Discovery COMMUNICATIONS™

#1 PAY-TV PROGRAMMER IN THE WORLD

Discovery Communications (DISCA.US, Market Capitalisation US$17.4bln) is the world's #1 Pay-TV programmer reaching 3bln cumulative subscribers in more than 220 countries and territories with popular brands/channels such as Discovery, TLC, Animal Planet and Eurosport. Discovery has experienced 30 years of strong growth with a superior business model; creating and distributing its own content that is evergreen, cost effective to produce, and has global appeal and local relevance.

Discovery is ranked as the top channel people would like in their U.S. T.V package (61.3%)[1]

BUSINESS OVERVIEW

In 2015, Discovery generated revenues of US$6.4bln and net income of US$1bln. The Company operates through 3 distinct business segments - US Networks with 49% of revenue, International Networks with 45% of revenue and Education which makes up the remaining 3%. Significant growth has been driven by the international networks in recent years representing over 50% of total revenues in 2014, (despite falling back to 48% of revenues in 2015 due to f/x headwinds). We continue to see attractive growth opportunities in international markets which remain under-penetrated and under-priced.

OPERATIONAL PERFORMANCE – BALANCE SHEET

Discovery has an impressive, free cash flow generative business model that generated over US$1bln of free cash flow in each of the past five years. The Company has experienced strong growth in Total Assets in recent years (except 2015), mainly due to increase in intangible assets/goodwill. Discovery's balance sheet has been leveraged up in recent years (approximately US$10bln) with a Net Debt/EV of 39%, however if we look at earnings/cash flow-based ratios such as Net Debt / EBITDA, Discovery is actually less levered than a number of its peers at 180%.

AGGRESSIVE CAPITAL RETURN VIA SHARE BUYBACKS

Discovery does not currently pay a dividend and Management has expressed no intention to do so in the near term. Instead focus has been toward share buybacks as the sole means to return capital and create value for shareholders. The Company has authorised US$7.5bln in share buybacks since 2010 when the repurchase program was initially implemented and has purchased 30%+ of the outstanding float, including preferred stock. There remains US$1.8bln (as at 1Q2016) authorised for future repurchases (which will expire on 8 October, 2017). The Company is capable of repurchasing more than US$1bln of shares annually based on its strong free cash flow generation.

CONTROLLING SHAREHOLDER - DR. JOHN MALONE

John Malone is one of the best business owners/operators/investors of our time with some suggesting he may be better than Warren Buffet himself. Malone owns most of Discovery's Supervoting B Shares holding 3.3% economic ownership and 21% of the Company's voting rights. He is well known for his effective financial engineering and operational optimisation with a focus toward wealth creation, levered cash flow growth, tax efficiencies and exploitation of both horizontal and vertical synergies.

> **David Faber:** *Yeah, but you aren't going to exit Discovery to allow Charter to buy Time Warner Cable.*
> **John Malone:** *No, but I could exit Charter. I mean, why I would exit Discovery when that is a double bank shot, if you want to call it that* - As interviewed on CNBC – 12 November 2015

[1] *Source: Digitalsmiths Q4 2015 Video Trends Report*

"BEST IN CLASS" MANAGEMENT

In 2014, the Company extended its employment contract with President and CEO David Zaslav to 31 December, 2019. Under his tenure, Discovery has experienced extraordinary growth which we highlight in the adjacent table. Zaslav is highly incentivised to create long-term value for shareholders with his contract renewal providing for 98% of his total direct compensation package to be linked to performance, aligning his personal interests to those of the shareholders. Zaslav is but one example within a management team which we believe will continues to drive excellence through every part of the business.

	2008	2015	Δ
Cumulative Subscribers	1.5bln	3.0bln	+100%
Countries	170	223	+31%
# Networks	100	200	+100%
Revenue	US$3.44bln	US$6.39bln	+86%
Adjusted OIBDA*	US$1.31bln	US$2.40bln	+83%
International Revenue	34%	48%	+14%

**Adjusted OIBDA is defined as operating income excluding: (i) mark-to-market equity-based compensation, (ii) depreciation and amortization, (iii) amortization of deferred launch incentives, (iv)restructuring and other charges, (v) certain impairment charges, (vi) gains and losses on business and asset dispositions, and (vii) certain inter-segment eliminations related to production studios.*

OPPORTUNITY TO INCREASE U.S. FEES

Discovery's audience share in the US is at 12% yet its share of revenue is just 3%. Management has stated that they believe there is margin expansion potential for the US market over time. The recent increases in distribution/carriage fees instituted with Comcast (July 2015) is evidence of the pricing power that Discovery's suite of channels can command despite widespread uncertainty and bearishness in the sector. Fee increases are expected to drive high single digit growth in US revenues in the medium term.

ANCILLARY RIGHTS MONETISATION - TV EVERYWHERE & OVER-THE-TOP (OTT) PLATFORMS

Discovery (in our opinion) has been slow to monetise ancillary content rights. It began this process with Time Warner Cable in 2013 and Comcast in 2015. These agreements provide TV Everywhere access to Discovery content (that is, anywhere/anytime access to current Discovery subscribers). On 1 December 2015, Discovery launched its own streaming app "Discovery Go" to provide a new way to deliver digital content to pay-TV cable subscribers. In additional to TV everywhere rights with existing distributors, we expect Discovery to more freely monetise its content via OTT platforms to provide a third revenue stream to its current dual revenue (distribution fees and advertising) model.

We believe the popularity of OTT services such as Netflix, Hulu and Amazon Video will create opportunities for content providers like Discovery to be on such platforms. In addition, the Company could garner revenues from providing content directly to consumers through the internet (e.g., Eurosport Player) or via a platform such as Apple TV and Amazon Video. This would create an additional monetisation mechanism for the Company's deep library of content.

** Over-The-Top (OTT) is the delivery of media content via internet, without requiring users to have a cable subscription.*

GROWTH IN SPORTS REVENUE IN EUROPE

In 2015, Discovery took full control of Eurosport, acquiring the remaining 49% stake from its previous controlling stake acquired in 2014. Eurosport is expected to provide long-term growth opportunities from existing and future paying subscribers. Discovery intends to invest in additional sports programming to make it the No. 1 sports channel in the European continent. This will help the Company to maximise its reach to Europe's 700 million residents across all platforms.

Sports represents a unique category. As time-shifting viewership continues to rise for traditional programming and consumers shift toward on-demand content the value of paid advertising decreases. However, 99% of sports events are viewed live, in comparison to just 53% of regular TV content, driving value for advertisers and increasing potential advertiser revenues. We believe sports taps into a global and extremely loyal fan base which allows compound growth through high audience retention.

CONTINUED EXPANSION OVERSEAS

Discovery has terrific opportunities to grow organically through increased penetration and reach. This is possible due to the ubiquitous nature of the content that Discovery produces which has the ability to transcend boundaries/nationalities. The strong growth in audience share achieved in countries like Brazil and India is evidence of that and we see tremendous growth in emerging markets given their significant population bases. As noted, international markets still look like the U.S. in the 1990's – underpenetrated and under-priced.

INDISCRIMINATE SELLING IN MEDIA STOCKS PRESENTS INVESTMENT OPPORTUNITY

For the last two years, fears among U.S. media investors concerning growing number of “cord-cutters”, “cord-shavers” and OTT services have pressured the listed U.S. media sector, and compressed U.S. media sector multiples significantly. This saw Discovery’s share price decline 35.78% from US$44.83 (20 August, 2014) to US$28.79 (05 August, 2015), at which point we began acquiring a position. We see value in Discovery’s premium content which is geographic/platform agnostic and should continue to thrive with the next generation of media distribution/consumption models. As at 25 April 2016, the Elevation Capital Value Fund had acquired a position in Discovery an average cost of US$28.26 per share.

INVESTMENT THESIS - SUMMARY

Discovery is very well positioned – the Company has world class brands, and international appeal with approximately half of its revenues generated outside U.S., particularly in markets where pay-TV subscribers are still growing in aggregate numbers. In the long run, we believe that Discovery should command a premium to its slower growing peers due to its economic moat, which is provided through the Company’s economies of scale, highly valuable brands, robust business model and high quality management. Excluding currency fluctuations Discovery is expected to achieve high single digit growth in revenues, EBITDA and earnings per share in the medium term as both its US and international networks are forecast to grow strongly. We currently value Discovery at US$34.62-US$49.33 per share representing potential upside +22.51% to +74.56% on our cost basis detailed above.

For an in-depth appraisal of our investment in Discovery please refer to our full presentation which can be viewed at:
http://www.elevationcapital.co.nz/discovery-communications/

This summary report was written in June, 2016.