Discovery Communications, Inc.
Form 10-Q
November 01, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-34177

Discovery Communications, Inc.
(Exact name of Registrant as specified in its charter)

Delaware	35-2333914
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
One Discovery Place Silver Spring, Maryland	20910
(Address of principal executive offices)	(Zip Code)

(240) 662-2000
(Registrant’s telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changed since last report.)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o
Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes ý No ¨

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ý	Accelerated filer ¨
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý

Total number of shares outstanding of each class of the Registrant’s common stock as of October 26, 2016:

Series A Common Stock, par value $0.01 per share	151,943,509
Series B Common Stock, par value $0.01 per share	6,512,379
Series C Common Stock, par value $0.01 per share	234,668,886

DISCOVERY COMMUNICATIONS, INC.
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PART I. FINANCIAL INFORMATION
ITEM 1. Unaudited Financial Statements.
DISCOVERY COMMUNICATIONS, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited; in millions, except par value)

	September 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 224	$ 390
Receivables, net	1,545	1,479
Content rights, net	350	313
Deferred income taxes	110	68
Prepaid expenses and other current assets	454	346
Total current assets	2,683	2,596
Noncurrent content rights, net	2,117	2,030
Property and equipment, net	464	488
Goodwill	8,179	8,164
Intangible assets, net	1,621	1,730
Equity method investments	515	567
Other noncurrent assets	271	289
Total assets	$ 15,850	$ 15,864
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 202	$ 282
Accrued liabilities	1,045	988
Deferred revenues	180	190
Current portion of debt	95	119
Total current liabilities	1,522	1,579
Noncurrent portion of debt	7,901	7,616
Deferred income taxes	536	556
Other noncurrent liabilities	440	421
Total liabilities	10,399	10,172
Commitments and contingencies (Note 15)		
Redeemable noncontrolling interests	247	241
Equity:		
Discovery Communications, Inc. stockholders’ equity:		
Series A convertible preferred stock: $0.01 par value; 75 shares authorized; 71 shares issued	1	1
Series C convertible preferred stock: $0.01 par value; 75 shares authorized; 31 and 38 shares issued	1	1
Series A common stock: $0.01 par value; 1,700 shares authorized; 155 and 153 shares issued	1	1
Series B convertible common stock: $0.01 par value; 100 shares authorized; 7 shares issued	—	—
Series C common stock: $0.01 par value; 2,000 shares authorized; 379 and 376 shares issued	4	4
Additional paid-in capital	7,016	7,021
Treasury stock, at cost	(6,214)	(5,461)
Retained earnings	5,038	4,517

Accumulated other comprehensive loss	(643)	(633)
Total equity	5,204	5,451
Total liabilities and equity	$ 15,850	$ 15,864

The accompanying notes are an integral part of these consolidated financial statements.

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DISCOVERY COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited; in millions, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues:				
Distribution	$806	$776	$2,420	$2,309
Advertising	670	699	2,170	2,200
Other	80	82	235	239
Total revenues	1,556	1,557	4,825	4,748
Costs and expenses:				
Costs of revenues, excluding depreciation and amortization	592	574	1,787	1,703
Selling, general and administrative	419	394	1,227	1,224
Depreciation and amortization	80	80	239	243
Restructuring and other charges	7	4	52	37
Gain on disposition	—	—	(13)	(3)
Total costs and expenses	1,098	1,052	3,292	3,204
Operating income	458	505	1,533	1,544
Interest expense	(91)	(82)	(267)	(248)
Income (loss) from equity investees, net	3	(10)	(28)	(2)
Other expense, net	(49)	—	(27)	(78)
Income before income taxes	321	413	1,211	1,216
Income tax expense	(96)	(130)	(302)	(394)
Net income	225	283	909	822
Net income attributable to noncontrolling interests	—	—	(1)	—
Net income attributable to redeemable noncontrolling interests	(6)	(4)	(18)	(7)
Net income available to Discovery Communications, Inc.	$219	$279	$890	$815
Net income per share available to Discovery Communications, Inc. Series A, B and C common stockholders:				
Basic	$0.37	$0.43	$1.45	$1.25
Diluted	$0.36	$0.43	$1.44	$1.24
Weighted average shares outstanding:				
Basic	395	432	404	434
Diluted	602	653	615	658

The accompanying notes are an integral part of these consolidated financial statements.

DISCOVERY COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited; in millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	$225	$283	$909	$822
Other comprehensive (loss) income, net of tax:				
Currency translation adjustments	(16)	(46)	(23)	(162)
Market value adjustments	50	—	25	—
Derivative adjustments	3	1	(9)	(1)
Comprehensive income	262	238	902	659
Comprehensive income attributable to noncontrolling interests	—	—	(1)	—
Comprehensive (income) loss attributable to redeemable noncontrolling interests	(6)	(7)	(21)	16
Comprehensive income attributable to Discovery Communications, Inc.	$256	$231	$880	$675

The accompanying notes are an integral part of these consolidated financial statements.

DISCOVERY COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited; in millions)

	Nine Months Ended September 30,	
	2016	2015
Operating Activities		
Net income	$909	$822
Adjustments to reconcile net income to cash provided by operating activities:		
Equity-based compensation expense	49	16
Depreciation and amortization	239	243
Content amortization and impairment expense	1,293	1,243
Gain on disposition	(13)	(3)
Remeasurement gain on previously held equity interest	—	(2)
Equity in losses (earnings) of investee companies, net of cash distributions	33	9
Deferred income taxes	(55)	4
Realized loss from derivative instruments	3	11
Other-than-temporary impairment of AFS investments	62	—
Other, net	45	29
Changes in operating assets and liabilities, net of business combinations:		
Receivables, net	(48)	(133)
Content rights, net	(1,464)	(1,386)
Accounts payable and accrued liabilities	(44)	(14)
Equity-based compensation liabilities	(5)	(25)
Income taxes receivable and prepaid income taxes	(50)	(136)
Other, net	(127)	(26)
Cash provided by operating activities	827	652
Investing Activities		
Investments in equity method investees, net	(67)	(26)
Purchases of property and equipment	(69)	(76)
Distributions from equity method investees	69	67
Proceeds from disposition, net of cash disposed	19	61
Investments in cost method investments	(4)	(16)
Payments for derivative instruments, net	—	(11)
Business acquisitions, net of cash acquired	—	(24)
Other investing activities, net	(2)	(1)
Cash used in investing activities	(54)	(26)
Financing Activities		
Commercial paper repayments, net	(23)	(140)
Borrowings under revolving credit facility	445	222
Principal repayments of revolving credit facility	(672)	(179)
Borrowings from debt, net of discount	498	936
Principal repayments of debt	—	(849)
Principal repayments of capital lease obligations	(23)	(22)
Repurchases of stock	(1,124)	(576)
Prepayments for common stock repurchase contracts	(71)	—
Distributions to redeemable noncontrolling interests	(17)	(38)

Equity-based plan proceeds (payments), net	32	(9)
Hedge of borrowings from debt instruments	—	(29)
Other financing activities, net	(13)	(15)
Cash used in financing activities	(968)	(699)
Effect of exchange rate changes on cash and cash equivalents	29	(32)
Net change in cash and cash equivalents	(166)	(105)
Cash and cash equivalents, beginning of period	390	367
Cash and cash equivalents, end of period	$224	$262

The accompanying notes are an integral part of these consolidated financial statements.

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DISCOVERY COMMUNICATIONS, INC.
CONSOLIDATED STATEMENT OF EQUITY
(unaudited; in millions)

	Preferred Stock		Common Stock		Additional Paid-In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Discovery Communications, Inc. Stockholders' Equity	Noncontrolling Interests	Total Equity
	Shares	Par Value	Shares	Par Value							
December 31, 2015	109	$ 2	536	$ 5	$ 7,021	$ (5,461)	$ 4,517	$ (633)	$ 5,451	$ —	$ 5,451
Net income available to Discovery Communications, Inc.	—	—	—	—	—	—	890	—	890	1	891
Other comprehensive loss	—	—	—	—	—	—	—	(10)	(10)	—	(10)
Repurchases of stock	(7)	—	—	—	—	(753)	(371)	—	(1,124)	—	(1,124)
Prepayments for common stock repurchase contracts	—	—	—	—	(71)	—	—	—	(71)	—	(71)
Equity-based compensation	—	—	—	—	25	—	—	—	25	—	25
Excess tax benefits from equity-based compensation	—	—	—	—	7	—	—	—	7	—	7
Tax settlements associated with equity-based compensation	—	—	—	—	(11)	—	—	—	(11)	—	(11)
Issuance of common stock in connection with equity-based plans	—	—	4	—	45	—	—	—	45	—	45
Redeemable noncontrolling interest adjustments to redemption value	—	—	—	—	—	—	2	—	2	—	2
Cash distributions to noncontrolling interests	—	—	—	—	—	—	—	—	—	(1)	(1)
Share conversion	—	—	1	—	—	—	—	—	—	—	—
September 30, 2016	102	$ 2	541	$ 5	$ 7,016	$ (6,214)	$ 5,038	$ (643)	$ 5,204	$ —	$ 5,204

The accompanying notes are an integral part of these consolidated financial statements.

DISCOVERY COMMUNICATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Description of Business

Discovery Communications, Inc. (“Discovery” or the “Company”) is a global media company that provides content across multiple distribution platforms, including pay-TV, free-to-air ("FTA") and broadcast television networks, websites, digital distribution arrangements and content licensing agreements. The Company also develops and sells curriculum-based education products and services and operates production studios. The Company classifies its operations in two reportable segments: U.S. Networks, consisting principally of domestic television networks and websites, and International Networks, consisting principally of international television networks and websites; and two combined operating segments referred to as Education and Other, consisting principally of curriculum-based product and service offerings and production studios. Financial information for Discovery’s reportable segments is discussed in Note 16.

Basis of Presentation

The consolidated financial statements include the accounts of Discovery and its majority-owned subsidiaries in which a controlling interest is maintained. For each non-wholly owned subsidiary, the Company evaluates its ownership and other interests to determine whether it should consolidate the entity or account for its ownership interest as an investment. As part of its evaluation, the Company makes judgments in determining whether the entity is a variable interest entity ("VIE") and, if so, whether it is the primary beneficiary of the VIE and is thus required to consolidate the entity. (See Note 3.) Inter-company accounts and transactions between consolidated entities have been eliminated in consolidation.

Unaudited Interim Financial Statements

These consolidated financial statements are unaudited; however, in the opinion of management, they reflect all adjustments consisting only of normal recurring adjustments necessary to state fairly the financial position, results of operations and cash flows for the periods presented in conformity with U.S. generally accepted accounting principles (“GAAP”) applicable to interim periods. The results of operations for the interim periods presented are not necessarily indicative of results for the full year or future periods. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in Discovery’s Annual Report on Form 10-K for the year-ended December 31, 2015 (the “2015 Form 10-K”).

Use of Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates, judgments and assumptions that affect the amounts and disclosures reported in the consolidated financial statements and accompanying notes. Management continually re-evaluates its estimates, judgments and assumptions, and management’s evaluation could change. These estimates are sometimes complex, sensitive to changes in assumptions and require fair value determinations using Level 3 fair value measurements. Actual results may differ materially from those estimates.

Estimates inherent in the preparation of the consolidated financial statements include accounting for asset impairments, revenue recognition, allowances for doubtful accounts, content rights, depreciation and amortization, business combinations, equity-based compensation, income taxes, other financial instruments, contingencies and the determination of whether the Company is the primary beneficiary of entities in which it holds variable interests.

Accounting and Reporting Pronouncements Adopted

Business Consolidation

In February 2015, the Financial Accounting Standards Board ("FASB") issued guidance that amends the analysis that a reporting entity performs to determine whether it should consolidate certain legal entities. The changes in this guidance include how related parties and de facto agents are considered in the primary beneficiary determination and the analysis for determining whether a fee paid to a decision maker or service provider is a variable interest. In

accordance with the adoption requirement, the Company adopted this guidance effective January 1, 2016, and there was no effect on the consolidated financial statements.

Business Combinations

In September 2015, the FASB issued new guidance on adjustments to provisional amounts recognized in a business combination, which are currently recognized on a retrospective basis. Under the new requirements, adjustments will be recognized

in the reporting period in which the adjustments are determined. The effects of changes in depreciation, amortization, or other income arising from changes to the provisional amounts, if any, are included in earnings of the reporting period in which the adjustments to the provisional amounts are determined. An entity is also required to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The Company adopted this guidance effective January 1, 2016, and there was no effect on the consolidated financial statements.

Accounting for Fees Paid in a Cloud Computing Arrangement

In April 2015, the FASB issued explicit guidance on the recognition of fees paid by a customer for cloud computing arrangements as either the acquisition of a software license or a service contract. The Company adopted this guidance effective October 1, 2015, and there was no material effect on the consolidated financial statements.

Presentation of Debt Issuance Costs

In April 2015, the FASB issued guidance requiring all debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the debt instead of being presented as an asset on the balance sheet. The Company retrospectively adopted the new guidance on April 1, 2015 and reclassified its unamortized debt issuance costs related to the Company's debt from other noncurrent assets to noncurrent portion of debt on the consolidated balance sheet as of December 31, 2014.

Accounting and Reporting Pronouncements Not Yet Adopted

Income Taxes

In October 2016, the FASB issued guidance that simplifies the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. The new guidance includes requirements to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs, and therefore eliminates the exception for an intra-entity transfer of an asset other than inventory. The new standard is effective for reporting periods beginning after December 15, 2017, and can be adopted early in any interim period, with any adjustments applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is currently evaluating the impact that the pronouncement will have on the consolidated financial statements.

Share-Based Payment

In March 2016, the FASB issued guidance that simplifies how share-based payments are accounted for and presented in the financial statements. The new guidance includes requirements to record all of the tax effects related to share-based payments at settlement through the income statement, allows for tax withholdings up to maximum statutory rates before precluding equity accounting, and allows the Company to make an accounting policy election for the impact of forfeitures on the recognition of expense. The new standard is effective for reporting periods beginning after December 15, 2016 and can be adopted early in any interim period, with any adjustments reflected as of the beginning of the fiscal year of adoption in retained earnings. The Company is currently evaluating the impact that the pronouncement will have on the consolidated financial statements.

Leases

In February 2016, the FASB issued guidance on leases that will require lessees to recognize almost all of their leases on the balance sheet by recording a right-of-use asset and liability. The new standard will be effective for reporting periods beginning after December 15, 2018, and requires application of the new accounting guidance at the beginning of the earliest comparative period presented in the year of adoption. The Company is currently evaluating the impact that the pronouncement will have on the consolidated financial statements.

Recognition and Measurement of Financial Instruments

In January 2016, the FASB issued guidance regarding the classification and measurement of financial instruments. The standard requires equity securities, including available-for-sale ("AFS") securities, to be measured at fair value

with changes in the fair value recognized through net income, superseding the guidance permitting entities to record gains and losses on equity securities with readily determinable fair values in accumulated other comprehensive income. Investments accounted for under the equity method of accounting or that result in consolidation are not included within the scope of this update. The new standard will affect the Company's accounting for AFS securities for reporting periods beginning after December 15, 2017.

DISCOVERY COMMUNICATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Balance Sheet Classification of Deferred Taxes
In November 2015, the FASB issued guidance to simplify the presentation of deferred income taxes, which removes the requirement to separate deferred tax liabilities and assets into current and noncurrent amounts and instead requires all such amounts be classified as noncurrent on the Company's consolidated balance sheets. The new requirement will be effective for financial statements issued for annual periods beginning after December 15, 2016, and can be adopted on either a retrospective or prospective basis. The Company will record a balance sheet reclassification adjustment for the impact that the pronouncement will have on the consolidated financial statements. The Company will retrospectively adopt the pronouncement.
Presentation of Financial Statements - Going Concern
In August 2014, the FASB issued guidance requiring the Company to perform interim and annual assessments regarding conditions or events that raise substantial doubt about the Company's ability to continue as a going concern and to provide related disclosures, if applicable. The new standard is effective for reporting periods ending after December 15, 2016, with early adoption permitted. The adoption of this standard is not expected to have a material impact on the Company's disclosures in the consolidated financial statements.
Revenue from Contracts with Customers
In May 2014, the FASB issued an accounting pronouncement related to revenue recognition, which applies a single, comprehensive revenue recognition model for all contracts with customers. This standard, as amended, contains principles with respect to the measurement and timing of recognition of revenue. The Company will recognize revenue to reflect the transfer of goods or services to customers at an amount that it expects to be entitled to receive in exchange for those goods or services. The new standard is effective for annual reporting periods beginning after December 15, 2017, with early adoption permitted for annual reporting periods beginning after December 15, 2016. The Company is required to apply the new revenue standard beginning in the first interim period within the year of adoption. The Company is currently evaluating the impact that the pronouncement will have on the consolidated financial statements.
Concentrations Risk
Customers
The Company has long-term contracts with distributors around the world. For the U.S. Networks segment, more than 90% of distribution revenue comes from the Company's top 10 distributors in the U.S. For the International Networks segment, approximately 46% of distribution revenue comes from the Company's top 10 distributors outside of the U.S. Agreements in place with the major cable and satellite operators in the U.S. expire at various times from 2016 through 2021. Although the Company seeks to renew its agreements with its distributors prior to expiration of a contract, a delay in securing a renewal that results in a service disruption, a failure to secure a renewal or a renewal on less favorable terms may have a material adverse effect on the Company’s financial condition and results of operations. Not only could the Company experience a reduction in distribution revenue, but it could also experience a reduction in advertising revenue, as viewership is impacted by affiliate subscriber levels.
No individual customer accounted for more than 10% of total consolidated revenues for the three and nine months ended September 30, 2016 or 2015. As of September 30, 2016 and December 31, 2015, the Company’s trade receivables did not represent a significant concentration of credit risk as the customers and markets in which the Company operates are varied and dispersed across many geographic areas.
Financial Institutions
Cash and cash equivalents are maintained with several financial institutions. The Company has deposits held with banks that exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and are maintained with financial institutions of reputable credit and, therefore, bear minimal credit risk. Additionally, the Company has cash and cash equivalents held by its foreign subsidiaries that would result in U.S. tax consequences should the Company decide it needs to repatriate these funds to the U.S.

Lender Counterparties

There is a risk that the counterparties associated with the Company's revolving credit facility will not be available to fund as obligated under the terms of the facility and that the Company may, at the time of such unavailability to fund, have limited or no access to the commercial paper market. If funding under the revolving credit facility is unavailable, the Company may have to acquire a replacement credit facility from different counterparties at a higher cost or may be unable to find a suitable replacement. Typically, the Company seeks to manage such risks from its revolving credit facility by contracting with experienced large financial institutions and monitoring the credit quality of its lenders. As of September 30, 2016, the Company did not anticipate nonperformance by any of its counterparties.

DISCOVERY COMMUNICATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Counterparty Credit Risk
The Company is exposed to the risk that the counterparties to outstanding derivative financial instruments will default on their obligations. The Company manages these credit risks through the evaluation and monitoring of the creditworthiness of, and concentration of risk with, the respective counterparties. In this regard, credit risk associated with outstanding derivative financial instruments is spread across a relatively broad counterparty base of banks and financial institutions. In connection with the Company's hedge of certain investments classified as available-for-sale securities, the Company has pledged shares as collateral to the derivative counterparty. (See Note 3.) The Company also has a limited number of arrangements where collateral is required to be posted in the instance that certain fair value thresholds are exceeded. As of September 30, 2016, no collateral has been posted by either party under these arrangements. As of September 30, 2016, our exposure to counterparty credit risk included derivative assets with an aggregate fair value of $92 million.

NOTE 2. ACQUISITIONS AND DISPOSITIONS

Acquisitions

Eurosport France

On December 21, 2012, the Company acquired a 20% equity method investment in Eurosport France. On March 31, 2015, the Company acquired an additional 31% interest in Eurosport France for €36 million ($38 million). This transaction gave the Company a 51% controlling stake in Eurosport France. The Company recognized a gain of $2 million during the three months ended March 31, 2015, to account for the difference between the carrying value and the fair value of the previously held 20% equity method investment in Eurosport France as a component of other expense, net in the Company's consolidated statements of operations. (See Note 13.) On October 1, 2015, the Company acquired the remaining 49% of Eurosport France. (See Note 8.)
Eurosport France is part of Eurosport, a leading pan-European sports media platform. The flagship Eurosport network focuses on regionally popular sports, such as tennis, skiing, cycling and motor sports. Eurosport's brands and platforms also include Eurosport HD (high definition simulcast), Eurosport 2, Eurosport 2 HD and Eurosportnews. The acquisition is intended to increase the growth of Eurosport and enhance the Company's pay-TV offerings in Europe.
The Company used a discounted cash flow ("DCF") analysis, which represents a Level 3 fair value measurement, to assess certain components of the Eurosport France purchase price allocation. The fair value of the assets acquired, liabilities assumed, noncontrolling interest recognized and the remeasurement gain recorded on the previously held equity interest is presented in the table below (in millions).

	March 31, 2015
Goodwill	$ 69
Intangible assets	40
Other assets acquired	25
Cash	35
Removal of TF1 put right	2
Currency translation adjustment	(6)
Remeasurement gain on previously held equity interest	(2)
Liabilities assumed	(30)
Deferred tax liabilities	(14)
Redeemable noncontrolling interest (Note 8)	(60)
Carrying value of previously held equity interest	(21)
Net assets acquired	$ 38

The goodwill reflects the workforce and synergies expected from increased pan-European market penetration as the operations of Eurosport and the Company are combined. The goodwill recorded as part of this acquisition is included

in the International Networks reportable segment and is not amortizable for tax purposes. Intangible assets primarily consist of distribution and advertising customer relationships, advertiser backlog and trademarks with a weighted average estimated useful life of 10 years.

DISCOVERY COMMUNICATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Other
In the year ended December 31, 2015, the Company acquired several other unrelated businesses for total cash and contingent consideration of $91 million, net of cash acquired. Total consideration, net of cash acquired, included contingent consideration of $13 million as of December 31, 2015, of which $1 million was paid during the nine months ended September 30, 2016. The Company recorded $54 million and $43 million of goodwill and intangible assets, respectively, in connection with these acquisitions. The acquisitions included FTA networks in Italy and Turkey, cable networks in Denmark and a pay-TV sports channel in Asia. The goodwill reflects the synergies and regional market penetration from combining the operations of these acquisitions with the Company's operations.
Impact of Business Combinations
The operations of each of the business combinations in 2015 discussed above were included in the consolidated financial statements as of each of their respective acquisition dates. The following table presents their revenue and earnings as reported within the consolidated financial statements for the current period (in millions).

	Three months ended September 30, 2016	Nine months ended September 30, 2016
Revenues:		
Distribution	$ 21	$ 64
Advertising	12	42
Other	1	3
Total revenues	$ 34	$ 109
Net income	$ 6	$ 21

	Three months ended September 30, 2015	Nine months ended September 30, 2015
Revenues:		
Distribution	$ 21	$ 39
Advertising	8	11
Other	—	—
Total revenues	$ 29	$ 50
Net income	$ 1	$ 1

Dispositions
Russia
On October 7, 2015, Discovery recorded a loss of $5 million upon deconsolidation of its Russian business following its contribution to a joint venture (the “New Russian Business”) with a Russian media company, National Media Group ("NMG"). The New Russian Business was established to comply with changes in Russian legislation that limit foreign ownership of media companies in Russia. No cash consideration was exchanged in the transaction. NMG contributed an FTA license which enables advertising for the New Russian Business. As part of the transaction, Discovery obtained a 20% ownership interest in the New Russian Business, which is accounted for under the equity method of

accounting. The loss on contribution of the Russian business included $15 million of goodwill allocated to the transaction based on the relative fair values of the Russian business disposed of and the portion of the reporting unit that was retained. Although Discovery no longer consolidates the Russian business, Discovery earns revenue by providing content and brands to the New Russian Business under long-term licensing arrangements (Note 14). The Russian business was included in the International Networks reportable segment; the licensing arrangements are reported as distribution revenue in the International Networks reportable segment (See Note 16).

DISCOVERY COMMUNICATIONS, INC.
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Radio

On June 30, 2015, Discovery sold its radio business in Northern Europe to Bauer Media Group ("Bauer") for total consideration, net of cash disposed, of €72 million ($80 million), which included €54 million ($61 million) in cash and €18 million ($19 million) of contingent consideration. The cumulative gain on the disposal is $1 million and includes $26 million of goodwill allocated to the transaction based on the relative fair values of the radio business disposed of and the portion of the reporting unit that was retained. Upon sale, the Company recorded a $3 million gain including estimated contingent consideration as disclosed for the nine months ended September 30, 2015. As of December 31, 2015, the Company revised its estimated contingent consideration resulting in a $12 million loss. Based on the final resolution and receipt of contingent consideration payable, Discovery recorded a pre-tax gain of $13 million for the nine months ended September 30, 2016.

The Company determined that the disposal did not meet the definition of a discontinued operation because it does not represent a strategic shift that has a significant impact on the Company's operations and consolidated financial results. The Company's radio business had no impact on income before income taxes for the nine months ended September 30, 2015. The Company's radio businesses were part of the International Networks reportable segment.

Discovery Digital Networks

On October 13, 2016, the Company announced a plan to contribute $100 million and its digital network Seeker and production studio SourceFed in exchange for a 39% minority interest in a new holding company, Group Nine Media. Group Nine Media includes digital companies Thrillist Media Group, Now This Media, and The Dodo. The businesses contributed by Discovery have a net asset balance of approximately $30 million, primarily comprised of goodwill. The Company expects to record a gain upon deconsolidation of these businesses.

NOTE 3. INVESTMENTS

The Company’s investments consisted of the following (in millions).

Category	Balance Sheet Location	September 30, 2016	December 31, 2015
Trading securities:			
Mutual funds	Prepaid expenses and other current assets	$ 161	$ 149
Equity method investments	Equity method investments	515	567
Available-for-sale securities:			
Common stock	Other noncurrent assets	50	81
Common stock - pledged	Other noncurrent assets	50	81
Cost method investments	Other noncurrent assets	48	43
Total investments		$ 824	$ 921

Trading Securities

Trading securities include investments in mutual funds held in a separate trust which are owned as part of the Company’s supplemental retirement plan. (See Note 4.)

Equity Method Investments

In the normal course of business, the Company makes investments that support its underlying business strategy and enable it to enter new markets and develop programming. All equity method investees are privately owned. The carrying values of the Company’s equity method investments are consistent with its ownership in the underlying net assets of the investees, except for Oprah Winfrey Network ("OWN"), because the Company has recorded losses in excess of its ownership interest. Certain of the Company's equity method investments are VIEs, for which the Company is not the primary beneficiary. As of September 30, 2016, the Company’s estimated risk of loss for all its VIEs including the investment carrying values, unfunded contractual commitments, and guarantees made on behalf of VIEs was approximately $380 million. The Company's estimated risk of loss excludes the non-contractual future funding of VIEs. The aggregate carrying values of these VIE investments were $374 million and $423 million as of

September 30, 2016 and December 31, 2015, respectively. The Company recognized its portion of net income generated by VIEs of $10 million and $21 million for the three months ended September 30, 2016 and 2015, respectively, and $13 million and $31 million for the nine months ended September 30, 2016 and 2015, respectively.

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OWN

OWN is a pay-TV network and website that provides adult lifestyle content, which is focused on self-discovery, self-improvement and entertainment. Since the initial equity was not sufficient to fund OWN's activities without additional subordinated financial support in the form of a note receivable held by the Company, OWN is a VIE. While the Company and Harpo, Inc. ("Harpo") are partners who share equally in voting control, power is not shared because Harpo holds operational rights related to programming and marketing, as well as selection and retention of key management personnel, that significantly impact OWN’s economic performance. Accordingly, the Company has determined that it is not the primary beneficiary of OWN and accounts for its investment in OWN using the equity method. However, the Company provides OWN content licenses and services, such as distribution, sales and administrative support, for a fee and has provided OWN funding. (See Note 14.)

The carrying value of the Company’s investment in OWN of $317 million and $373 million as of September 30, 2016 and December 31, 2015, respectively, includes the Company's note receivable and accumulated investment losses. The Company's combined advances to and note receivable from OWN, including accrued interest, were $326 million and $384 million as of September 30, 2016 and December 31, 2015, respectively. On April 30, 2015, Oprah Winfrey agreed to extend her exclusivity agreement with OWN and the note receivable agreement was modified to reduce its interest rate, compounded annually, from 7.5% to 5.0%, retroactive to January 1, 2014. During the nine months ended September 30, 2016, the Company received net repayments of $71 million from OWN and accrued interest on the note receivable of $13 million.

The note receivable is secured by the net assets of OWN. While the Company has no further funding commitments, the Company will provide additional funding to OWN, if necessary, and expects to recoup amounts funded. There can be no event of default on the borrowing until 2023. However, borrowings are scheduled for repayment four years after the borrowing date to the extent that OWN has excess cash to repay the borrowings then due. Following such repayment, OWN’s subsequent cash distributions will be shared equally between the Company and Harpo.

In accordance with the venture agreement, losses generated by OWN are generally allocated to both investors based on their proportionate ownership interests. However, the Company has recorded its portion of OWN’s losses based upon accounting rules for equity method investments. Prior to the contribution of the Discovery Health network to OWN at its launch, the Company had recognized $104 million, or 100%, of OWN’s net losses. During the three months ended March 31, 2012, accumulated operating losses at OWN exceeded the equity contributed to OWN, and Discovery began again to record 100% of OWN’s net losses. Although OWN has become profitable, the Company will record 100% of any net losses to the extent they occur resulting from OWN's operations as long as Discovery has provided all funding to OWN and OWN’s accumulated losses continue to exceed the equity contributed. All of OWN's net income has been and will continue to be recorded by the Company until the Company recovers losses absorbed in excess of the Company's equity ownership interest. The Company monitors the financial results of OWN along with other relevant business information to assess the recoverability of the OWN note receivable. There has been no impairment of the OWN note receivable.

Based on the joint venture agreement, as amended on April 1, 2016, Harpo has the right to conditionally require the Company to purchase all or part of Harpo’s interest in OWN at fair market value up to a maximum put amount during 90-day windows beginning on April 1, 2017 and every two and a half years commencing July 1, 2018 through January 1, 2026. The maximum put amount ranges from $100 million on the first put exercise date up to a cumulative cap of $400 million on the fifth put exercise date. The Company has not recorded amounts for the put right because the fair value of this put right was zero as of September 30, 2016 and December 31, 2015.

Other Equity Method Investments

At September 30, 2016 and December 31, 2015, the Company's other equity method investments included the New Russian Business, All3Media and certain joint ventures in Canada. In addition on June 24, 2016, the Company acquired a 27.5% interest in Mega TV, a FTA channel in Chile owned by Bethia Comunicaciones, for $53 million.

The Company acquired other equity method investments and made additional contributions to existing equity method investments totaling $14 million during the nine months ended September 30, 2016.

Available-for-Sale Securities ("AFS")

On November 12, 2015, the Company acquired 5 million shares, or approximately 3%, of Lions Gate Entertainment Corp. ("Lionsgate"), an entertainment company, for $195 million. As the shares have a readily determinable fair value and the Company has the intent to retain the investment, the shares are classified as AFS securities.

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The accumulated amounts associated with the components of the Company's AFS securities, which are included in other non-current assets, are summarized in the table below (in millions).

	September 30, 2016	December 31, 2015
Cost	$ 195	$ 195
Other-than-temporary impairment of AFS securities	(62)	—
Adjusted Cost Basis	133	195
Unrealized losses for changes in fair value of:		
Hedged AFS - Other expense, net	(33)	(2)
Unhedged AFS - Other comprehensive (loss) income, net of tax	—	(31)
Carrying value	$ 100	$ 162

During the three months ended September 30, 2016, the Company determined that the decline in value of AFS securities related to our investment in Lionsgate is other-than-temporary in nature and, as such, the cost basis was adjusted to a fair value of $100 million. The impairment determination is based on the sustained decline in the stock price of Lionsgate in relation to the purchase price and the prolonged length of time the fair value of the investment has been less than the carrying value. Based on the other-than-temporary impairment determination, unrealized pre-tax losses of $62 million previously recorded as a component of other comprehensive (loss) income were recognized as an impairment charge that is included as a component of other expense, net for the three months ended September 30, 2016.

The total decline in fair value of $95 million on the Lionsgate investment since its purchase has been recorded to other expense, net, of which $93 million was recorded in 2016. (See Note 9.)

The Company hedged 50% of the shares with an equity collar (the "Lionsgate Collar") and pledged those shares as collateral to the derivative counter party. In the application of hedge accounting, when the share price of Lionsgate is within the boundaries of the collar and the hedge has no intrinsic value, the Company records the gains or losses on the Lionsgate AFS securities as a component of other comprehensive (loss) income. When the share price of the Lionsgate AFS is outside the boundaries of the collar and the hedge has intrinsic value, the Company records a gain or loss for the change in the fair value of the hedged portion of Lionsgate shares that correspond to the change in intrinsic value of the hedge as a component of other expense, net. (See Note 7.)

Cost Method Investments

Cost method investments include ownership rights in entities that do not provide the Company with control or significant influence in these investments and that have no readily determinable fair values. The Company's cost method investments as of September 30, 2016 primarily include an educational website and an electric car racing series.

NOTE 4. FAIR VALUE MEASUREMENTS

Fair value is defined as the amount that would be received for selling an asset or paid to transfer a liability in an orderly transaction between market participants. Assets and liabilities carried at fair value are classified in the following three categories:

Level 1 —	Quoted prices for identical instruments in active markets.
Level 2 —	Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.
Level 3 —	Valuations derived from techniques in which one or more significant inputs are unobservable.

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The tables below present assets and liabilities measured at fair value on a recurring basis (in millions).

		September 30, 2016			
Category	Balance Sheet Location	Level 1	Level 2	Level 3	Total
Assets					
Trading securities - mutual funds	Prepaid expenses and other current assets	$161	$ —	$ —	$161
Available-for-sale securities:					
Common stock	Other noncurrent assets	50	—	—	50
Common stock - pledged	Other noncurrent assets	50	—	—	50
Derivatives:					
Cash flow hedges:					
Foreign exchange	Prepaid expenses and other current assets	—	29	—	29
Interest rate	Prepaid expenses and other current assets	—	2	—	2
Foreign exchange	Other noncurrent assets	—	2	—	2
Net investment hedges:					
Cross-currency swaps	Other noncurrent assets	—	22	—	22
Fair value hedges:					
Equity (Lionsgate Collar)	Other noncurrent assets	—	36	—	36
No hedging designation:					
Cross-currency swaps	Other noncurrent assets	—	1	—	1
Total		$261	$ 92	$ —	$353
Liabilities					
Deferred compensation plan	Accrued liabilities	$161	$ —	$ —	$161
Derivatives:					
Cash flow hedges:					
Foreign exchange	Accrued liabilities	—	31	—	31
Foreign exchange	Other noncurrent liabilities	—	4	—	4
Net investment hedges:					
Cross-currency swaps	Accrued liabilities	—	3	—	3
Cross-currency swaps	Other noncurrent liabilities	—	48	—	48
Total		$161	$ 86	$ —	$247

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Category	Balance Sheet Location	December 31, 2015			
		Level 1	Level 2	Level 3	Total
Assets					
Trading securities - mutual funds	Prepaid expenses and other current assets	$149	$ —	$ —	$149
Available-for-sale securities:					
Common stock	Other noncurrent assets	81	—	—	81
Common stock - pledged	Other noncurrent assets	81	—	—	81
Derivatives:					
Cash flow hedges:					
Foreign exchange	Prepaid expenses and other current assets	—	21	—	21
Foreign exchange	Other noncurrent assets	—	2	—	2
Fair value hedges:					
Equity (Lionsgate Collar)	Other noncurrent assets	—	15	—	15
Total		$311	$ 38	$ —	$349
Liabilities					
Deferred compensation plan	Accrued liabilities	$149	$ —	$ —	$149
Derivatives:					
Foreign exchange	Accrued liabilities	—	4	—	4
Total		$149	$ 4	$ —	$153

Trading securities are comprised of investments in mutual funds held in a separate trust which are owned as part of the Company’s deferred compensation plan. The fair value of Level 1 trading securities was determined by reference to the quoted market price per unit in active markets multiplied by the number of units held without consideration of transaction costs. The fair value of the deferred compensation plan liability was determined based on the fair value of the related investments elected by employees.

AFS securities represent equity investments with readily determinable fair values. The fair value of Level 1 AFS securities was determined by reference to the quoted market price per unit in active markets multiplied by the number of units held without consideration of transaction costs. (See Note 3).

Derivative financial instruments are comprised of foreign exchange, interest rate and equity contracts. (See Note 7).

In addition to the financial instruments listed in the tables above, the Company holds other financial instruments, including cash deposits, accounts receivable, accounts payable, commercial paper, borrowings under the revolving credit facility, capital leases and senior notes. The carrying values for such financial instruments, other than the senior notes, each approximated their fair values as of September 30, 2016. The estimated fair value of the Company’s outstanding senior notes using quoted prices from over the counter markets, considered Level 2 inputs, was $7.7 billion and $6.6 billion as of September 30, 2016 and December 31, 2015, respectively.

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NOTE 5. CONTENT RIGHTS

The table below presents the components of content rights (in millions).

	September 30, 2016	December 31, 2015
Produced content rights:		
Completed	$ 3,846	$ 3,624
In-production	452	376
Coproduced content rights:		
Completed	686	691
In-production	54	62
Licensed content rights:		
Acquired	1,103	1,078
Prepaid	157	96
Content rights, at cost	6,298	5,927
Accumulated amortization	(3,831)	(3,584)
Total content rights, net	2,467	2,343
Current portion	(350)	(313)
Noncurrent portion	$ 2,117	$ 2,030

Content expense is included in costs of revenues on the consolidated statements of operations and consisted of the following (in millions).

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Content amortization	$424	$414	$1,279	$1,210
Other production charges	67	54	205	163
Content impairments[a]	5	3	14	33
Total content expense	$496	$471	$1,498	$1,406

[a] Content impairments are generally recorded as a component of costs of revenue. However, during the three and nine months ended September 30, 2016, $3 million in content impairments were reflected as a component of restructuring and other charges. During the nine months ended September 30, 2015, $21 million in content impairments were reflected as a component of restructuring and other charges. These impairment charges resulted from the cancellation of certain high profile series due to legal circumstances pertaining to the associated talent.

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NOTE 6. DEBT

The table below presents the components of outstanding debt (in millions).

	September 30, 2016	December 31, 2015
5.625% Senior notes, semi-annual interest, due August 2019	$ 500	$ 500
5.05% Senior notes, semi-annual interest, due June 2020	1,300	1,300
4.375% Senior notes, semi-annual interest, due June 2021	650	650
2.375% Senior notes, euro denominated, annual interest, due March 2022	336	328
3.30% Senior notes, semi-annual interest, due May 2022	500	500
3.25% Senior notes, semi-annual interest, due April 2023		