBDA** | **$367** | **$455** | **$418** | **$459** | **$1,699** | 10% | 18% | 14% | 18% | 15% |
| **D & A** | | | | | | | | | | |
| US Networks | $8.0 | $7.0 | $7.0 | $5.0 | $27 | -43% | -46% | -42% | -58% | -47% |
| International Networks | $18.0 | $19.0 | $19.0 | $10.0 | $66 | 0% | 6% | 0% | -50% | -12% |
| Education and Other | $1.0 | $2.0 | $2.0 | $2.0 | $7 | 0% | 100% | 0% | 0% | 17% |
| Corporate and Eliminations | $18.0 | $15.0 | $15.0 | $16.0 | $64 | -5% | -25% | -25% | -16% | -18% |
| **Total D & A** | **$45.0** | **$43.0** | **$43.0** | **$33.0** | **$164** | -13% | -17% | -19% | -38% | -22% |
| **Operating Income** | | | | | | | | | | |
| US Networks | $285 | $372 | $339 | $346 | $1,342 | 7% | 14% | 14% | 25% | 15% |
| International Networks | $106 | $113 | $111 | $155 | $485 | 36% | 55% | 28% | 17% | 31% |
| Education and Other | $4 | ($1) | ($1) | $2 | $4 | -20% | | | -79% | -71% |
| Corporate and Eliminations | ($73) | ($72) | ($74) | ($76) | ($295) | 9% | 9% | 6% | -4% | 5% |
| **Segment Op Inc (bef charges)** | **$322** | **$412** | **$375** | **$426** | **$1,535** | 14% | 23% | 19% | 26% | 21% |
| Restructuring and Impairment Charges | ($39) | ($40) | ($63) | ($36) | ($178) | | | | | |
| Gains on Dispostitions | $0 | $0 | $0 | $0 | $0 | | | | | |
| **Operating Income** | **$283** | **$372** | **$312** | **$390** | $1,357 | 14% | -25% | 41% | 38% | 9% |
| Interest Expense | ($58) | ($48) | ($49) | ($49) | ($204) | 2% | -20% | -25% | -28% | -18% |
| Loss on Extinguishment of Debt | $0 | ($136) | $0 | $0 | ($136) | | | | | |
| Other, net | ($5) | ($37) | ($16) | ($15) | ($73) | -350% | -563% | 1500% | -141% | -259% |
| Income from Continuing Ops Before Taxes | $220 | $151 | $247 | $326 | $944 | 14% | -66% | 59% | 29% | -10% |
| Provision for Taxes | ($47) | ($41) | ($83) | ($111) | ($282) | -33% | -84% | 60% | 29% | -40% |
| **Income from Continuing Ops, net of tax** | **$173** | **$110** | **$164** | **$215** | **$662** | 41% | -39% | 59% | 30% | 16% |
| Income from Discontinued Ops, net of tax | $0 | $0 | $25 | $0 | $25 | | | | | |
| Net Income (Loss) | $173 | $110 | $189 | $215 | $687 | 41% | -39% | 82% | 30% | 20% |
| Less: Inc Attributable to Non-Controlling Interests | ($4) | ($3) | ($3) | ($3) | ($13) | 0% | | | | |
| Net Income-Attributable to DISCA | $169 | $107 | $186 | $212 | $674.0 | | | | | |
| Stock Dividend to Preferred Interests | $0 | ($1) | $0 | $0 | ($1.0) | | | | | |
| Net Income Available to DISCA Shareholders | $169 | $106 | $186 | $212 | $673.0 | 42% | -40% | 98% | 20% | 19% |
| **EPS Operating, Less Extraordinary** | **$0.39** | **$0.25** | **$0.37** | **$0.50** | **$1.51** | 40% | -41% | 72% | 20% | 13% |
| EPS from Discontinued Operations | $0.00 | $0.00 | $0.06 | $0.00 | $0.06 | | | | | |
| **EPS-GAAP** | $0.39 | $0.25 | $0.43 | $0.50 | $1.57 | 40% | -41% | 96% | 21% | 18% |
| Avg. Diluted Shares Out. | 429 | 431 | 431 | 428 | 430 | 2% | 2% | 1% | 0% | 1% |

Sources: Company Reports, Needham & Company estimates.

Table 3

**Discovery Communications, Inc. : Annual Income Statement Data, 2008A-2011E**

$ and shares in thousands, except per share data

| FYE 12/31: | 2008A | 2009A | 2010E | 2011E | '08-'11 CAGR |
|---|---|---|---|---|---|
| **Revenue** | | | | | |
| US Networks | | | | | |
| Distribution | $927 | $982 | $1,058 | $1,124 | 6.6% |
| Advertising | $1,058 | $1,082 | $1,233 | $1,315 | 7.5% |
| Other | $77 | $78 | $92 | $101 | 9.5% |
| Total US Networks | $2,062 | $2,142 | $2,383 | $2,540 | 7.2% |
| International Networks | | | | | |
| Distribution | $713 | $731 | $753 | $810 | 4.3% |
| Advertising | $336 | $345 | $429 | $502 | 14.3% |
| Other | $109 | $113 | $83 | $69 | -14.0% |
| Total International Networks | $1,158 | $1,189 | $1,265 | $1,381 | 6.0% |
| Education and Other | $196 | $176 | $151 | $152 | -8.1% |
| Corporate and Eliminations | $27 | $9 | $10 | $12 | -23.7% |
| **Total Revenue** | **$3,443** | **$3,516** | **$3,808** | **$4,085** | **5.9%** |
| | | | | | |
| **OIBDA** | | | | | |
| US Networks | $1,111 | $1,219 | $1,369 | $1,439 | 9.0% |
| International Networks | $387 | $445 | $551 | $601 | 15.8% |
| Education and Other | $13 | $18 | $11 | $15 | 4.4% |
| Corporate and Eliminations | ($201) | ($204) | ($231) | ($248) | 7.3% |
| **Total OIBDA** | **$1,310** | **$1,478** | **$1,699** | **$1,807** | **11.3%** |
| **D & A** | | | | | |
| US Networks | $90 | $51 | $27 | $22 | -37.5% |
| International Networks | $84 | $75 | $66 | $38 | -23.2% |
| Education and Other | $9 | $6 | $7 | $6 | -12.6% |
| Corporate and Eliminations | $78 | $78 | $64 | $64 | -6.4% |
| **Total D & A** | **$261** | **$210** | **$164** | **$130** | -20.7% |
| | | | | | |
| **Operating Income** | | | | | |
| US Networks | $1,021 | $1,168 | $1,342 | $1,417 | 11.6% |
| International Networks | $303 | $370 | $485 | $563 | 22.9% |
| Education and Other | $4 | $12 | $4 | $9 | 30.1% |
| Corporate and Eliminations | ($279) | ($282) | ($295) | ($310) | 3.6% |
| **Segment Op Inc (bef charges)** | **$1,049** | **$1,268** | **$1,535** | **$1,679** | **17.0%** |
| Restructuring and Impairment Charges | $8 | ($19) | ($178) | ($120) | |
| Gains on Dispostitions | $0 | $0 | $0 | $0 | |
| **Operating Income** | $1,057 | $1,249 | $1,357 | $1,559 | 13.8% |
| Interest Expense | ($256) | ($250) | ($204) | ($196) | -8.5% |
| Loss on Extinguishment of Debt | $0 | $0 | ($136) | $0 | |
| Other, net | ($47) | $46 | ($73) | $0 | |
| Income from Continuing Ops Before Taxes | $754 | $1,045 | $944 | $1,363 | 21.8% |
| Provision for Taxes | ($352) | ($472) | ($282) | ($477) | 10.7% |
| **Income from Continuing Ops, net of tax** | **$402** | **$573** | **$662** | **$886** | |
| Income from Discontinued Ops, net of tax | $43 | $0 | $25 | $0 | -100.0% |
| Net Income (Loss) | $445 | $573 | $687 | $886 | 25.8% |
| Less: Inc Attributable to Non-Controlling Interests | ($128) | $1 | ($13) | ($12) | -54.6% |
| Net Income-Attributable to DISCA | $317 | $574 | $674 | $874 | 40.2% |
| Stock Dividend to Preferred Interests | $0 | ($8) | ($1) | $0 | |
| Net Income Available to DISCA Shareholders | $317 | $566 | $673 | $874 | 40.2% |
| **EPS Operating, Less Extraordinary** | **$0.85** | **$1.33** | **$1.51** | **$2.10** | **35.1%** |
| EPS from Discontinued Operations | $0.13 | $0.00 | $0.06 | $0.00 | |
| **EPS-GAAP** | $0.98 | $1.33 | $1.57 | $2.10 | 28.7% |
| Avg. Diluted Shares Out. | 322 | 426 | 430 | 417 | 9.0% |

Sources: Company Reports, Needham & Company estimates.

Table 4

**Discovery Communications: Target Price Calculation, 2012E-2021E**

$ and shares in millions, except per share data

| **Valuation Conclusions** | | **% of Total** |
|---|---|---|
| Sum of PV of Free Cash Flow [1] | $9,869 | 46% |
| PV of Terminal Value Discounted at WACC [1] | $10,112 | 47% |
| **Value of Operations (WACC Method)** | **$19,980** | **93%** |
| Plus: Excess Cash at 12/31/11E | $1,100 | |
| Plus: Non-Consolidated Assets (From PMV) | $525 | |
| Less: Minority Interest | ($12) | |
| **Enterprise Value** | **$21,593** | **100%** |
| Less: Debt at 12/31/11E | ($3,600) | |
| Less: Lease Obligations | ($150) | |
| Less: Preferred Stock Outstanding | $0 | |
| Less: Value of Options & Restricted Sk, After-tax | ($150) | |
| **Common Equity Value** | **$17,693** | **82%** |
| Fully Diluted Shares Out, 2011E | 417 | |
| **DCF Value/Share** | **$42.43** | |
| Current Share Price @ 12/20/10 | $42.42 | |
| **Upside Potential (DCF-Current Price/Current Price)** | **0%** | |

**Standard Discounted Cash Flow (DCF) Valuation**

**Why We Calculate:** DCF is a rigorous bottoms-up valuation of the enterprise focusing on cash flows (not accounting)

**Strengths**

1 Focuses on operations. Removes financing
2 Focuses on FCF. Removes non-cash accounting
3 Explicitly forecasts capital needs (WC & CapX)
3 Uses a levered beta (widely available)
4 Ent value focus captures entire business model

**Weaknesses**

1 Many assumptions. Valuation can be manipulated
2 Terminal value big & based on low visiblity projections
3 Model assumes constant debt/equity ratio
4 Complex to calculate
5 Calculates the enterprise value first, then equity value

**[1] Calculation of the Value of Operations (WACC Method)**

| FYE 9/30: | 2011E | 2012E | 2013E | 2014E | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E | 2021E | **CAGR '12-21E** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **OIBDA (after sk comp exp & corp):** | **$1,807** | **$1,845** | **$1,884** | **$1,923** | **$1,963** | **$2,005** | **$2,047** | **$2,090** | **$2,134** | **$2,178** | **$2,224** | **2.1%** |
| - Depreciation | ($130) | ($63) | ($65) | ($66) | ($68) | ($69) | ($71) | ($72) | ($74) | ($75) | ($77) | |
| + Option Exercise Proceec | $10 | $10 | $10 | $10 | $10 | $10 | $10 | $10 | $10 | $10 | $10 | |
| + Int & Inv Income only | $5 | $5 | $5 | $5 | $5 | $5 | $5 | $5 | $5 | $5 | $5 | |
| EBIT | $1,692 | $1,797 | $1,834 | $1,872 | $1,911 | $1,951 | $1,991 | $2,033 | $2,075 | $2,118 | $2,162 | |
| Cash Taxes (at 25%) | ($491) | ($521) | ($532) | ($543) | ($554) | ($566) | ($577) | ($589) | ($602) | ($614) | ($627) | |
| Plus: Depreciation | $130 | $63 | $65 | $66 | $68 | $69 | $71 | $72 | $74 | $75 | $77 | |
| Plus: Sk Based Comp Exp | $200 | $200 | $200 | $200 | $200 | $200 | $200 | $200 | $200 | $200 | $200 | |
| Working Capital Change | ($65) | ($45) | ($50) | ($50) | ($50) | ($50) | ($50) | ($50) | ($50) | ($50) | ($50) | |
| Less: Capital Spending | ($55) | ($55) | ($57) | ($58) | ($59) | ($60) | ($61) | ($63) | ($64) | ($65) | ($67) | |
| **FCF from Operations** | **$1,411** | **$1,439** | **$1,460** | **$1,488** | **$1,515** | **$1,544** | **$1,573** | **$1,603** | **$1,633** | **$1,664** | **$1,695** | **1.8%** |
| PV Discounted at WACC [2] | | $1,319 | $1,228 | $1,147 | $1,072 | $1,001 | $935 | $874 | $816 | $763 | $713 | |
| Sum of PV of Free Cash Flow | | | | | | | | | | | $9,869 | |
| Terminal Value of 2020E FCF [3] | | | | | | | | | | | $24,048 | |
| PV of Terminal Value at WACC [2] | | | | | | | | | | | $10,112 | |
| Discount Period | | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | |

| **[2] Calculation of WACC:** | |
|---|---|
| 10-Year Risk Free Rate ("RFR") | 2.0% |
| Equity Risk Premium (Ibbotson-Arithmetic) | 6.5% |
| Levered Beta (Bloomberg) | 1.20 |
| Target Equity/(Debt + Equity) | 85% |
| Debt Rating | BBB+ |
| Debt Spread | 6.0% |
| Marginal Tax Rate ("T") | 40.0% |
| **WACC** | **9.1%** |

(RFR+(Equity Risk Premium x Beta)) x Equity/Total Capital + ((RFR + Debt Spread) x (1-T) x Debt/Total Capital).

| **[3] Calculation of Terminal Multiple (WACC Method)** | |
|---|---|
| WACC | 9.1% |
| Long-term Nominal GDP Growth | 2.0% |
| WACC-GDP Growth | 7.1% |
| **FCF Terminal Multiple [1/(WACC-Growth Rate)]** | **14.2** |
| **EBITDA Terminal Mutiple** | **10.8** |

Sources: Company Reports, Needham & Company estimates.

Table 5

**Discovery Communications: Breakeven Discounted Cash Flow Valuation Calculation, 2012E - 2021E**

$ and shares in millions, except per share data

| Valuation Conclusions | | 2011E |
|---|---|---|
| Sum of PV of Free Cash Flow [1] | | $9,869 |
| PV of Terminal Value Discounted at WACC [1] | | $10,112 |
| **Value of Operations (WACC Method)** | | **$19,980** |
| Plus: Excess Cash at 12/31/11E | | $1,100 |
| Plus: Non-Consolidated Assets (From PMV) | | $525 |
| Less: Minority Interest | | ($12) |
| **Enterprise Value** | | **$21,593** |
| Less: Debt at 12/31/11E | | ($3,600) |
| Less: Lease Obligations | | ($150) |
| Less: Preferred Stock Outstanding | | $0 |
| Less: Value of Options & Restricted Sk, After-tax | | ($150) |
| **Common Equity Value** | | **$17,693** |
| Fully Diluted Shares Out, 2011E | | 417 |
| **Breakeven DCF Value/Share** | | **$42.43** |
| Current Share Price @ | 12/20/10 | $42.42 |
| Discount to DCF Value (DCF-Current Price/DCF) | | 0% |

**Breakeven Discounted Cash Flow Valuation**

**Why We Calculate:** BE DCF uses the current share price to calculate the market's growth expectations for the enterprise.

**Strengths**

1 Makes no assumption about growth for first 10 years
2 Prevents over-optimism by working backwards
3 Data widely available and model well understood
4 Explicitly forecasts capital needs (WC & CapX)
5 Uses a levered beta (widely available)

**Weaknesses**

1 Terminal value big & based on low visiblity projections
2 Model assumes constant debt/equity ratio
3 Complex to calculate
4 Calculates the enterprise value first, then equity value

[1] **Calculation of the Value of Operations (WACC Method)**

| FYE 9/30: | 2011E | 2012E | 2013E | 2014E | 2015E | 2016E | 2017E | 2018E | 2019E | 2020E | 2021E | Required LT Growth Rate |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **OIBDA** (after sk comp exp & corp): | **$1,807** | **$1,845** | **$1,884** | **$1,923** | **$1,963** | **$2,005** | **$2,047** | **$2,090** | **$2,134** | **$2,178** | **$2,224** | **2.1%** |
| - Depreciation | ($130) | ($63) | ($65) | ($66) | ($68) | ($69) | ($71) | ($72) | ($74) | ($75) | ($77) | |
| + Option Exercise Proceec | $10 | $10 | $10 | $10 | $10 | $10 | $10 | $10 | $10 | $10 | $10 | |
| + Int & Inv Income only | $5 | $5 | $5 | $5 | $5 | $5 | $5 | $5 | $5 | $5 | $5 | |
| EBIT | $1,692 | $1,797 | $1,834 | $1,872 | $1,911 | $1,951 | $1,991 | $2,033 | $2,075 | $2,118 | $2,162 | |
| Cash Taxes (at 25%) | ($491) | ($521) | ($532) | ($543) | ($554) | ($566) | ($577) | ($589) | ($602) | ($614) | ($627) | |
| Plus: Depreciation | $130 | $63 | $65 | $66 | $68 | $69 | $71 | $72 | $74 | $75 | $77 | |
| Plus: Sk Based Comp Exp | $200 | $200 | $200 | $200 | $200 | $200 | $200 | $200 | $200 | $200 | $200 | |
| Working Capital Change | ($65) | ($45) | ($50) | ($50) | ($50) | ($50) | ($50) | ($50) | ($50) | ($50) | ($50) | |
| Less: Capital Spending | ($55) | ($55) | ($57) | ($58) | ($59) | ($60) | ($61) | ($63) | ($64) | ($65) | ($67) | |
| **FCF from Operations** | **$1,411** | **$1,439** | **$1,460** | **$1,488** | **$1,515** | **$1,544** | **$1,573** | **$1,603** | **$1,633** | **$1,664** | **$1,695** | |
| PV Discounted at WACC [2] | | $1,319 | $1,228 | $1,147 | $1,072 | $1,001 | $935 | $874 | $816 | $763 | $713 | |
| Sum of PV of Free Cash Flow | | | | | | | | | | | $9,869 | |
| Terminal Value of 2021E FCF [3] | | | | | | | | | | | $24,048 | |
| PV of Terminal Value at WACC [2] | | | | | | | | | | | $10,112 | |
| Discount Period | | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | |

[2] **Calculation of WACC:**

| | |
|---|---|
| 10-Year Risk Free Rate ("RFR") | 2.0% |
| Equity Risk Premium (Ibbotson-Arithmetic) | 6.5% |
| Levered Beta (Bloomberg) | 1.20 |
| Target Equity/(Debt + Equity) | 85% |
| Debt Rating | BBB+ |
| Debt Spread | 6.0% |
| Marginal Tax Rate ("T") | 40.0% |
| **WACC** | **9.1%** |

(RFR+(Equity Risk Premium x Beta)) x Equity/Total Capital + ((RFR + Debt Spread) x (1-T) x Debt/Total Capital).

[3] **Calculation of Terminal Multiple (WACC Method)**

| | |
|---|---|
| WACC | 9.1% |
| Long-term Nominal GDP Growth | 2.0% |
| WACC-GDP Growth | 7.1% |
| **FCF Terminal Multiple [1/(WACC-Growth Rate)]** | **14.2** |
| **EBITDA Terminal Mutiple** | **10.8** |

Sources: Company Reports, Needham & Company estimates.

Table 6

**DISCA: Valuation Multiples (Sales, OIBDA, P/E)**

$ and shares in millions, except per share data

| **Valuation Conclusions** | | **2011E** |
|---|---|---|
| Market-Based Enterprise Value [1] | | $19,864 |
| 2011E Sales (From Annual Projections) | | $4,085 |
| **EV/Sales** | | **4.9** |
| Market-Based Enterprise Value [1] | | $19,864 |
| 2011E OIBDA (From Annual Projections) | | $1,807 |
| **EV/OIBDA** | | **11.0** |
| Target Price | | NA |
| **Target Price EV/2012 OIBDA** | | **NA** |
| Current Price | 12/20/10 | $42.42 |
| 2011E EPS (From Annual Projections) | | $2.10 |
| **P/E Ratio** | | **20.2** |

| [1] **Calculation of Market-Based Enterprise Value** | | |
|---|---|---|
| Year End 12/31: | | 2011E |
| Current Share Price | 12/20/10 | $42.42 |
| Fully Diluted Shares Out | | 417 |
| **Market Capitalization** | | **$17,689** |
| Less: Excess Cash | | ($1,100) |
| Less: Non-Consolidated Assets | | ($525) |
| Plus: Unfunded Retirement Liabilities | | $50 |
| Plus: Debt at 12/31/11 | | $3,600 |
| Plus: Lease Obligations | | $150 |
| Plus: Preferred Stock Outstanding | | $0 |
| Plus: Value of Options & Restricted Sk | | $150 |
| **Market-Based Enterprise Value** | | **$19,864** |

Sources: Company Reports, Needham & Company estimates.

Table 7

**DISCA: Free Cash Flow Valuation Metrics**

$ and shares in millions, except per share data

| **Valuation Conclusions** | | **2011E** |
|---|---|---|
| FCF/Share [2] | | $2.45 |
| Current Price | 12/20/10 | $42.42 |
| **FCF Yield** | | **6%** |
| FCF [2] | | $1,022 |
| 2011E OIBDA (From Annual Projections) | | $1,807 |
| **FCF Conversion Rate (FCF/OIBDA)** | | **57%** |
| Market-Based Enterprise Value [1] | | $19,864 |
| FCF [2] | | $1,022 |
| **EV/FCF** | | **19.4** |
| Net Debt/OIBDA | | 1.4 |
| Net Debt | | $2,550 |
| **Net Debt/Market Cap** | | **14.4%** |

| [2] **Calculation of Free Cash Flow** | |
|---|---|
| Year End 12/31: | 2011E |
| OIBDA | $1,807 |
| Plus: Option Exercise Proceeds | $10 |
| Less: Cash Interest Expense | ($196) |
| Minority Interest | $12 |
| Less: Preferred Dividends | $0 |
| Less: Operating Cash Taxes | ($491) |
| Less: Change in Working Capital | ($65) |
| Less: Capital Spending | ($55) |
| **Free Cash Flow** | **$1,022** |
| Less: Dividends | $0 |
| Free Cash Flow After Dividends | $1,022 |
| Shares Outstanding | 417 |
| **FCF/Share** | **$2.45** |
| FCF/Share After Dividends | $2.45 |

Sources: Company Reports, Needham & Company estimates.

Table 8

**Summary Comparative Financial & Valuation Information**

$ and shares in millions, except per share data

| Laura Martin's Coverage<br>Sorted by Industry | Ticker | Market Cap ($B) | Rating | 2011E Multiples<br>EV/ EBITDA | P/E | EV/ FCF | FCF Yield | Break-even DCF | 12/20/10<br>Target Price | Current Price | Target/ Current | Conflicts Disclosure |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| ***Content Companies*** | | | | | | | | | | | | |
| 1 AOL, Inc. | AOL | $3 | BUY | 4.4 | 15.6 | 6.3 | 12.6% | -15.5% | $35.00 | $23.96 | 46% | B |
| 2 CBS | CBS | $13 | BUY | 8.2 | 13.8 | 14.0 | 11.6% | 0.2% | $19.00 | $18.92 | 0% | B |
| **3 Discovery Communications** | **DISCA** | **$18** | HOLD | **11.0** | **20.2** | **19.4** | **5.8%** | **2.1%** | NA | **$42.42** | | **B** |
| 4 Disney | DIS | $71 | HOLD | 8.7 | 15.5 | 26.8 | 4.3% | 5.3% | NA | $37.06 | | B |
| 5 NewsCorp | NWS | $42 | BUY | 7.4 | 13.9 | 17.0 | 6.5% | 0.3% | $20.00 | $16.11 | 24% | B, G |
| 6 Time Warner Inc | TWX | $36 | HOLD | 7.5 | 12.4 | 20.0 | 7.0% | 0.4% | NA | $31.65 | | B |
| 7 Viacom | VIAB | $23 | BUY | 7.5 | 12.0 | 17.0 | 7.5% | 0.9% | $43.00 | $38.59 | 11% | B |
| 8 Warner Music | WMG | $0.9 | BUY | 7.1 | (6.7) | 15.6 | 17.9% | -7.5% | $8.50 | $5.63 | 51% | B |
| Industry Total/Average | | $205 | | 7.7 | 12.1 | 17.0 | 9.2% | -1.8% | NA | $26.79 | NA | |
| ***Cable Companies*** | | | | | | | | | | | | |
| 9 Mediacom | MCCC | $0.6 | HOLD | 7.6 | NMF | NMF | NMF | 0.6% | NA | $8.45 | | B, G |
| 10 Time Warner Cable | TWC | $23 | BUY | 6.1 | 15.3 | 41.9 | 4.5% | 1.4% | $65.00 | $65.26 | 0% | B |
| Industry Total/Average | | $23 | | 6.8 | 15.3 | 41.9 | 4.5% | 1.0% | $65.00 | $36.86 | -0.4% | |
| **Total/Average from Above** | | **$229** | | **7.3** | **13.7** | **29.4** | **6.8%** | **-0.4%** | | | **NM** | |

| Sorted by Industry | WACC | Revenue 2011E | OIBDA 2011E | EPS 2011E | EV | Net Debt | Debt/ OIBDA | Debt Rating | FCF | FCF/ Share | Dividend/ Share | Div. Yield |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| $ in millions, except per share data | | | | | | | | | | | | |
| ***Content Companies*** | | | | | | | | | | | | |
| 1 AOL, Inc. | 10.5% | $2,093 | $480 | $1.53 | $2,100 | ($1,000) | (2.1) | BBB | $333 | $3.01 | $0.00 | NA |
| 2 CBS | 9.1% | $14,332 | $2,555 | $1.37 | $20,871 | $7,150 | 2.8 | BBB- | $1,495 | $2.20 | $0.20 | 1.1% |
| **3 Discovery Communications** | **9.1%** | **$4,085** | **$1,807** | **$2.10** | **$19,864** | **$2,550** | **1.4** | **BBB+** | **$1,022** | **$2.45** | $0.00 | NA |
| 4 Disney | 8.7% | $40,511 | $9,314 | $2.39 | $80,907 | $10,250 | 1.1 | A | $3,019 | $1.59 | $0.35 | 0.9% |
| 5 NewsCorp | 8.8% | $34,790 | $6,260 | $1.16 | $46,361 | $3,300 | 0.5 | BBB+ | $2,730 | $1.05 | $0.15 | 0.9% |
| 6 Time Warner Inc | 9.1% | $28,050 | $6,705 | $2.54 | $50,023 | $11,600 | 1.7 | BBB | $2,507 | $2.21 | $0.85 | 2.7% |
| 7 Viacom | 9.0% | $14,241 | $3,890 | $3.22 | $29,365 | $5,400 | 1.4 | BBB | $1,725 | $2.91 | $0.60 | 1.6% |
| 8 Warner Music | 9.1% | $2,782 | $336 | ($0.84) | $2,370 | $1,420 | 4.2 | BB- | $152 | $1.01 | $0.00 | NA |
| ***Cable Companies*** | | | | | | | | | | | | |
| 9 Mediacom | 9.2% | $1,515 | $570 | $0.63 | $4,305 | $3,680 | 6.5 | B+ | $124 | $1.75 | $0.00 | NA |
| 10 Time Warner Cable | 9.1% | $19,491 | $7,051 | $4.27 | $42,760 | $20,500 | 2.9 | BBB | $1,021 | $2.92 | $1.60 | 2.5% |

Sources: Needham & Co, LLC estimates, Company documents, FirstCall, Yahoo Finance.

Analyst: Laura Martin, CFA (917) 373-3066. LMartin@Needhamco.com

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I, Laura Martin, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company (ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

I, Dan Medina, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company (ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Price, Rating, and Price Target History: Discovery Communications, Inc. (DISCA/NASDAQ) as of 12-20-10


Source: Factset (Prices) / Needham (ratings)

**Disclosures applicable to this security: B, G.**

Price, Rating, and Price Target History: Disney (Walt) Co. (DIS/NYSE) as of 12-20-10


Source: Factset (Prices) / Needham (ratings)

**Disclosures applicable to this security: B.**

Price, Rating, and Price Target History: CBS Corp. (CBS/NYSE) as of 12-20-10


Source: Factset (Prices) / Needham (ratings and target price)

**Disclosures applicable to this security: B.**

Price, Rating, and Price Target History: Mediacom Communications Corp. (MCCC/NASDAQ) as of 12-20-10


Source: Factset (Prices) / Needham (ratings and target price)

**Disclosures applicable to this security: B, G.**

Price, Rating, and Price Target History: News Corporation (NWSA/NASDAQ) as of 12-20-10


Source: Factset (Prices) / Needham (ratings and target price)

**Disclosures applicable to this security: B, G.**

Price, Rating, and Price Target History: Time Warner Cable Inc. (TWC/NYSE) as of 12-20-10


Source: Factset (Prices) / Needham (ratings and target price)

**Disclosures applicable to this security: B.**

Price, Rating, and Price Target History: Time Warner Inc. (TWX/NYSE) as of 12-20-10


Source: Factset (Prices) / Needham (ratings)

**Disclosures applicable to this security: B.**

Price, Rating, and Price Target History: Viacom Inc. CL B (VIAB/NYSE) as of 12-20-10


Source: Factset (Prices) / Needham (ratings and target price)

**Disclosures applicable to this security: B.**

Price, Rating, and Price Target History: Warner Music Group Corp. (WMG/NYSE) as of 12-20-10


Source: Factset (Prices) / Needham (ratings and target price)

**Disclosures applicable to this security: B.**

Price, Rating, and Price Target History: AOL Inc. (AOL/NYSE) as of 12-20-10


Source: Factset (Prices) / Needham (ratings and target price)

**Disclosures applicable to this security: B.**

| | % of companies under coverage with this rating | % for which investment banking services have been provided for in the past 12 months |
|---|---|---|
| Strong Buy | 9 | 15 |
| Buy | 62 | 15 |
| Hold | 27 | 3 |
| Under Perform | <1 | 0 |
| Rating Suspended | 1 | 25 |
| Restricted | 0 | 0 |
| Under Review | 0 | 0 |

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