Discovery Communications, Inc.
Form 10-Q
August 04, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2011

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 x No ¨

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 x 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	x	Accelerated filer	¨
Non-accelerated filer	¨ (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 x

Total number of shares outstanding of each class of the Registrant s common stock as of July 26, 2011:

Series A Common Stock, par value $0.01 per share	140,766,034
Series B Common Stock, par value $0.01 per share	6,589,084
Series C Common Stock, par value $0.01 per share	126,355,687

DISCOVERY COMMUNICATIONS, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements.

DISCOVERY COMMUNICATIONS, INC.

CONSOLIDATED BALANCE SHEETS

(unaudited; in millions, except par value)

	June 30, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,095	$ 466
Receivables, net	908	880
Content rights, net	93	83
Deferred income taxes	65	81
Prepaid expenses and other current assets	160	225
Total current assets	2,321	1,735
Noncurrent content rights, net	1,310	1,245
Property and equipment, net	382	399
Goodwill	6,302	6,434
Intangible assets, net	584	605
Investments	806	455
Other noncurrent assets	131	146
Total assets	$ 11,836	$ 11,019
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 48	$ 87
Accrued liabilities	364	393
Deferred revenues	98	114
Current portion of stock-based compensation liabilities	52	118
Current portion of long-term debt	22	20
Other current liabilities	30	53
Total current liabilities	614	785
Long-term debt	4,235	3,598
Deferred income taxes	373	304
Other noncurrent liabilities	100	99
Total liabilities	5,322	4,786
Commitments and contingencies (Note 13)		
Equity:		
Discovery Communications, Inc. stockholders equity:		
Series A convertible preferred stock: $0.01 par value; 75 shares authorized; 71 shares issued at 2011 and 2010	1	1
Series C convertible preferred stock: $0.01 par value; 75 shares authorized; 57 shares issued at 2011 and 2010	1	1
	1	1

Series A common stock: $0.01 par value; 1,700 shares authorized; 140 and 138 shares issued at 2011 and 2010, respectively		
Series B convertible common stock: $0.01 par value; 100 shares authorized; 7 shares issued at 2011 and 2010		
Series C common stock: $0.01 par value; 2,000 shares authorized; 142 shares issued at 2011 and 2010	2	2
Additional paid-in capital	6,441	6,358
Treasury stock, at cost: 13 and 3 Series C common shares at 2011 and 2010, respectively	(482)	(105)
Retained earnings	559	
Accumulated other comprehensive loss	(10)	(33)
Total Discovery Communications, Inc. stockholders equity	6,513	6,225
Noncontrolling interests	1	8
Total equity	6,514	6,233
Total liabilities and equity	$ 11,836	$ 11,019

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 June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Revenues:				
Distribution	$ 493	$ 449	$ 973	$ 894
Advertising	494	435	886	783
Other	80	79	159	155
Total revenues	1,067	963	2,018	1,832
Costs of revenues, excluding depreciation and amortization	288	254	561	521
Selling, general and administrative	300	304	569	588
Depreciation and amortization	30	33	60	66
Restructuring charges	4		5	3
Gains on dispositions			(129)	
	622	591	1,066	1,178
Operating income	445	372	952	654
Interest expense, net	(49)	(48)	(98)	(106)
Loss on extinguishment of debt		(136)		(136)
Other income (expense), net	2	(37)	(5)	(41)
Income before income taxes	398	151	849	371
Provision for income taxes	(144)	(41)	(290)	(88)
Net income	254	110	559	283
Less net income attributable to noncontrolling interests		(3)		(7)
Net income attributable to Discovery Communications, Inc.	254	107	559	276
Stock dividends to preferred interests		(1)		(1)
Net income available to Discovery Communications, Inc. stockholders	$ 254	$ 106	$ 559	$ 275
Net income per share available to Discovery Communications, Inc. stockholders:				
Basic	$ 0.63	$ 0.25	$ 1.37	$ 0.65
Diluted	$ 0.62	$ 0.25	$ 1.36	$ 0.64
Weighted average shares outstanding:				
Basic	406	426	407	425
Diluted	410	431	412	430

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

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DISCOVERY COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited; in millions)

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Operating Activities		
Net income	$ 559	$ 283
Adjustments to reconcile net income to cash provided by operating activities:		
Content expense	381	350
Stock-based compensation	49	94
Depreciation and amortization	60	67
Gains on dispositions	(129)	
Deferred income tax expense (benefit)	71	(44)
Noncash portion of loss on extinguishment		12
Other noncash expenses, net	30	43
Changes in operating assets and liabilities:		
Receivables, net	(31)	(31)
Content rights	(430)	(370)
Accounts payable and accrued liabilities	(116)	(159)
Stock-based compensation liabilities	(92)	(123)
Income tax receivable	94	(11)
Other, net	(15)	(21)
Cash provided by operating activities	431	90
Investing Activities		
Purchases of property and equipment	(27)	(20)
Business acquisitions, net of cash acquired		(38)
Investments in and advances to equity investees	(82)	(41)
Cash used in investing activities	(109)	(99)
Financing Activities		
Borrowings from long term debt, net of discount and issuance costs	641	2,970
Principal repayments of long-term debt		(2,883)
Principal repayments of capital lease obligations	(13)	(5)
Repurchases of common stock	(377)	
Cash distributions to noncontrolling interests	(7)	(2)
Proceeds from stock option exercises	38	15
Excess tax benefits from stock-based compensation	17	4
Cash provided by financing activities	299	99
Effect of exchange rate changes on cash and cash equivalents	8	
Net change in cash and cash equivalents	629	90
Cash and cash equivalents, beginning of period	466	623
Cash and cash equivalents, end of period	$ 1,095	$ 713
Supplemental Cash Flow Information		

Cash paid for interest, net:				
Periodic interest payments for debt, interest rate swaps and capital lease obligations	$	99	$	115
Make-whole premiums, termination payments, and repayment of original issue discount				148
Total cash paid for interest, net	$	99	$	263
Cash paid for taxes, net	$	93	$	178
Noncash Investing and Financing Transactions				
Investment in OWN	$	273	$	
Assets acquired under capital lease arrangements	$		$	20
Stock dividends to preferred interests	$		$	1

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

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DISCOVERY COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF EQUITY

(unaudited; in millions)

	Three Months Ended June 30, 2011			Three Months Ended June 30, 2010		
	Discovery Stockholders	Noncontrolling Interests	Total Equity	Discovery Stockholders	Noncontrolling Interests	Total Equity
Beginning balance	$ 6,408	$ 3	$ 6,411	$ 6,365	$ 25	$ 6,390
Comprehensive income:						
Net income	254		254	107	3	110
Other comprehensive income (loss):						
Foreign currency translation adjustments, net	6		6	(10)		(10)
Market value adjustments and reclassifications for securities and derivatives				6		6
Total comprehensive income	260		260	103	3	106
Stock dividends declared to preferred interests				(1)		(1)
Stock-based compensation	14		14	10		10
Excess tax benefits from stock-based compensation	13		13	3		3
Issuance of common stock in connection with stock-based plans	28		28	6		6
Repurchases of common stock	(210)		(210)			
Cash distributions to noncontrolling interests		(2)	(2)			
Ending balance	$ 6,513	$ 1	$ 6,514	$ 6,486	$ 28	$ 6,514

	Six Months Ended June 30, 2011			Six Months Ended June 30, 2010		
	Discovery Stockholders	Noncontrolling Interests	Total Equity	Discovery Stockholders	Noncontrolling Interests	Total Equity
Beginning balance	$ 6,225	$ 8	$ 6,233	$ 6,197	$ 23	$ 6,220
Comprehensive income:						
Net income	559		559	276	7	283
Other comprehensive income (loss):						
Foreign currency translation adjustments, net	23		23	(30)		(30)
Market value adjustments and reclassifications for securities and derivatives				7		7
Total comprehensive income	582		582	253	7	260
Stock dividends declared to preferred interests				(1)		(1)
Stock-based compensation	28		28	18		18
Excess tax benefits from stock-based compensation	17		17	4		4
Issuance of common stock in connection with stock-based plans	38		38	15		15
Repurchases of common stock	(377)		(377)			
Cash distributions to noncontrolling interests		(7)	(7)		(2)	(2)
Ending balance	$ 6,513	$ 1	$ 6,514	$ 6,486	$ 28	$ 6,514

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 leading nonfiction media and entertainment company that provides programming across multiple distribution platforms throughout the world and owns and operates a diversified portfolio of website properties and other digital media services. The Company also develops and sells curriculum-based products and services, as well as postproduction audio services. The Company classifies its operations in three segments: U.S. Networks, consisting principally of domestic cable and satellite television networks, websites, and other digital media services; International Networks, consisting primarily of international cable and satellite television networks and websites; and Education and Other, consisting principally of curriculum-based product and service offerings and postproduction audio services. Financial information for Discovery s reportable segments is set forth in Note 14.

Basis of Presentation

The consolidated financial statements include the accounts of Discovery, its majority-owned subsidiaries in which a controlling interest is maintained, and variable interest entities (VIE) for which the Company is the primary beneficiary. Inter-company accounts and transactions between consolidated entities have been eliminated in consolidation.

Unaudited Interim Financial Statements

These consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) applicable to interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. These consolidated financial statements are unaudited; however, in the opinion of management, they reflect all adjustments, consisting only of those of a normal recurring nature, necessary to state fairly the financial position, results of operations, and cash flows for the periods presented in conformity with 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, 2010 (the 2010 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 evaluates its estimates, judgments, and assumptions; and management s assessments could change. Actual results may differ from those estimates and could have a material impact on the consolidated financial statements.

Significant estimates inherent in the preparation of the Company s consolidated financial statements include, but are not limited to, consolidation of VIEs, accounting for acquisitions, dispositions, allowances for doubtful accounts, content rights, asset impairments, fair value measurements, revenue recognition, depreciation and amortization, stock-based compensation, income taxes, and contingencies.

Accounting and Reporting Pronouncements Adopted

Fair Value Measurements

In January 2010, the Financial Accounting Standards Board (FASB) issued guidance that requires additional disclosures about recurring and nonrecurring fair value measurements, including significant transfers into and out of Level 1 and Level 2 of the fair value measurement hierarchy, and separately presenting information regarding purchases, sales, issuances, and settlements in the reconciliation of Level 3 fair value measurements. The Company prospectively adopted the new guidance effective January 1, 2010, except for Level 3 reconciliation disclosures, which was effective for the Company on January 1, 2011. The adoption of the new guidance did not impact the Company s consolidated financial statements.

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DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Revenue Recognition for Multiple-Element Revenue Arrangements

In October 2009, the FASB issued guidance that changed the determination of when the individual deliverables included in a multiple-element revenue arrangement may be treated as separate units of accounting, modified the manner in which the arrangement consideration is allocated across the separately identified deliverables, and expanded the disclosures required for multiple-element revenue arrangements. Under the new guidance, the Company must allocate the arrangement consideration to each deliverable based on management s estimate of the price at which each element would be separately sold, if fair value is not available. The Company prospectively adopted the new guidance effective January 1, 2011, which did not have a material impact on its consolidated financial statements.

Accounting and Reporting Pronouncements Not Yet Adopted

A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring

In April 2011, the FASB issued new accounting guidance related to identifying and disclosing troubled debt restructurings (TDRs), which is effective for the Company on July 1, 2011 and to be applied retrospectively to restructurings occurring on or after January 1, 2011. This guidance provides clarification in assessing whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for the purpose of determining whether a restructuring constitutes a TDR. The Company is currently assessing the impact of this guidance on its financial statements.

Fair Value Measurements

In May 2011, the FASB and the International Accounting Standards Board (IASB) issued guidance, which results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between U.S. GAAP and International Financial Reporting Standards (IFRS). Under the new guidance, the highest and best use concepts are only relevant when measuring the fair value of nonfinancial assets. The new guidance also extends the prohibition of the application of a blockage factor to all financial measurements and requires the Company to disclose quantitative information about unobservable inputs used in a description of the valuation processes, and a qualitative discussion about the sensitivity of the measurements for recurring Level 3 fair value measurements. The Company will prospectively adopt the new guidance effective January 1, 2012. The Company is currently assessing the impact of this guidance on its financial statements.

Comprehensive Income

In June 2011, the FASB issued guidance eliminating the current option to report other comprehensive income and its components in the statement of changes in equity. Entities may elect to present items of net income and other comprehensive income in one continuous statement or in two separate, but consecutive, statements. Under the new guidance, each component of net income and each component of other comprehensive income, together with totals for comprehensive income and its two parts, net income and other comprehensive income, are required to be disclosed under either alternative. The guidance is effective January 1, 2012, but early adoption is permitted. The Company is currently assessing the impact of this guidance on its financial statements.

Concentrations Risk

Receivables

The Company s trade receivables do not represent a significant concentration of credit risk as of June 30, 2011, due to the wide variety of customers and market segments dispersed across many geographic areas in which the Company operates.

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 on demand and are maintained with financial institutions of reputable credit and, therefore, bear minimal credit risk.

Lender Counterparties

The risk associated with a debt transaction under the Company s revolving credit facility is that the counterparty will not be available to fund as obligated. If funding under the revolving credit facility is unavailable, the Company may have to acquire a

DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

replacement credit facility from a different counterparty at a higher cost or may be unable to find a suitable replacement. Typically, the Company seeks to manage these exposures by contracting with experienced large financial institutions and monitoring the credit quality of its lenders. As of June 30, 2011, the Company did not anticipate nonperformance by any of its counterparties.

NOTE 2. ACQUISITIONS AND DISPOSITIONS

Acquisitions

London Uplink Facility

On February 17, 2010, the Company acquired all interests in an uplink facility in London, including its employees and operations, for a payment of $35 million. The uplink facility has been included in the Company s operating results since the date of acquisition.

Dispositions

Discovery Health Network

On January 1, 2011, the Company contributed the domestic Discovery Health network to OWN LLC in connection with the launch of The Oprah Winfrey Network (OWN), which resulted in pretax gain of $129 million (Note 3). As the Company continues to be involved in the operations of the Discovery Health network through its ownership interests in OWN LLC, the Company has not presented the financial position, results of operations, and cash flows of the Discovery Health network as discontinued operations.

Antenna Audio

On September 1, 2010, the Company sold Antenna Audio, which was a component of its International Networks segment. Antenna Audio s operating results for the three and six months ended June 30, 2010 have been reclassified as discontinued operations on the Consolidated Statements of Operations. For the three months ended June 30, 2010, Antenna Audio s revenues, income before income taxes, and net income were $11 million, zero, and zero, respectively. For the six months ended June 30, 2010, Antenna Audio s revenues, income before taxes, and net income were $21 million, zero, and zero, respectively. As the income associated with Antenna Audio is zero, there is no separate line in the Consolidated Statements of Operations for discontinued operations.

NOTE 3. VARIABLE INTEREST ENTITIES

In the normal course of business, the Company enters into joint ventures or makes investments that support its underlying business strategy and provide it the ability to enter new markets for its brands, develop programming, and distribute its existing content. In certain instances, a joint venture or an investment may qualify as a VIE. As of June 30, 2011 and December 31, 2010, the Company s VIEs primarily consisted of Hub Television Networks LLC and OWN LLC, which are 50-50 joint ventures that operate pay-television networks. The Company previously had ownership interests in joint ventures with BBC Worldwide (the BBC) that were VIEs, substantially all of which were consolidated. On November 12, 2010, the Company acquired the BBC s interests in these joint ventures. The Company now wholly owns these entities and continues to consolidate them.

As of June 30, 2011 and December 31, 2010, the Company accounted for its interests in all other joint venture VIEs using the equity method. The aggregate carrying values of investments in VIEs accounted for using the equity method were $806 million and $453 million as of June 30, 2011 and December 31, 2010, respectively, which were recorded in Investments on the Consolidated Balance Sheets. During the three and six months ended June 30, 2011, the Company recognized equity earnings of $3 million and equity losses of $7 million, respectively, for its portion of net earnings (losses) generated by VIEs accounted for using the equity method, which were recorded in Other income (expense), net on the Consolidated Statements of Operations. During the three and six months ended June 30, 2010, the Company recognized equity losses of $10 million and $16 million, respectively, for its portion of net losses generated by VIEs accounted for using the equity method, which were recorded in Other income (expense), net on the Consolidated Statements of Operations.

The Company s estimated risk of loss for investments in VIEs was approximately $845 million as of June 30, 2011, which includes the carrying value of its investments and the unfunded portion of contractual funding commitments to joint ventures. Actual amounts funded exceed contractual funding commitments. The Company intends to fund significant amounts to OWN. No amounts have been recorded for future funding commitments. The estimated risk of loss excludes the Company s operating performance guarantee to Hub Television Networks LLC disclosed below.

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Hub Television Networks LLC

Hub Television Networks LLC operates The Hub, which is a pay-television network that provides children s and family entertainment and educational programming that launched October 10, 2010. The Company provides the joint venture with funding and services such as distribution, sales, and administrative support. See Note 12 for further discussion. Based upon the level of equity investment at risk, the Company has determined that the joint venture is a VIE. The joint venture partners share equally in voting control, as well as the profits, losses, and funding of the joint venture. The Company has determined that it is not the primary beneficiary of The Hub, because it does not control the activities that are most significant to the joint venture s operating performance and success. Accordingly, the Company accounts for its investment in The Hub using the equity method.

The Company has guaranteed a certain level of operating performance for the joint venture, which is reduced over time as performance targets are achieved. As of June 30, 2011, the remaining maximum exposure to loss under this performance guarantee was below $185 million. The Company believes the likelihood is remote that the performance guarantee will not be achieved and, therefore, the performance guarantee is unlikely to have a material adverse impact on the Company s financial position, operating results, or cash flows. Accordingly, the fair value of the guarantee as of June 30, 2011 was not material. The Company is also committed to fund up to $15 million to the joint venture; none of which has been funded through June 30, 2011.

On May 23, 2011, The Hub revised its arrangement with Hasbro Studios to increase the license fees for animated programming. This change created a trigger event for purposes of intangible asset and goodwill impairment testing. The Hub s management prepared a fair value assessment using a discounted cash flow valuation model, for purposes of performing step one of the goodwill impairment test. The underlying assumptions, such as future cash flows, weighted average costs of capital, and long-term growth rates were generally not observable in the marketplace, and therefore, involved significant judgment. The estimated fair value of The Hub exceeded its carrying value; no impairments were recorded. Given that the early results of The Hub s operations have been below its initial long-term business plan, there is a possibility that future results may vary from the current assumptions in the long-term business plan. The Company will monitor the valuation of its investment in accordance with GAAP, which requires an impairment charge for other-than-temporary decline in value.

The carrying values of the Company s investment in The Hub were $339 million and $344 million as of June 30, 2011 and December 31, 2010, respectively.

OWN LLC

OWN LLC operates OWN, which is a pay-television network and website that provides adult lifestyle content focused on self-discovery and self-improvement that launched on January 1, 2011. In connection with the launch of OWN, the Company contributed the domestic Discovery Health network to the joint venture, which included goodwill and other identifiable assets with carrying values of $136 million and $8 million, respectively. The Company recorded the contribution at fair value, which resulted in a pretax gain of $129 million. The fair value of the Company s retained equity interest in OWN was estimated at $273 million. The gain represents the fair value of the equity investment retained less the carrying values of contributed assets. The gain resulted in $27 million of tax expense.

The fair value of the contribution of the Discovery Health network to OWN was determined utilizing customary valuation methodologies including discounted cash flows. The underlying assumptions, such as future cash flows, weighted average costs of capital, long-term growth rates, marketplace valuation methodologies, and market comparable transactions and multiples were generally not observable in the marketplace, and therefore, involved significant judgment. Given the early stage of OWN s operations compared with its long-term business plan, there is a possibility that results may vary from these initial assumptions. The Company will monitor the valuation of its investment in accordance with GAAP, which requires an impairment charge for other-than-temporary decline in value.

The contribution did not impact the Company s ownership interest, voting control, or governance rights related to OWN. The Company no longer consolidates the domestic Discovery Health network subsequent to the contribution, which was a component of its U.S. Networks segment.

Based upon the level of equity investment at risk, the Company has determined that OWN is a VIE. While the joint venture partners share equally in voting control, Harpo Inc. (Harpo) holds certain operational rights related to programming and marketing. The Company has determined that it is not the primary beneficiary of OWN, because it does not control the activities that are most significant to the joint venture s operating performance and success. Accordingly, the Company accounts for its investment in OWN using the equity method. Following the contribution of the Discovery Health network to OWN, net losses generated by OWN are allocated to both joint venture partners based on their proportionate ownership interests, which are 50-50. Previously, the Company

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DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

recognized 100% of OWN s net losses. Future net income generated by OWN will initially be allocated 100% to the Company up to the amount of pre-launch net losses recognized. After the Company has recouped its losses, any excess net income will be allocated to both joint venture partners based on their proportionate ownership interests.

The Company provides the joint venture funding and services such as distribution, licensing, sales, and administrative support. See Note 12 for further discussion. As the Company has assumed all funding requirements as of June 30, 2011, the Company s total funding to OWN, including interest accrued on outstanding borrowings, was $242 million, which is in excess of its commitment of $189 million. While the Company expects to provide significant additional funding to OWN, the Company also expects to recoup amounts funded. OWN will distribute its initial excess cash to the Company to repay funding then due. Following repayment of funding then due, OWN s subsequent cash distributions will be shared equally between the Company and Harpo.

The carrying value of the Company s investment in OWN, including its equity method investment and note receivable balance, was $390 million and $52 million as of June 30, 2011 and December 31, 2010, respectively.

Pursuant to the joint venture agreement, Harpo has the right to require the Company to purchase its interest in OWN every two and one half years commencing on January 1, 2016. The put arrangement provides that the Company would purchase Harpo s interests at fair market value up to a maximum put amount. The maximum put amount is a range from $100 million on the first put exercise date up to $400 million on the fourth put exercise date. No amounts have been recorded for the put right.

NOTE 4. FAIR VALUE MEASUREMENTS

The Company records certain assets and liabilities at fair value. Fair value measurements are classified according to the following three-level fair value hierarchy established by the FASB.

Level 1	measurements based on observable inputs such as quoted prices for identical instruments in active markets.
Level 2	measurements based on inputs such as quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for the assets or liabilities.
Level 3	measurements based on valuations derived from present value and other valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

Assets and liabilities measured at fair value on a recurring basis consisted of the following (in millions).

		June 30, 2011			
Category	**Balance Sheet Location**	**Level 1**	**Level 2**	**Level 3**	**Total**
Trading securities:					
Mutual funds	Prepaid expenses and other current assets	$ 77	$	$	$ 77
Available-for-sale securities:					
Money market mutual funds	Cash and cash equivalents	654			654
U.S. Treasury securities	Cash and cash equivalents		200		200
Total assets		$ 731	$ 200	$	$ 931

Liabilities:					
Deferred compensation plan	Accrued liabilities	$ 77	$	$	$ 77
Other	Other current liabilities			1	1
Total liabilities		$ 77	$	$ 1	$ 78

DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Category	Balance Sheet Location	December 31, 2010 Level 1	Level 2	Level 3	Total
Trading securities:					
Mutual funds	Prepaid expenses and other current assets	$ 55	$	$	$ 55
Available-for-sale securities:					
Money market mutual funds	Cash and cash equivalents	172			172
U.S. Treasury securities	Cash and cash equivalents		200		200
Other	Cash and cash equivalents		3		3
Total assets		$ 227	$ 203	$	$ 430
Liabilities:					
Deferred compensation plan	Accrued liabilities	$ 55	$	$	$ 55
Other	Accrued liabilities and Other current liabilities		6		6
Total liabilities		$ 55	$ 6	$	$ 61

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 related deferred compensation plan liability was determined based on the fair value of the related investments elected by employees.

Available-for-sale securities represent investments in highly liquid instruments with original maturities of 90 days or less. The fair value of Level 1 available-for-sale 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 substantially all available-for-sale securities classified in Level 2 was based on quoted prices for similar instruments in active markets multiplied by the number of units held without consideration of transaction costs.

In addition to the financial instruments listed in the tables above, the Company holds other financial instruments, including cash, accounts receivable, accounts payable, and debt. The carrying values for cash, accounts receivable, and accounts payable approximated their fair values. The estimated fair value of the Company s outstanding debt using quoted market prices was $4.4 billion and $3.7 billion as of June 30, 2011 and December 31, 2010, respectively.

NOTE 5. CONTENT RIGHTS

Content rights consisted of the following (in millions).

	June 30, 2011	December 31, 2010
Produced content rights:		
Completed	$ 2,185	$ 1,963
In-production	243	229
Coproduced content rights:		

Completed	481	446
In-production	77	76
Licensed content rights:		
Acquired	348	297
Prepaid	19	19
Content rights, at cost	3,353	3,030
Accumulated amortization	(1,950)	(1,702)
Total content rights, net	1,403	1,328
Current portion	(93)	(83)
Noncurrent portion	$ 1,310	$ 1,245

Content expense was $196 million and $165 million for the three months ended June 30, 2011 and 2010, respectively, and $381 million and $350 million for the six months ended June 30, 2011 and 2010, respectively.

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DISCOVERY COMMUNICATIONS, INC.

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NOTE 6. DEBT

Outstanding debt consisted of the following (in millions).

	June 30, 2011	December 31, 2010
3.70% Senior Notes, semi-annual interest, due June 2015	$ 850	$ 850
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	
6.35% Senior Notes, semi-annual interest, due June 2040	850	850
Capital lease and other obligations	118	126
Total long-term debt	4,268	3,626
Unamortized discount	(11)	(8)
Long-term debt, net	4,257	3,618
Current portion of long-term debt	(22)	(20)
Noncurrent portion of long-term debt	$ 4,235	$ 3,598

On June 20, 2011, Discovery Communications, LLC (DCL), a wholly-owned subsidiary of the Company, issued $650 million aggregate principal amount of 4.375% Senior Notes due on June 15, 2021 (the 2021 Notes). DCL received net proceeds of approximately $641 million from the offering after the $4 million issuance discount and $5 million of deferred financing costs.

DCL may, at its option, redeem some or all of the 2021 Notes at any time by paying a make-whole premium, plus accrued and unpaid interest, if any, through the date of repurchase. Interest on the 2021 Notes is payable on June 15 and December 15 of each year. The 2021 Notes are unsecured and rank equally in right of payment with all of DCL s other unsecured senior indebtedness and are fully and unconditionally guaranteed on an unsecured and unsubordinated basis by Discovery.

In addition to the debt instruments listed in the table above, the Company also has a $1.0 billion revolving credit facility. There were no amounts drawn under the revolving credit facility as of June 30, 2011 and December 31, 2010. If the Company were to draw on the revolving credit facility, outstanding balances would bear interest at a variable rate determined pursuant to the credit agreement. Balances outstanding under the revolving credit facility would be due on the expiration date, which is October 11, 2013.

The Company was in compliance with all covenants and provisions under its credit agreements as of June 30, 2011 and December 31, 2010. There were no events of default.

NOTE 7. EQUITY

Stock Repurchase Program

On August 3, 2010, the Company implemented a stock repurchase program, with authorization to purchase up to $1.0 billion of its common stock. The repurchase program has no expiration date. During the three and six months ended June 30, 2011, the Company repurchased 5.64 million and 10.37 million shares, respectively, of its Series C common stock for an aggregate purchase price of $210 million and $377 million, respectively, through open market transactions. The repurchases were funded using cash on hand. As of June 30, 2011, the Company had remaining authorization of $518 million for future repurchases of its common stock. The stock repurchases were recorded in a separate account at cost, which was reported as a reduction in equity.

NOTE 8. STOCK-BASED COMPENSATION

The Company has various incentive plans under which unit awards, stock options, performance based restricted stock units (PRSUs), time based restricted stock units (RSUs), and stock appreciation rights (SARs) have been issued. The Company does not intend to grant additional unit awards or SARs, which are cash-settled, except as may be required by contract or to employees in countries in which stock options, PRSUs, or RSUs are not permitted. The vesting and service requirements of stock-based awards granted during the six months ended June 30, 2011 were consistent with the arrangements disclosed in the 2010 Form 10-K.

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Stock-Based Compensation Expense

Stock-based compensation expense was as follows (in millions).

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Unit awards	$ 18	$ 39	$ 21	$ 63
Stock options	8	8	18	15
PRSUs and RSUs	6	2	10	3
Other		1		13
Total stock-based compensation expense	$ 32	$ 50	$ 49	$ 94
Tax benefit recognized	$ 12	$ 20	$ 18	$ 35

Compensation expense for all awards was recorded in Selling, general and administrative expense on the Consolidated Statements of Operations. As of June 30, 2011 and December 31, 2010, the Company recorded total liabilities of $52 million and $125 million, respectively, for cash-settled awards.

Stock-Based Award Activity

Unit Awards

Unit award activity for the six months ended June 30, 2011 was as follows (in millions, except years).

	Unit Awards	Weighted-Average Grant Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2010	8.8	$ 21.98	0.79	$ 198
Granted	2.3	$ 41.17		
Settled	(3.7)	$ 18.95		$ 91
Forfeited	(0.1)	$ 21.46		
Outstanding as of June 30, 2011	7.3	$ 29.54	1.19	$ 93
Vested and expected to vest as of June 30, 2011	6.9	$ 29.47	1.18	$ 88
Vested and unpaid as of June 30, 2011	0.5	$ 21.77		$ 12

Unit awards represent the contingent right to receive a cash payment for the amount by which the vesting price exceeds the grant price. The weighted-average grant price of unit awards granted during the six months ended June 30, 2011 was $41.17 per unit award. Because unit awards are cash-settled, the Company remeasures the fair value and compensation expense of outstanding unit awards as of the last day of the most recent fiscal period, until settlement. The weighted-average fair value of unit awards outstanding as of June 30, 2011 was $15.64 per unit award. The Company made cash payments totaling $91 million and $67 million during the six months ended June 30, 2011 and 2010, respectively, to settle vested unit awards. As of June 30, 2011, there was $58 million of unrecognized compensation cost, net of estimated forfeitures, related to unit awards, which is expected to be recognized over a weighted-average period of 2.04 years.

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Stock Options

Stock option activity for the six months ended June 30, 2011 was as follows (in millions, except years).

	Stock Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2010	15.7	$ 19.26	5.21	$ 350
Granted	1.2	$ 39.14		
Exercised	(2.3)	$ 16.54		$ 62
Forfeited	(0.4)	$ 22.41		
Outstanding as of June 30, 2011	14.2	$ 21.27	5.35	$ 280
Vested and expected to vest as of June 30, 2011	13.8	$ 21.16	5.45	$ 272
Exercisable as of June 30, 2011	4.1	$ 17.16	5.20	$ 98

The weighted-average exercise price and weighted-average grant date fair value of stock options granted during the six months ended June 30, 2011 were $39.14 and $14.45, respectively, per option. The Company received cash payments totaling $38 million and $15 million during the six months ended June 30, 2011 and 2010, respectively, from the exercise of stock options. As of June 30, 2011, there was $63 million of unrecognized compensation cost, net of expected forfeitures, related to stock options, which is expected to be recognized over a weighted-average period of 1.72 years.

PRSUs and RSUs

PRSU and RSU activity for the six months ended June 30, 2011 was as follows (in millions, except years).

	PRSUs and RSUs	Weighted-Average Grant Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Fair Value
Outstanding as of December 31, 2010	1.5	$ 32.66	2.29	$ 61
Granted	1.0	$ 38.86		
Converted		$		$
Forfeited		$		
Outstanding as of June 30, 2011	2.5	$ 35.24	2.27	$ 99
Vested and expected to vest as of June 30, 2011	2.0	$ 34.99	2.25	$ 83

PRSUs represent the contingent right to receive shares of the Company s Series A common stock based on continuous service and whether the Company achieves certain operating performance targets. During the six months ended June 30, 2011, the Company granted 0.7 million PRSUs with a weighted-average grant date fair value of $38.78 per PRSU. As of June 30, 2011, there was $33 million of unrecognized compensation cost, net of expected forfeitures, related to PRSUs, which is expected to be recognized over a weighted-average period of 2.0 years based on the Company s current probability assessment of the PRSUs that will vest, which may differ from actual results.

RSUs represent the contingent right to receive shares of the Company s Series A common stock based on continuous service. During the six months ended June 30, 2011, the Company granted 0.3 million RSUs with a weighted-average grant date fair value of $39.01 per RSU. As of June 30, 2011, there was $18 million of unrecognized compensation cost, net of expected forfeitures, related to RSUs, which is expected to be recognized over a weighted-average period of 2.77 years.

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SARs

There were immaterial amounts of SARs outstanding as of June 30, 2011 and December 31, 2010. The Company made cash payments totaling $1 million and $54 million during the six months ended June 30, 2011 and 2010, respectively, to settle exercised SARs.

NOTE 9. INCOME TAXES

The Company s provisions for income taxes were $144 million and $41 million, and the effective tax rates were 36% and 27% for the three months ended June 30, 2011 and 2010, respectively. The effective tax rate for the three months ended June 30, 2011 differed from the U.S. federal statutory income tax rate of 35% due primarily to state taxes partially offset by production activity deductions. The effective tax rate for the three months ended June 30, 2010 differed from the U.S. federal statutory income tax rate of 35% due primarily to a production activity deduction and a $13 million tax benefit for a change in the Company s election to claim foreign tax credits that were previously taken as deductions, which were partially offset by state taxes.

The Company s provisions for income taxes were $290 million and $88 million, and the effective tax rates were 34% and 24% for the six months ended June 30, 2011 and 2010, respectively. The effective tax rate for the six months ended June 30, 2011 differed from the U.S. federal statutory income tax rate of 35% principally because the Company did not record a deferred tax liability of $21 million with respect to the portion of the outside basis in the OWN joint venture attributable to the nondeductible goodwill contributed to OWN and production activity deductions. These items were partially offset by state taxes. The effective tax rate for the six months ended June 30, 2010 differed from the U.S. federal statutory income tax rate of 35% primarily due to the reversal of a $28 million previously established foreign tax reserve recorded in connection with the completion of a tax audit, production activity deductions and a $13 million tax expense reduction for a change in the Company s election to claim foreign tax credits that were previously taken as deductions, which were partially offset by state taxes.

The Company is currently under examination by the Internal Revenue Service (IRS) for its 2009 and 2008 consolidated federal income tax returns. With few exceptions, the Company is no longer subject to audit by the IRS, state tax authorities, or foreign tax authorities for years prior to 2006. Certain of the Company s subsidiaries are currently under examination for the 2006 and 2007 tax years. The Company does not expect any material adjustments.

NOTE 10. NET INCOME PER SHARE

The following table presents a reconciliation of income and weighted average number of shares outstanding between basic and diluted income per share (in millions, except per share amounts).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Numerator:				
Net income	$ 254	$ 110	$ 559	$ 283
Less net income attributable to noncontrolling interests		(3)		(7)
Net income attributable to Discovery Communications, Inc.	254	107	559	276
Stock dividends to preferred interests		(1)		(1)
Net income available to Discovery Communications, Inc. stockholders basic and diluted	$ 254	$ 106	$ 559	$ 275

Denominator:				
Weighted average shares outstanding basic	406	426	407	425
Weighted average dilutive effect of equity awards	4	5	5	5
Weighted average shares outstanding diluted	410	431	412	430
Net income per share available to Discovery Communications, Inc. stockholders:				
Basic	$ 0.63	$ 0.25	$ 1.37	$ 0.65
Diluted	$ 0.62	$ 0.25	$ 1.36	$ 0.64

DISCOVERY COMMUNICATIONS, INC.

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Basic income per share is calculated by dividing Net income available to Discovery Communications, Inc. stockholders by the weighted average number of shares outstanding. Diluted income per share adjusts basic income per share for the dilutive effect for the assumed exercise of outstanding stock options and stock-settled SARs and the vesting of outstanding service based RSUs, using the treasury stock method. Diluted income per share also adjusts basic income per share for the dilutive effect for the assumed vesting of outstanding PRSUs or other contingently issuable shares that would be issued under the respective arrangements assuming the last day of the most recent fiscal period was the end of the contingency period.

The weighted average number of shares outstanding for the three and six months ended June 30, 2011 and 2010 included the Company s outstanding Series A, Series B, and Series C common shares, as well as its outstanding Series A and Series C convertible preferred shares. All series of the Company s common and preferred shares were included in the weighted average number of shares outstanding when calculating both basic and diluted income per share as the holder of each common and preferred series legally participates equally in any per share distributions.

For both the three and six months ended June 30, 2011, diluted income per share excluded three million options, PRSUs, and contingently issuable preferred shares, because their inclusion would have been anti-dilutive or specific criteria had not yet been achieved.

Diluted income per share for both the three and six months ended June 30, 2010 excluded five million options, PRSUs, and contingently issuable preferred shares, because their inclusion would have been anti-dilutive or specific criteria had not yet been achieved.

NOTE 11. SUPPLEMENTAL DISCLOSURES

Other Income (Expense), Net

Other income (expense), net consisted of the following (in millions).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Unrealized (losses) gains on derivative instruments, net	$ (1)	$ 6	$ 2	$ 5
Realized losses on derivative instruments, net		(33)	(2)	(33)
Earnings (losses) from equity investees, net	3	(10)	(8)	(17)
Other, net			3	4
Total other income (expense), net	$ 2	$ (37)	$ (5)	$ (41)

NOTE 12. RELATED PARTY TRANSACTIONS

The following is a description of the Company s related parties.

DIRECTV, Liberty Global, Inc., Liberty Media Corporation, and Ascent Media Corporation

The Company s Board of Directors includes two members who served as directors of DIRECTV through June 16, 2010, including John C. Malone, the former Chairman of the Board of DIRECTV. Prior to June 16, 2010, Dr. Malone owned approximately 24% of the aggregate voting power of DIRECTV. Effective June 16, 2010, Dr. Malone converted his Class B common stock into DIRECTV Class A common stock, which reduced his voting interest to 3% of DIRECTV, and Dr. Malone and the other member of the Company s Board of Directors who served as a DIRECTV director resigned from the DIRECTV Board. Through June 16, 2010,

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transactions with DIRECTV are reported as related party transactions. Revenues from transactions with DIRECTV were $50 million, or 5% of total revenues, and $104 million, or 6%, of total revenues, for the three and six months ended June 30, 2010. Expenses from transactions with DIRECTV were not material for the three and six months ended June 30, 2010.

Discovery s Board also includes three members who serve as directors of Liberty Global, Inc. (Liberty Global), including Dr. Malone, who is Chairman of the Board of Liberty Global, and three members who serve as directors of Liberty Media Corporation (Liberty Media), also including Dr. Malone, the Chairman of the Board of Liberty Media. Dr. Malone beneficially owns shares representing approximately 42% of the aggregate voting power of Liberty Global and 34% of the aggregate voting power of Liberty Media.

Revenues from transactions with both Liberty Global and Liberty Media totaled $9 million, or 1% of total revenues, and $7 million, or 1% of total revenues, for the three months ended June 30, 2011 and 2010, respectively. Revenues from transactions with both Liberty Global and Liberty Media totaled $18 million, or 1% of total revenues, and $14 million, or 1% of total revenues, for the six months ended June 30, 2011 and 2010, respectively. Expenses from transactions with both Liberty Global and Liberty Media for three and six months ended June 30, 2011 and 2010 were not material. The Company s Receivables, net balances included insignificant amounts due from both Liberty Global and Liberty Media as of June 30, 2011 and December 31, 2010.

Effective January 25, 2010, Dr. Malone joined the Board of Directors of Ascent Media Corporation (AMC). Dr. Malone owns 1% of AMC s Series A common stock and 85% of AMC s Series B common stock, effectively providing him voting equity securities representing approximately 30% of the voting power with respect to the general election of AMC directors.

Beginning January 25, 2010, transactions with AMC are reported as related party transactions as a result of Dr. Malone joining AMC s board. Operating expenses from transactions with AMC were $4 million, or 1% of total operating expenses for the three months ended June 30, 2011 and 2010. Operating expenses from transactions with AMC were $8 million, or 1% of total operating expenses, and $14 million, or 1% of total operating expenses, for the six months ended June 30, 2011 and 2010, respectively. Payable balances as of the periods ended June 30, 2011 and December 31, 2010 and revenues from transactions with AMC for the three and six months ended June 30, 2011 and 2010 were not material.

Dr. Malone serves as a director on Discovery s board and owns shares representing approximately 23% of the aggregate general voting power of Discovery s outstanding stock. At this time, Dr. Malone also controls approximately 31% of the Company s aggregate voting power relating to the election of the eight common stock directors, as the preferred stock held by the Advance/Newhouse Programming Partnership has not been converted into shares of Discovery s common stock.

As a result of this common directorship and ownership, transactions with Liberty Global, Liberty Media, AMC, their respective subsidiaries and equity method investees, and with DIRECTV through June 2010, are related party transactions. The majority of the amounts received under contractual arrangements with DIRECTV, Liberty Global, and Liberty Media entities relates to multi-year network distribution arrangements. Revenues under these arrangements include annual rate increases and are based on the number of subscribers receiving the related programming. AMC provides services, such as satellite uplink, systems integration, origination, and postproduction to Discovery.

Other Related Parties

Other related parties primarily include unconsolidated equity method investees, including unconsolidated VIEs described in Note 3. The Company provides equity method investees with content and services such as distribution, licensing, sales, and administrative support. Revenues from other related parties were $24 million, or 2% of total revenues, and $16 million, or 2% of total revenues, for the three months ended June 30, 2011 and 2010, respectively. Revenues from other related parties were $45 million, or 2% of total revenues, and $25 million, or 1% of total revenues, for the six months ended June 30, 2011 and 2010, respectively. Operating expenses for services acquired from other related parties were $3 million, or 1% of total operating expenses, for the three months ended June 30, 2011 and 2010. Operating expenses for services acquired from other related parties were $7 million, or 1% of total operating expenses, and $6 million, or 1% of total operating expenses, for the six months ended June 30, 2011 and 2010, respectively. The Company s Receivables, net balances include $15 million and $9 million due from the Company s other related parties as of June 30, 2011 and December 31, 2010, respectively.

The Company s Investments balance includes notes receivable, net of earnings and losses absorbed from equity method investees. See Note 3 for further discussion. The Company records interest earnings from loans to joint ventures as a component of Earnings (losses) from equity investees, which is a component of Other Income (Expense), Net. Interest earnings recorded totaled $4 million and $8 million for the three and six months ended June 30, 2011. Interest earnings recorded totaled $1 million and $2 million for the three and six months ended June 30, 2010.

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NOTE 13. COMMITMENTS, CONTINGENCIES, AND GUARANTEES

Commitments

In the normal course of business, the Company enters into various commitments, which primarily include arrangements for the purchase of programming and talent, operating and capital lease arrangements for the use of equipment and facilities, employment contracts, sponsorship commitments, arrangements to purchase various goods and services consumed in the normal course of business, future funding commitments to joint ventures (Note 3), and the obligation to issue additional preferred shares under the anti-dilution provisions of its outstanding preferred stock. Most commitments are payable over several years.

Contingencies

Put Right

Harpo has the right to require the Company to purchase its interest in OWN for fair value at various dates (Note 3). No amounts have been recorded for put right obligations.

Legal Matters

In the normal course of business, the Company experiences routine claims and legal proceedings. It is the opinion of the Company s management, based on information available at this time, that none of the current claims and proceedings will have a material adverse effect on the Company s consolidated financial position, results of operations, or cash flows.

Guarantees

The Company has guaranteed a certain level of operating performance for The Hub joint venture (Note 3) and payment under certain joint venture contracts. There were no material amounts for guarantees to joint ventures recorded as of June 30, 2011 and December 31, 2010.

The Company may provide or receive indemnities intended to allocate certain business transaction risks. Similarly, the Company may remain contingently liable for certain obligations of a divested business in the event that a third party does not fulfill its obligations under an indemnification obligation. The Company records a liability for its indemnification obligations and other contingent liabilities when probable. There were no material amounts for indemnifications or other contingencies recorded as of June 30, 2011 and December 31, 2010.

NOTE 14. REPORTABLE SEGMENTS

The Company s reportable segments are determined based on (i) financial information reviewed by its chief operating decision maker (CODM), the Chief Executive Officer, (ii) internal management and related reporting structure, and (iii) the basis upon which the CODM makes resource allocation decisions.

The accounting policies of the reportable segments are the same as the Company s, except that certain inter-segment transactions that are eliminated at the consolidated level are not eliminated at the segment level as they are treated as third-party sales transactions. Inter-segment transactions, which primarily include the purchase of advertising and content between segments, were not significant for the periods presented.

The Company evaluates the operating performance of its segments based on financial measures such as revenues and adjusted operating income before depreciation and amortization (Adjusted OIBDA). Adjusted OIBDA is defined as revenues less costs of revenues and selling, general and administrative expenses excluding: (i) mark-to-market stock-based compensation, (ii) depreciation and amortization, (iii) amortization of deferred launch incentives, (iv) exit and restructuring charges, (v) certain impairment charges, and (vi) gains (losses) on business and asset dispositions. The Company uses this measure to assess the operating results and performance of its segments, perform analytical comparisons, identify strategies to improve performance, and allocate resources to each segment. The Company believes Adjusted OIBDA is relevant to investors because it allows them to analyze the operating performance of each segment using the same metric management uses and also provides investors a measure to analyze the operating

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performance of each segment against historical data. The Company excludes mark-to-market stock-based compensation, exit and restructuring charges, certain impairment charges, and gains (losses) on business and asset dispositions from the calculation of Adjusted OIBDA due to their volatility or non-recurring nature. The Company also excludes depreciation of fixed assets and amortization of intangible assets and deferred launch incentives as these amounts do not represent cash payments in the current reporting period. Adjusted OIBDA should be considered in addition to, but not a substitute for, operating income, net income, cash flows provided by operating activities, and other measures of financial performance reported in accordance with GAAP.

The following tables present summarized financial information for each of the Company s reportable segments (in millions).

Revenues by Segment

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
U.S. Networks	$ 660	$ 620	$ 1,247	$ 1,166
International Networks	368	306	691	589
Education and Other	39	33	80	70
Corporate and inter-segment eliminations		4		7
Total revenues	$ 1,067	$ 963	$ 2,018	$ 1,832

Adjusted OIBDA by Segment

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
U.S. Networks	$ 395	$ 379	$ 729	$ 672
International Networks	173	132	317	254
Education and Other	5	1	13	6
Corporate and inter-segment eliminations	(63)	(57)	(122)	(112)
Total adjusted OIBDA	$ 510	$ 455	$ 937	$ 820

Reconciliation of Total Adjusted OIBDA to Consolidated Operating Income

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Total Adjusted OIBDA	$ 510	$ 455	$ 937	$ 820
Amortization of deferred launch incentives	(12)	(10)	(26)	(21)
Mark-to-market stock-based compensation	(19)	(40)	(23)	(76)
Depreciation and amortization	(30)	(33)	(60)	(66)
Restructuring charges	(4)		(5)	(3)
Gains on dispositions			129	

Total operating income	$ 445	$ 372	$ 952	$ 654

Total Assets by Segment

	June 30, 2011	December 31, 2010
U.S. Networks	$ 2,603	$ 2,218
International Networks	1,194	1,127
Education and Other	63	74
Corporate and inter-segment eliminations	7,976	7,600
Total assets	$ 11,836	$ 11,019

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Total assets allocated to Corporate in the table above include the Company s goodwill balance as the financial information reviewed by the Company s CODM does not include an allocation of goodwill to each reportable segment.

NOTE 15. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

Overview

The Senior Notes outstanding as of June 30, 2011 and December 31, 2010 (Note 6) have been issued by DCL, a wholly-owned subsidiary of the Company, pursuant to a Registration Statement on Form S-3 filed with the SEC on June 17, 2009 (the Shelf Registration). The Company fully and unconditionally guarantees the Senior Notes on an unsecured basis. The Company, DCL, and/or Discovery Communications Holding, LLC (DCH), a wholly-owned subsidiary of the Company (collectively the Issuers), may issue additional debt securities under the Shelf Registration that are fully and unconditionally guaranteed by the other Issuers.

Set forth below are condensed consolidating financial statements presenting the financial position, results of operations, and cash flows of (i) the Company, (ii) DCH, (iii) DCL, (iv) the non-guarantor subsidiaries of DCL on a combined basis, (v) the other non-guarantor subsidiaries of the Company on a combined basis, and (vi) reclassifications and eliminations necessary to arrive at the consolidated financial statement balances for the Company. DCL and the non-guarantor subsidiaries of DCL are the primary operating subsidiaries of the Company. DCL primarily includes the Discovery Channel and TLC networks in the U.S. The non-guarantor subsidiaries of DCL include the Animal Planet network and substantially all of the Company s other U.S. and international networks, education businesses, and most of the Company s websites and other digital media services. The non-guarantor subsidiaries of DCL are wholly-owned subsidiaries of DCL with the exception of certain equity method investments. DCL is a wholly-owned subsidiary of DCH. The Company wholly owns DCH through a 33 1/3% direct ownership interest and a 66 2/3% indirect ownership interest through Discovery Holding Company (DHC), a wholly-owned subsidiary of the Company. DHC is included in the other non-guarantor subsidiaries of the Company.

Basis of Presentation

Solely for purposes of presenting the condensed consolidating financial statements, investments in the Company s subsidiaries have been accounted for by their respective parent company using the equity method. Accordingly, in the following condensed consolidating financial statements the equity method has been applied to (i) the Company s interests in DCH and the other non-guarantor subsidiaries of the Company, (ii) DCH s interest in DCL, and (iii) DCL s interests in the non-guarantor subsidiaries of DCL. Inter-company accounts and transactions have been eliminated to arrive at the consolidated financial statement amounts for the Company. The Company s accounting bases in all subsidiaries, including goodwill and recognized intangible assets, have been pushed-down to the applicable subsidiaries.

All direct and indirect subsidiaries are included in the Company s consolidated U.S. tax return. In the condensed consolidating financial statements, tax expense related to permanent differences has been allocated to the entity that created the difference, while tax expense related to temporary differences has been allocated to each entity based on each entity s pretax income relative to consolidated pretax income. Deferred taxes of the Company, DCL, and the non-guarantor subsidiaries have been allocated based upon the temporary differences between the carrying amounts of the respective assets and liabilities of the applicable entities.

As of June 30, 2011 and December 31, 2010, the cash and cash equivalents of the non-guarantor subsidiaries of DCL included $1 million and $12 million, respectively, of cash related to a consolidated joint venture that is only available for use by the joint venture.

The condensed consolidating financial statements should be read in conjunction with the consolidated financial statements of the Company.

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DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Condensed Consolidating Balance Sheet

June 30, 2011

(in millions)

	Discovery	DCH	DCL	Non-Guarantor Subsidiaries of DCL	Other Non-Guarantor Subsidiaries of Discovery	Reclassifications and Eliminations	Discovery and Subsidiaries
ASSETS							
Current assets:							
Cash and cash equivalents	$	$	$ 1,000	$ 92	$ 3	$	$ 1,095
Receivables, net			412	486	12	(2)	908
Content rights, net			13	80			93
Prepaid expenses and other current assets	17		119	88	1		225
Total current assets	17		1,544	746	16	(2)	2,321
Investment in and advances to subsidiaries	8,874	6,481	4,539		6,700	(26,594)	
Noncurrent content rights, net			594	716			1,310
Goodwill			3,767	2,535			6,302
Other noncurrent assets		20	859	1,038	6	(20)	1,903
Total assets	$ 8,891	$ 6,501	$ 11,303	$ 5,035	$ 6,722	$ (26,616)	$ 11,836
LIABILITIES AND EQUITY							
Current liabilities:							
Accounts payable and accrued liabilities	$ 11	$ 3	$ 197	$ 198	$ 5	$ (2)	$ 412
Current portion of long-term debt			6	16			22
Other current liabilities			77	102	1		180
Total current liabilities	11	3	280	316	6	(2)	614
Long-term debt			4,156	79			4,235
Other noncurrent liabilities			386	100	7	(20)	473
Inter-company contributions and advances between Discovery Communications, Inc. and subsidiaries	2,367	1,585	(212)	4,651	967	(9,358)	
Equity (deficit) attributable to Discovery Communications, Inc.	6,513	4,913	6,693	(111)	5,742	(17,237)	6,513
Equity and advances attributable to Discovery Communications, Inc.	8,880	6,498	6,481	4,540	6,709	(26,595)	6,513
Noncontrolling interests						1	1

Total equity	8,880	6,498	6,481	4,540	6,709	(26,594)	6,514
Total liabilities and equity	$ 8,891	$ 6,501	$ 11,303	$ 5,035	$ 6,722	$ (26,616)	$ 11,836

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DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Condensed Consolidating Balance Sheet

December 31, 2010

(in millions)

	Discovery	DCH	DCL	Non-Guarantor Subsidiaries of DCL	Other Non-Guarantor Subsidiaries of Discovery	Reclassifications and Eliminations	Discovery and Subsidiaries
ASSETS							
Current assets:							
Cash and cash equivalents	$	$	$ 369	$ 93	$ 4	$	$ 466
Receivables, net			391	476	13		880
Content rights, net			8	75			83
Prepaid expenses and other current assets	109	3	105	89	1	(1)	306
Total current assets	109	3	873	733	18	(1)	1,735
Investment in and advances to subsidiaries	8,530	6,091	4,129		6,484	(25,234)	
Noncurrent content rights, net			557	688			1,245
Goodwill			3,876	2,558			6,434
Other noncurrent assets		12	872	726	7	(12)	1,605
Total assets	$ 8,639	$ 6,106	$ 10,307	$ 4,705	$		