Discovery Communications, Inc.
Form 10-Q
July 30, 2013

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 June 30, 2013

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 (State or other jurisdiction of incorporation or organization)	35-2333914 (I.R.S. Employer Identification No.)
One Discovery Place Silver Spring, Maryland (Address of principal executive offices)	20910 (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 July 23, 2013:

Series A Common Stock, par value $0.01 per share	147,220,400
Series B Common Stock, par value $0.01 per share	6,546,237
Series C Common Stock, par value $0.01 per share	89,256,557

DISCOVERY COMMUNICATIONS, INC.
FORM 10-Q
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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, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$375	$1,201
Receivables, net	1,332	1,130
Content rights, net	214	122
Deferred income taxes	75	74
Prepaid expenses and other current assets	269	203
Total current assets	2,265	2,730
Noncurrent content rights, net	1,781	1,555
Property and equipment, net	460	388
Goodwill	7,278	6,399
Intangible assets, net	1,618	611
Equity method investments	1,097	1,095
Other noncurrent assets	188	152
Total assets	$14,687	$12,930
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$116	$71
Accrued expenses and other current liabilities	741	721
Deferred revenues	122	123
Current portion of long-term debt	23	31
Total current liabilities	1,002	946
Long-term debt	6,455	5,212
Deferred income taxes	656	272
Other noncurrent liabilities	270	207
Total liabilities	8,383	6,637
Commitments and contingencies (Note 15)		
Redeemable noncontrolling interest	31	—
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; 44 and 49 shares issued	1	1
Series A common stock: $0.01 par value; 1,700 shares authorized; 149 and 147 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; 150 shares issued	2	2
Additional paid-in capital	6,758	6,689
Treasury stock, at cost	(2,747)	(2,482)
Retained earnings	2,349	2,075
Accumulated other comprehensive (loss) income	(96)	4

Total Discovery Communications, Inc. stockholders’ equity	6,269	6,291
Noncontrolling interest	4	2
Total equity	6,273	6,293
Total liabilities and equity	$14,687	$12,930

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,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenues:				
Distribution	$662	$540	$1,245	$1,116
Advertising	749	534	1,257	987
Other	56	52	121	108
Total revenues	1,467	1,126	2,623	2,211
Costs and expenses:				
Costs of revenues, excluding depreciation and amortization	437	298	779	594
Selling, general and administrative	379	307	746	618
Depreciation and amortization	78	31	110	60
Restructuring charges	9	2	10	3
Total costs and expenses	903	638	1,645	1,275
Operating income	564	488	978	936
Interest expense	(80)	(61)	(148)	(116)
Losses from equity investees, net	(7)	(6)	(9)	(54)
Other income (expense), net	4	—	37	(2)
Income from continuing operations before income taxes	481	421	858	764
Provision for income taxes	(181)	(127)	(327)	(247)
Income from continuing operations, net of taxes	300	294	531	517
Loss from discontinued operations, net of taxes	—	(1)	—	(2)
Net income	300	293	531	515
Net income attributable to noncontrolling interests	—	—	—	(1)
Net income available to Discovery Communications, Inc. stockholders	$300	$293	$531	$514
Basic earnings per share available to Discovery Communications, Inc. stockholders:				
Continuing operations	$0.83	$0.77	$1.47	$1.35
Discontinued operations	$—	$—	$—	$(0.01)
Net income	$0.83	$0.77	$1.47	$1.34
Diluted earnings per share available to Discovery Communications, Inc. stockholders:				
Continuing operations	$0.82	$0.77	$1.45	$1.33
Discontinued operations	$—	$—	$—	$(0.01)
Net income	$0.82	$0.76	$1.45	$1.33
Weighted average shares outstanding:				
Basic	359	381	361	383
Diluted	363	384	365	387

Income per share amounts may not sum as each is calculated independently.
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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income	$300	$293	$531	$515
Other comprehensive (loss) income, net of tax:				
Currency translation adjustments	(48)	(10)	(107)	1
Derivative and market value adjustments	2	(1)	6	(1)
Comprehensive income	254	282	430	515
Comprehensive income attributable to noncontrolling interests	—	—	—	(1)
Comprehensive loss attributable to redeemable noncontrolling interests	1	—	1	—
Comprehensive income attributable to Discovery Communications, Inc. stockholders	$255	$282	$431	$514

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

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

	Six Months Ended June 30,	
	2013	2012
Operating Activities		
Net income	$531	$515
Adjustments to reconcile net income to cash provided by operating activities:		
Equity-based compensation expense	84	72
Depreciation and amortization	110	61
Content amortization and impairment expense	542	421
Remeasurement gain on previously held equity interest	(92)	—
Equity in losses and distributions from investee companies	13	67
Deferred income tax expense (benefit)	139	(71)
Other, net	83	18
Changes in operating assets and liabilities:		
Receivables, net	(90)	(109)
Content rights	(680)	(528)
Accounts payable and accrued liabilities	(83)	(11)
Equity-based compensation liabilities	(61)	(37)
Income tax receivable	9	19
Other, net	(35)	(28)
Cash provided by operating activities	470	389
Investing Activities		
Purchases of property and equipment	(54)	(24)
Business acquisitions, net of cash acquired	(1,832)	(20)
Investments in foreign exchange contracts	(55)	—
Distribution from equity method investee	4	17
Investments in and advances to equity method investees	(26)	(87)
Other investing activities, net	(1)	—
Cash used in investing activities	(1,964)	(114)
Financing Activities		
Borrowings from long term debt, net of discount and issuance costs	1,186	983
Principal repayments of capital lease obligations	(17)	(13)
Repurchases of common stock	(265)	(692)
Repurchases of preferred stock	(256)	—
Tax settlements associated with equity-based plans	(22)	(3)
Proceeds from issuance of common stock in connection with equity-based plans	31	70
Excess tax benefits from equity-based compensation	26	33
Other financing activities, net	(3)	(2)
Cash provided by financing activities	680	376
Effect of exchange rate changes on cash and cash equivalents	(12)	(1)
Net change in cash and cash equivalents	(826)	650
Cash and cash equivalents, beginning of period	1,201	1,048
Cash and cash equivalents, end of period	$375	$1,698

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

	Six Months Ended June 30,	
	2013	2012
Supplemental Cash Flow Information		
Cash paid for taxes, net	$ (149)	$ (166)
Cash paid for interest	$ (142)	$ (119)
Noncash Investing and Financing Transactions		
Investment in OWN	$ —	$ 7
Assets acquired under capital lease arrangements	$ 54	$ 3

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

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

	Three Months Ended June 30, 2013			Three Months Ended June 30, 2012		
	Discovery Stockholders	Noncontrolling Interests	Total Equity	Discovery Stockholders	Noncontrolling Interests	Total Equity
Beginning balance	$6,240	$ 2	$6,242	$6,565	$ 3	$6,568
Comprehensive income	255	—	255	282	—	282
Equity-based compensation	14	—	14	14	—	14
Issuance of common stock in connection with equity-based plans	15	—	15	11	—	11
Excess tax benefits from equity-based compensation	13	—	13	3	—	3
Repurchases of common stock	(265)	—	(265)	(404)	—	(404)
Adjustment of redeemable noncontrolling interest to redemption value	(3)	—	(3)	—	—	—
Noncontrolling interests of acquired businesses	—	2	2	—	—	—
Cash distributions to noncontrolling interests	—	—	—	—	(1)	(1)
Ending balance	$6,269	$ 4	$6,273	$6,471	$ 2	$6,473

	Six Months Ended June 30, 2013			Six Months Ended June 30, 2012		
	Discovery Stockholders	Noncontrolling Interests	Total Equity	Discovery Stockholders	Noncontrolling Interests	Total Equity
Beginning balance	$6,291	$ 2	$6,293	$6,517	$ 2	$6,519
Comprehensive income	431	—	431	514	1	515
Equity-based compensation	34	—	34	32	—	32
Issuance of common stock in connection with equity-based plans	31	—	31	70	—	70
Excess tax benefits from equity-based compensation	26	—	26	33	—	33
Tax settlements associated with equity-based plans	(22)	—	(22)	(3)	—	(3)
Repurchases of preferred and common stock	(521)	—	(521)	(692)	—	(692)
Adjustment of redeemable noncontrolling interest to redemption value	(1)	—	(1)	—	—	—
Noncontrolling interests of acquired businesses	—	2	2	—	—	—
Cash distributions to noncontrolling interests	—	—	—	—	(1)	(1)

Ending balance	$6,269	$ 4	$6,273	$6,471	$ 2	$6,473

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 distribution platforms, including through digital distribution arrangements. The Company also develops and sells curriculum-based education products and services. The Company classifies its operations in three segments: U.S. Networks, consisting of domestic television networks, websites, and digital distribution arrangements; International Networks, consisting of international television networks, radio and websites; and Education, consisting of educational curriculum-based product and service offerings. 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. Inter-company accounts and transactions between consolidated entities have been eliminated in consolidation.

Reclassifications

Beginning January 1, 2013, the Company reclassified losses from equity method investees, net from other expense, net to a separate line on the consolidated statement of operations for all periods presented.

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 Amendment No. 1 to Discovery's Annual Report on Form 10-K for the year ended December 31, 2012 (the "2012 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 assessments could change. Actual results may differ from those estimates.

Significant 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

Offsetting Assets and Liabilities

In January 2011, the Financial Accounting Standards Board ("FASB") issued guidance expanding the disclosure requirements for financial instruments that are offset in the balance sheet or subject to a master netting arrangement or similar agreement. In January 2013, the FASB issued additional guidance clarifying that the scope of the guidance applies only to derivatives, repurchase agreements and reverse purchase agreements, and securities borrowing and securities lending transactions. The adoption of the new guidance, effective January 1, 2013, did not have a material impact on the Company's financial statements. (See Note 7.)

Comprehensive Income

In January 2013, the FASB amended its guidance on the presentation of comprehensive income. Under the amended guidance, an entity must present information regarding reclassification adjustments from accumulated other comprehensive income in a single note or on the face of the financial statements. This is required for both annual and interim reporting. The Company retrospectively adopted the new guidance effective January 1, 2013 and elected to present reclassification adjustments from accumulated other comprehensive income in a single note. (See Note 9.)

Concentrations Risk

Customers

The Company has long-term contracts with distributors, including the largest distributors in the U.S. and major international distributors. For U.S. Networks, approximately 90% of the Company's distribution revenue comes from the segment's top 10 distributors. For International Networks, approximately 50% of the Company's distribution revenue comes from the segment's top 10 distributors. Agreements in place with the major cable and satellite operators in the U.S. expire at various times beginning in 2013 through 2020. 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 affiliate revenue, but it could also experience a reduction in advertising revenue which is impacted by affiliate subscriber levels.

No individual customer accounted for more than 10% of total consolidated revenues for the three and six months ended June 30, 2013 or 2012. The Company’s trade receivables do not represent a significant concentration of credit risk as of June 30, 2013 or December 31, 2012 due to the wide variety of customers and global markets in which the Company operates and their dispersion 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 on demand and are maintained with financial institutions of reputable credit and, therefore, bear minimal credit risk.

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. 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 these exposures by contracting with experienced large financial institutions and monitoring the credit quality of its lenders. As of June 30, 2013, the Company did not anticipate nonperformance by any of its counterparties.

NOTE 2. ACQUISITIONS AND DISPOSITIONS

Acquisitions

SBS Nordic

On April 9, 2013, the Company acquired the general entertainment television and radio business operations ("SBS Nordic") of Prosiebensat.1 Media AG for cash of approximately $1.8 billion (€1.4 billion) including closing purchase price adjustments. SBS Nordic has operations in Sweden, Norway, Denmark, Finland and England. The acquisition of SBS Nordic supports the Company’s strategic priority of increasing its presence in key international markets and is a component of the Company's International Networks segment.

DISCOVERY COMMUNICATIONS, INC.
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(unaudited)

The Company used discounted cash flow ("DCF") analyses, which represent Level 3 fair value measurements, to perform its preliminary purchase price allocation. The table below presents the preliminary allocation of the purchase price to the assets and liabilities acquired (in millions).

	April 9, 2013
Goodwill	$772
Intangible assets	1,001
Content	248
Other net assets acquired	203
Cash	106
Liabilities assumed	(262)
Deferred tax liabilities	(247)
Noncontrolling interests	(2)
Net assets acquired	$1,819

The goodwill reflects the workforce, synergies and increased Nordic region market penetration expected from combining the operations of SBS and the Company. The goodwill recorded as part of this acquisition is not amortizable for tax purposes. The assignment of goodwill to reporting units has not been completed as of the date of these financial statements. Intangible assets primarily consist of broadcast licenses, distribution and advertising customer relationships, advertiser backlog and television and radio trademarks with a weighted average estimated useful life of 8 years. The Company's process of identifying the assets acquired and the liabilities assumed and determining their fair values is not complete as of the date of this filing, principally with respect to intangible assets and income taxes.

Discovery Japan

On January 10, 2013, the Company purchased an additional 30% of Discovery Japan for $53 million. Discovery Japan operates Discovery Channel and Animal Planet in Japan. As of December 31, 2012, Discovery and Jupiter Telecommunications Co., Ltd ("J:COM") each owned a 50% interest in Discovery Japan, and Discovery accounted for its 50% interest using the equity method of accounting. Discovery consolidated Discovery Japan on January 10, 2013 and recognized a gain of $92 million to account for the difference between the carrying value and the fair value of the previously held 50% equity interest. The gain is included in other income (expense), net in the Company's consolidated statements of operations (see Note 13). The Company used a combination of a DCF analysis and market-based valuation methodologies, which represent Level 3 fair value measurements, to measure the fair value of Discovery Japan and to perform its preliminary purchase price allocation.

The table below presents the preliminary allocation of the purchase price to the assets and liabilities acquired (in millions).

	January 10, 2013
Goodwill	$103
Intangible assets	100
Other assets acquired	25
Currency translation adjustment	6
Cash	4
Remeasurement gain on previously held equity interest	(92)
Liabilities assumed	(55)
Redeemable noncontrolling interest	(35)

Carrying value of previously held equity interest	(3)
Net assets acquired	$53

The terms of the agreement provide J:COM with a right to put its 20% noncontrolling interest to Discovery for cash at any time and Discovery with the right to call J:COM's 20% noncontolling interest beginning January 2018. As J:COM's put right is outside the control of the Company, J:COM's 20% noncontrolling interest is presented as redeemable noncontrolling interest outside of stockholders' equity on the Company's consolidated balance sheet (see Note 8). The goodwill reflects the synergies and increased regional flexibility expected from controlling the operations of Discovery Japan and is included in the International Networks segment. The goodwill recorded as part of this acquisition is not amortizable for tax purposes. Intangible assets are primarily distribution customer relationships.

Other

On June 1, 2013, the Company, through SBS, acquired the business operations of a television station in Sweden ("TV 11") for a cash payment of $54 million. Assets acquired include goodwill and intangible assets of $41 million and $11 million, respectively.

On December 28, 2012, the Company acquired Switchover Media, a group of five Italian television channels with children's and entertainment programming. During the year ended December 31, 2012, the Company also purchased a digital media company in the U.S., a television station in Dubai, and certain affiliate agreements in Latin America. Total consideration for these businesses was $173 million, net of cash acquired, including $15 million paid during the six months ended June 30, 2013. Contingent consideration of up to $13 million may be paid if certain performance targets are achieved. During the year ended December 31, 2012, the Company recorded $108 million and $70 million of goodwill and intangible assets, respectively, in connection with these acquisitions. These business combinations have been included in the Company’s operating results since their acquisition date.

Amortization expense

Amortization expense relating to intangible assets subject to amortization beginning June 30, 2013 through each of the next four years and thereafter is estimated in the table below. The amounts represent U.S. dollar equivalents based on June 30, 2013 exchange rates (in millions).

	July 1 through December 31,	Year ending December 31,				
	2013	2014	2015	2016	2017	Thereafter
Amortizing intangibles assets owned as of December 31, 2012	$ 16	$ 31	$ 31	$ 31	$ 23	$ 298
Acquisitions completed during the six months ended June 30, 2013	92	128	109	109	109	476
Amortizing intangibles owned as of June 30, 2013[(a)]	$ 108	$ 159	$ 140	$ 140	$ 132	$ 774

(a) Assets subject to amortization beginning June 30, 2013 exclude $165 million of indefinite-lived intangible assets not subject to amortization.

The operations of acquisitions are included in the Company's consolidated financial statements as of their respective acquisition dates. (See Note 16.)

Dispositions

Postproduction Audio Business

On September 17, 2012, the Company sold its postproduction audio business, CSS Studios, LLC, and the results of the postproduction audio business have been reflected in loss from discontinued operations, net of taxes, in the consolidated statements of operations. The postproduction audio business was an operating segment combined with Education as a reportable segment.

NOTE 3. VARIABLE INTEREST ENTITIES

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. In certain instances, an investment may qualify as a variable interest entity ("VIE"). As of June 30, 2013 and December 31, 2012, the Company's VIEs primarily consisted of Hub Television Networks LLC and OWN LLC, which operate pay-television networks.

The Company accounts for its interests in VIEs using the equity method as the Company is not the primary beneficiary. The aggregate carrying values of these equity method investments were $822 million and $825 million as of June 30, 2013 and

December 31, 2012, respectively. The Company recognized losses in the consolidated statements of operations of $10 million and $13 million during the three and six months ended June 30, 2013, respectively, and $9 million and $57 million during the three and six months ended June 30, 2012, respectively, for its portion of net losses generated by VIEs.

As of June 30, 2013, the Company's estimated risk of loss for investment carrying values, unfunded contractual commitments and guarantees made on behalf of equity method investees was approximately $871 million. The estimated risk of loss excludes the Company's expected non-contractual funding of OWN and its operating performance guarantee for Hub Television Networks LLC, which is disclosed below.

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. The Company is obligated to provide The Hub with funding up to $15 million; the Company has not provided any funding as of June 30, 2013. The Company also provides The Hub distribution, sales and administrative support services for a fee (see Note 14).

Based upon the level of equity investment at risk, The Hub is a VIE. Discovery and its partner, Hasbro Inc. ("Hasbro"), share equally in voting control and jointly consent to decisions about programming and marketing strategy and thereby direct the activities of The Hub that most significantly impact its economic performance. Neither has special governance rights, and both are equally represented on the board of The Hub. The partners also share equally in the profits, losses and funding of The Hub. The Company has determined that it is not the primary beneficiary of The Hub. Accordingly, the Company accounts for its investment in The Hub using the equity method.

Through December 31, 2015, the Company has guaranteed the performance of The Hub and is required to compensate Hasbro to the extent that distribution metrics decline versus levels historically achieved by the Discovery Kids channel. This guarantee extends on a declining basis through the period of guarantee. Upon inception of The Hub on May 22, 2009, the maximum amount potentially due under this guarantee was $300 million. As of June 30, 2013, the maximum amount potentially due under this guarantee was less than $80 million. The exposure to loss is expected to decline to zero during 2014. As The Hub's distribution is obtained under long-term contracts with stable subscriber levels, the Company believes the likelihood is remote that the guaranteed performance levels will not be achieved and, therefore, believes the performance guarantee is unlikely to have an adverse impact on the Company.

The carrying value of the Company's investment in The Hub was $321 million and $322 million as of June 30, 2013 and December 31, 2012, respectively. The value of the investment may decline if future results vary negatively from the current long range plan. The Company continues to monitor the valuation of its investment in accordance with GAAP, which requires an impairment charge when there is an other-than-temporary decline in the investment's value. No impairment was recorded during the six months ended June 30, 2013.

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. Based upon the level of equity investment at risk, OWN is a VIE. While the Company and Harpo, Inc. ("Harpo") are partners who share equally in voting control, power is not shared because certain activities that significantly impact OWN's economic performance are directed by Harpo. Harpo holds operational rights related to programming and marketing, as well as selection and retention of key management personnel. 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 funding, content licenses, and distribution, sales and administrative support services for a fee (see Note 14).

The Company's combined advances to and note receivable from OWN were $509 million and $482 million, as of June 30, 2013 and December 31, 2012, respectively. During the six months ended June 30, 2013 and 2012, the Company provided OWN with net funding of $13 million and $84 million and net interest accrued on the note receivable of $14 million and $13 million, respectively. The note receivable is secured by the net assets of OWN. While the Company has no further funding commitments, the Company expects to provide additional funding to OWN, if necessary, and to recoup amounts funded. The funding to OWN accrues interest at 7.5% compounded annually. 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

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

accounting policies for equity method investments. Prior to the launch of OWN on January 1, 2011, the Company 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 to record 100% of OWN’s net losses. The Company will continue to record 100% of OWN's operating losses as long as Discovery provides all funding to OWN and OWN’s accumulated losses continue to exceed the equity contributed. All of OWN's future net income will initially be recorded by the Company until the Company recovers losses absorbed in excess of the Company's equity ownership interest.

The carrying value of the Company’s investment in OWN, including its equity method investment and note receivable balance, was $466 million and $469 million as of June 30, 2013 and December 31, 2012, respectively. Given that the early results of OWN’s operations have been below its initial business plan, there is a possibility that the results of OWN’s future operations will fall below the revised long-term projections. The Company continues to monitor the financial results of OWN along with other relevant business information to assess the recoverability of the OWN note receivable and determine whether the Company's investment in OWN has been impaired. No impairment was recorded during the six months ended June 30, 2013.

Harpo has the right to require the Company to purchase all or part of Harpo’s interest in OWN at fair market value up to a maximum put amount every two and one half years commencing January 1, 2016. The maximum put amount ranges from $100 million on the first put exercise date up to a cumulative cap of $400 million on the fourth put exercise date. The Company has recorded no amounts for the put right.

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 table below presents assets and liabilities measured at fair value on a recurring basis (in millions).

		June 30, 2013			
Category	Balance Sheet Location	Level 1	Level 2	Level 3	Total
Assets:					
Trading securities:					
Mutual funds	Prepaid expenses and other current assets	$115	$—	$—	$115
Derivatives:					
Foreign exchange	Prepaid expenses and other current assets	—	3	—	3
Foreign exchange	Other noncurrent assets	—	8	—	8
Total assets		$115	$11	$—	$126
Liabilities:					
Deferred compensation plan	Accrued expenses and other current liabilities	$115	$—	$—	$115
TF1 put right	Other noncurrent liabilities	—	—	14	14
Total liabilities		$115	$—	$14	$129

		December 31, 2012			
Category	Balance Sheet Location	Level 1	Level 2	Level 3	Total
Assets:					
Trading securities:					
Mutual funds	Prepaid expenses and other current assets	$96	$—	$—	$96
Available-for-sale securities:					
Money market mutual funds	Cash and cash equivalents	475	—	—	475
Total assets		$571	$—	$—	$571
Liabilities:					
Deferred compensation plan	Accrued expenses and other current liabilities	$96	$—	$—	$96
Derivatives:					
Foreign exchange	Accrued expenses and other current liabilities	—	2	—	2
Total liabilities		$96	$2	$—	$98

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.

Derivative financial instruments are comprised of foreign exchange contracts used by the Company to modify its exposure to market risks from foreign exchange rates. The fair value of Level 2 derivative financial instruments was determined using a market-based approach.

On December 21, 2012, the Company acquired 20% equity ownership interests in Eurosport, a European sports satellite and cable network, and in a portfolio of pay television networks from a French media company, TF1, for $264 million, including transaction costs. TF1 has the right to require the Company to purchase its remaining shares at various dates should Discovery acquire a controlling interest in Eurosport. Written puts that do not qualify for equity classification are reported at fair value and subsequently marked to fair value through earnings regardless of associated contingencies.

The fair value measurement of the TF1 put was determined through the use of a Monte Carlo simulation model.

The Monte Carlo model simulates the various sources of uncertainty impacting the value of a financial instrument and uses those simulations to develop an estimated fair value for the instrument. The valuation methodology for the TF1 put is based on unobservable estimates and judgments, and therefore represents a Level 3 fair value measurement. At both June 30, 2013 and December 31, 2012, the fair value of the TF1 put was determined to be $14 million. During the three and six months ended

June 30, 2013, there were no changes to the valuation methodology used to estimate the fair value of the TF1 put. (See Note 15.)

In addition to the financial instruments listed in the tables above, the Company holds other financial instruments, including cash deposits, 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 senior notes using quoted prices from over the counter markets, considered Level 2 inputs, was $6.6 billion and $5.9 billion as of June 30, 2013 and December 31, 2012, respectively.

NOTE 5. CONTENT RIGHTS

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

	June 30, 2013	December 31, 2012
Produced content rights:		
Completed	$2,999	$2,724
In-production	346	308
Coproduced content rights:		
Completed	580	566
In-production	93	76
Licensed content rights:		
Acquired	684	483
Prepaid	27	17
Content rights, at cost	4,729	4,174
Accumulated amortization	(2,734)	(2,497)
Total content rights, net	1,995	1,677
Current portion	(214)	(122)
Noncurrent portion	$1,781	$1,555

Content expense consists of content amortization, impairments and other production charges and is included in cost of revenues in the consolidated statements of operations. Content expense was $333 million and $589 million for the three and six months ended June 30, 2013, respectively, and $232 million and $460 million for the three and six months ended June 30, 2012, respectively. Content impairments were $8 million and $12 million for the three and six months ended June 30, 2013, respectively, and $11 million and $14 million for the three and six months ended June 30, 2012, respectively. Acquired content increased following the acquisition of SBS Nordic (see Note 2).

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NOTE 6. DEBT
The table below presents the components of outstanding debt (in millions).

	June 30, 2013	December 31, 2012
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	650
3.30% Senior Notes, semi-annual interest, due May 2022	500	500
3.25% Senior Notes, semi-annual interest, due April 2023	350	—
6.35% Senior Notes, semi-annual interest, due June 2040	850	850
4.95% Senior Notes, semi-annual interest, due May 2042	500	500
4.875% Senior Notes, semi-annual interest, due April 2043	850	—
Capital lease obligations	145	110
Total long-term debt	6,495	5,260
Unamortized discount	(17)	(17)
Long-term debt, net	6,478	5,243
Current portion of debt	(23)	(31)
Noncurrent portion of debt	$6,455	$5,212

On March 19, 2013, Discovery Communications, LLC ("DCL"), a wholly-owned subsidiary of the Company, issued $1.2 billion aggregate principal amount of senior notes consisting of $350 million aggregate principal amount of 3.25% Senior Notes due April 1, 2023 and $850 million aggregate principal amount of 4.875% Senior Notes due April 1, 2043 (the "2023 and 2043 Notes"). The proceeds received by DCL from the offering were net of a $2 million issuance discount and $12 million of deferred financing costs.

DCL has the option to redeem some or all of the 2023 and 2043 Notes at any time prior to their maturity by paying a make-whole premium plus accrued and unpaid interest, if any, through the date of repurchase. Interest on the 2023 and 2043 Notes is payable on April 1 and October 1 of each year. The 2023 and 2043 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 access to a $1.0 billion revolving credit facility. There were no amounts drawn under the revolving credit facility as of June 30, 2013 or December 31, 2012. If the Company were to draw on the revolving credit facility, outstanding balances would bear interest at a variable rate determined pursuant to the lending agreement. Balances outstanding under the revolving credit facility would be due on the expiration date which is October 12, 2017.

The revolving credit facility contains affirmative and negative covenants, including an interest coverage ratio and leverage ratio, events of default and other customary provisions. The Company was in compliance with all covenants and there were no events of default as of June 30, 2013 and December 31, 2012.

NOTE 7. DERIVATIVE FINANCIAL INSTRUMENTS
The Company may use derivative financial instruments to modify its exposure to market risks from changes in interest rates and foreign exchange rates. The Company does not enter into or hold derivative financial instruments for speculative trading purposes.

During the six months ended June 30, 2013, the Company entered into foreign exchange contracts in connection with forecasted business combinations (see Note 2). These derivatives, which economically hedged the Company's exposure to fluctuations in certain foreign currency exchange rates, did not qualify for hedge accounting and realized and unrealized losses resulting thereon were reflected in the consolidated statements of operations.

During the six months ended June 30, 2013, the Company also designated foreign currency forward contracts used to hedge anticipated distribution revenue as cash flow hedges. Gains and losses on the effective portion of designated cash flow

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hedges are initially recorded in accumulated other comprehensive (loss) income on the consolidated balance sheet and reclassified to the statement of operations when the hedged item is recognized. The Company also entered into interest rate contracts to hedge the pricing for certain senior notes (see Note 6). These derivatives qualified for hedge accounting and gains and losses from changes in fair value were recorded as a component of other comprehensive (loss) income and will be amortized into income over the life of the notes. There were no unsettled interest rate contracts held by the Company as of June 30, 2013 and December 31, 2012.

The Company records all derivative contracts on the consolidated balance sheet at fair value (see Note 4); derivatives in an asset position are classified as assets, and derivatives in a liability position are classified as liabilities. The Company's master netting agreements allow the Company to settle derivative contracts denominated in the same currency with a single counterparty on the same day on a net basis. There were no amounts eligible to be offset under master netting agreements as of June 30, 2013 and December 31, 2012.

The following table summarizes the notional amount and fair value of the Company's derivative positions as of June 30, 2013 and December 31, 2012 (in millions).

		June 30, 2013		December 31, 2012	
	Balance Sheet Location	Notional	Fair Value	Notional	Fair Value
Derivatives designated as hedges:					
Foreign exchange	Prepaid expenses and other current assets	$27	$3	$—	$—
Foreign exchange	Other noncurrent assets	$43	$8	$—	$—
Foreign exchange	Accrued expenses and other current liabilities	$16	$—	$—	$—
Derivatives not designated as hedges:					
Foreign exchange	Prepaid expenses and other current assets	$—	$—	$661	$—
Foreign exchange	Accrued expenses and other current liabilities	$—	$—	$56	$(2)

The following table presents the impact of derivative instruments on income and other comprehensive (loss) income (in millions).

		Three Months Ended June 30,		Six Months Ended June 30,	
	Comprehensive Income Location (gross of tax)	2013	2012	2013	2012
Derivatives designated as hedges:					
Foreign exchange	Other comprehensive (loss) income	$1	$—	$6	$—
Interest rate	Other comprehensive (loss) income	$—	$(2)	$—	$(2)
Derivatives not designated as hedges:					
Foreign exchange	Other income (expense), net	$3	$—	$(56)	$—

NOTE 8. REDEEMABLE NONCONTROLLING INTEREST

In connection with the acquisition of Discovery Japan on January 10, 2013, the Company recognized $35 million for the fair value of J:COM's noncontrolling interest (see Note 2). The terms of the agreement provide J:COM with a right to put all, but not less than all, of its 20% noncontrolling interest to Discovery at any time for cash. For the first four years, the settlement value is the January 10, 2013 fair value denominated in Japanese yen; thereafter, the redemption value is the greater of the then current fair value or the January 10, 2013 fair value denominated in Japanese yen.

Because J:COM's put right is outside the Company's control, J:COM's 20% noncontrolling interest is presented as redeemable noncontrolling interest outside of stockholders' equity on the Company's consolidated balance sheet. Redeemable noncontrolling interest reflected as of the balance sheet date is the greater of the noncontrolling interest balance adjusted for comprehensive income attributable to noncontrolling interest or the redemption value remeasured at the period end foreign exchange rate. Adjustments to the carrying amount of redeemable noncontrolling interest to redemption value, excluding foreign currency translation adjustments, are reflected in retained earnings. Adjustments to the carrying amount of redeemable noncontrolling interest to redemption value as a result of changes in exchange rates are reflected in currency translation adjustments, a component of other comprehensive (loss) income; however, in calculating earnings per share, such adjustments to redemption value are allocated to Discovery stockholders only.

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The table below presents the reconciliation of changes in the redeemable noncontrolling interest (in millions).

	Redeemable Noncontrolling Interest	
Balance, January 10, 2013	$35	
Comprehensive income adjustments:		
Share of translation and derivative adjustments	(1	)
Currency translation on redemption value	(4	)
Retained earnings adjustments:		
Redemption value to floor	1	
Balance, June 30, 2013	$31	

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NOTE 9. EQUITY

Stock Repurchase Program

Under the Company's stock repurchase program, management is authorized to purchase shares from time to time through open market transactions or privately negotiated transactions at prevailing prices as permitted by securities laws and other legal requirements, and subject to stock price, business and market conditions and other factors. The total authorization under the stock repurchase program is $4.0 billion. As of June 30, 2013, the Company had remaining authorization of $1.3 billion for future repurchases of its common stock under the stock repurchase program, of which $253 million and $1.0 billion will expire on April 25, 2014 and December 11, 2014, respectively. Repurchased stock is recorded in treasury stock on the consolidated balance sheet. All repurchases during the three and six months ended June 30, 2013 and 2012 were made through open market transactions and were funded using cash on hand. As of June 30, 2013, the Company had repurchased over the life of the program 2.0 million and 60.5 million shares of Series A and Series C common stock for the aggregate purchase price of $109 million and $2.6 billion, respectively.

The table below presents a summary of stock repurchases (in millions).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Series A Common Stock:				
Shares repurchased	—	0.3	—	0.3
Purchase price	$—	$15	$—	$15
Series C Common Stock:				
Shares repurchased	3.8	8.2	3.8	15.1
Purchase price	$265	$389	$265	$677
Total shares repurchased	3.8	8.5	3.8	15.4
Total purchase price	$265	$404	$265	$692

Preferred Stock Repurchase

On April 5, 2013, the Company repurchased and retired 4 million shares of its Series C convertible preferred stock from Advance Programming Holdings, LLC for an aggregate purchase price of $256 million, which was recorded as a decrease of par value of preferred stock and retained earnings. The repurchase was made outside of the Company's publicly announced stock repurchase program, using cash on hand.

Other Comprehensive Loss

The table below presents the tax effects related to each component of other comprehensive loss and reclassifications made into the consolidated statements of operations (in millions).

	Three Months Ended June 30, 2013			Three Months Ended June 30, 2012		
	Pretax	Tax Benefit (Provision)	Net-of-tax	Pretax	Tax Benefit (Provision)	Net-of-tax
Currency translation adjustments:						
Unrealized losses	$(50)	$2	$(48)	$(18)	$8	$(10)
Derivative and market value adjustments:						
Unrealized gains/(losses)	2	—	2	(2)	1	(1)
Other comprehensive loss	$(48)	$2	$(46)	$(20)	$9	$(11)

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	Six Months Ended June 30, 2013			Six Months Ended June 30, 2012		
	Pretax	Tax Benefit (Provision)	Net-of-tax	Pretax	Tax Benefit (Provision)	Net-of-tax
Currency translation adjustments						
Unrealized (losses)/gains	$(114)	$13	$(101)	$—	$1	$1
Reclassification of cumulative translation adjustments to other income (expense), net	(9)	3	(6)	—	—	—
Derivative and market value adjustments						
Unrealized gains/(losses)	9	(3)	6	(2)	1	(1)
Other comprehensive loss	$(114)	$13	$(101)	$(2)	$2	$—

Accumulated Other Comprehensive (Loss) Income

The table below presents the changes in the components of accumulated other comprehensive (loss) income, net of taxes (in millions).

	Three Months Ended June 30, 2013			Three Months Ended June 30, 2012		
	Currency Translation Adjustments	Derivative and Market Value Adjustments	Accumulated Other Comprehensive Loss	Currency Translation Adjustments	Derivative and Market Value Adjustments	Accumulated Other Comprehensive Loss
Beginning balance	$(60)	$9	$ (51)	$(18)	$6	$ (12)
Other comprehensive (loss) income before reclassifications	(48)	2	(46)	(10)	(1)	(11)
Other comprehensive (loss) income	(48)	2	(46)	(10)	(1)	(11)
Other comprehensive loss (income) attributable to redeemable noncontrolling interests	2	$(1)	1	—	—	—
Ending balance	$(106)	$10	$ (96)	$(28)	$5	$ (23)

	Six Months Ended June 30, 2013			Six Months Ended June 30, 2012		
	Currency Translation Adjustments	Derivative and Market Value Adjustments	Accumulated Other Comprehensive Income (Loss)	Currency Translation Adjustments	Derivative and Market Value Adjustments	Accumulated Other Comprehensive Loss
Beginning balance	$(1)	$5	$ 4	$(29)	$6	$ (23)
Other comprehensive (loss) income before reclassifications	(101)	6	(95)	1	(1)	—
Amount reclassified from accumulated other comprehensive income	(6)	—	(6)	—	—	—
Other comprehensive (loss) income	(107)	6	(101)	1	(1)	—

Other comprehensive loss (income) attributable to redeemable noncontrolling interests	2	(1)	1	—	—	—
Ending balance	$(106)	$10	$ (96)	$(28)	$5	$ (23)

NOTE 10. EQUITY-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. During the six months ended June 30, 2013, the vesting and service requirements of equity-based awards granted were consistent with the arrangements disclosed in the 2012 Form 10-K.

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Equity-Based Compensation Expense

The table below presents the components of equity-based compensation expense (in millions).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Unit awards	$ 4	$ 13	$ 28	$ 33
SARs	6	4	22	7
PRSUs and RSUs	9	8	21	15
Stock options	5	6	13	17
Total equity-based compensation expense	$ 24	$ 31	$ 84	$ 72
Tax benefit recognized	$ 9	$ 12	$ 32	$ 27

Compensation expense for all awards is recorded in selling, general and administrative expense in the consolidated statements of operations. As of June 30, 2013 and December 31, 2012, the Company recorded total liabilities for cash-settled awards of $68 million and $80 million, respectively.

Equity-Based Award Activity

Unit Awards

The table below presents unit award activity (in millions, except years and weighted-average grant price).

	Unit Awards	Weighted-Average Grant Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2012	3.1	$ 34.78		
Settled	(1.4)	30.84		$ 50
Outstanding as of June 30, 2013	1.7	$ 38.14	0.84	$ 64
Vested and expected to vest as of June 30, 2013	1.6	$ 38.14	0.84	$ 61

Unit awards represent the contingent right to receive a cash payment for the amount by which the vesting price of Company stock exceeds the grant price. Because unit awards are cash-settled, the Company remeasures the fair value and compensation expense of outstanding unit awards each reporting date until settlement. As of June 30, 2013, the weighted-average fair value of unit awards outstanding was $38.19 per unit award. The Company made cash payments to settle vested unit awards totaling $50 million and $36 million during the six months ended June 30, 2013 and 2012, respectively. As of June 30, 2013, there was $26 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 1.27 years.

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SARs

The table below presents SAR award activity (in millions, except years and weighted-average grant price).

	SARs	Weighted-Average Grant Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2012	1.8	$ 41.13		
Granted	1.9	65.26		
Settled	(0.5)	41.25		$ 11
Outstanding as of June 30, 2013	3.2	$ 55.15	1.88	$ 71
Vested and expected to vest as of June 30, 2013	3.0	$ 55.14	1.88	$ 67

As of June 30, 2013, the weighted-average fair value of SARs outstanding was $24.32 per award. The Company made cash payments of $11 million and $1 million to settle exercised SARs during the six months ended June 30, 2013 and 2012, respectively. As of June 30, 2013, there was $45 million of unrecognized compensation cost, net of estimated forfeitures, related to SARs, which is expected to be recognized over a weighted-average period of 1.78 years.

PRSUs and RSUs

The table below presents PRSU and RSU activity (in millions, except years and weighted-average grant price).

	PRSUs and RSUs	Weighted-Average Grant Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Fair Value
Outstanding as of December 31, 2012	2.9	$ 39.66		
Granted	0.3	75.02		
Converted	(0.7)	33.72		$ 48
Outstanding as of June 30, 2013	2.5	$ 46.19	1.51	$ 196
Vested and expected to vest as of June 30, 2013	2.3	$ 45.78	1.47	$ 180

PRSUs represent the contingent right to receive shares of the Company’s Series A common stock based on continuous service and the Company's achievement of certain operating performance targets. As of June 30, 2013, there were approximately 2 million outstanding PRSUs with a weighted-average grant price of $43.57. As of June 30, 2013, unrecognized compensation cost, net of expected forfeitures, related to PRSUs was $27 million, which is expected to be recognized over a weighted-average period of 1.25 years.

RSUs represent the contingent right to receive shares of the Company’s Series A common stock based on continuous service. As of June 30, 2013, there were approximately 1 million outstanding RSUs with a weighted-average grant price of $51.81. As of June 30, 2013, unrecognized compensation cost, net of expected forfeitures, related to RSUs was $27 million, which is expected to be recognized over a weighted-average period of 2.48 years.

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Stock Options

The table below presents stock option activity (in millions, except years and weighted-average exercise price).

	Stock Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2012	9.0	$28.53		
Granted	1.0	74.87		
Exercised	(1.2)	24.11		$63
Outstanding as of June 30, 2013	8.8	$34.38	5.12	$374
Vested and expected to vest as of June 30, 2013	8.5	$33.68	5.10	$369
Exercisable as of June 30, 2013	5.1	$23.23	4.81	$274

The Company received cash payments from the exercise of stock options totaling $28 million and $68 million during the six months ended June 30, 2013 and 2012, respectively. The weighted average grant date fair value of stock options granted during the six months ended June 30, 2013 was $24.40 per option. As of June 30, 2013, there was $47 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 1.78 years.

Employee Stock Purchase Plan

The Discovery Communications, Inc. 2011 Employee Stock Purchase Plan (the "DESPP") enables eligible employees to purchase shares of the Company’s common stock through payroll deductions or other permitted means. During the six months ended June 30, 2013 and 2012, the Company received cash totaling $3 million and $2 million, respectively, from the purchase of shares.

NOTE 11. INCOME TAXES

The Company's provisions for income taxes on income from continuing operations were $181 million and $327 million, and effective income tax rate was 38% for each of the three and six months ended June 30, 2013. The Company's provisions for income taxes on income from continuing operations were $127 million and $247 million, and effective income tax rates were 30% and 32%, for the three and six months ended June 30, 2012, respectively.

The following table reconciles the Company's effective income tax rate to the U.S. federal statutory income tax rate of 35%.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
U.S. federal statutory income tax rate	35%	35%	35%	35%
State and local income taxes, net of federal tax benefit	3%	2%	3%	2%
Effect of foreign operations	2%	3%	2%	2%
Domestic production activity deductions	(3)%	(3)%	(1)%	(3)%
Remeasurement gain on previously held equity interest	(2)%	—%	(2)%	—%
Reorganization of operations	—%	(6)%	—%	(3)%
Other, net	3%	(1)%	1%	(1)%
Effective income tax rate	38%	30%	38%	32%

The income tax rates for the three and six months ended June 30, 2013 increased 8% and 6%, respectively, compared to the prior year. The increases were primarily due to income tax benefits in the prior year related to the reorganization of certain operations and extraterritorial income deductions for which no similar benefit was recognized in the current year and nondeductible hedging losses associated with the acquisition of SBS Nordic. These increases were partially offset by the $92 million remeasurement gain on previously held equity interest which is not taxable in the current year because the Company intends to defer indefinitely the realization of this gain for tax purposes and by the reduction in SBS Nordic deferred tax liabilities as a result of the tax rate reduction in Denmark. The increase in the income tax rate for the six months ended June 30, 2013 was further driven by an $11 million current year decrease in tax benefits from domestic production activity deductions following legislative changes enacted in 2013.

The Company and its subsidiaries file income tax returns in the U.S. and various state and foreign jurisdictions. The Internal Revenue Service (“IRS”) concluded its examination of the Company's 2009 and 2008 consolidated federal income tax returns in the second quarter with no material adjustments. The Company is currently under examination by the IRS for its 2011 and 2010 consolidated federal income tax returns. The Company does not anticipate any material adjustments. With few exceptions, the Company is no longer subject to audit by any jurisdiction for years prior to 2006.

The Company's reserves for uncertain tax positions at June 30, 2013 and December 31, 2012 totaled $149 million and $128 million, respectively. The increase in the reserves during the six months ended June 30, 2013 was attributable to reserves established as part of the preliminary purchase price allocation for SBS Nordic and, to a lesser extent, uncertainties regarding allocation and taxation of income among multiple jurisdictions and the eligibility for, and application of, the rules surrounding certain tax credits.

As of June 30, 2013 and December 31, 2012, the Company had accrued approximately $12 million and $9 million, respectively, of total interest and penalties payable related to uncertain tax positions. The Company recognizes interest and penalties related to uncertain tax positions as a component of income tax expense.

It is reasonably possible that the total amount of unrecognized tax benefits related to certain of the Company's uncertain tax positions could decrease as much as $10 million within the next twelve months as a result of ongoing audits, lapses of statutes of limitations or regulatory developments.

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NOTE 12. EARNINGS PER SHARE

The table below sets forth the computation of the weighted-average number of shares outstanding utilized in determining basic and diluted earnings per share (in millions, except per share amounts).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Numerator:				
Income from continuing operations, net of taxes	$300	$294	$531	$517
Less:				
Net income attributable to noncontrolling interests	—	—	—	(1)
Adjustment of noncontrolling interest to redemption value	(3)	—	(1)	—
Income from continuing operations available to Discovery Communications, Inc. stockholders	297	294	530	516
Loss from discontinued operations available to Discovery Communications, Inc. stockholders	—	(1)	—	(2)
Net income available to Discovery Communications, Inc. stockholders	$297	$293	$530	$514
Denominator:				
Weighted average shares outstanding — basic	359	381	361	383
Weighted average dilutive effect of equity awards	4	3	4	4
Weighted average shares outstanding — diluted	363	384	365	387
Basic earnings per share available to Discovery Communications, Inc. stockholders:				
Continuing operations	$0.83	$0.77	$1.47	$1.35
Discontinued operations	$—	$—	$—	$(0.01)
Net income	$0.83	$0.77	$1.47	$1.34
Diluted earnings per share available to Discovery Communications, Inc. stockholders:				
Continuing operations	$0.82	$0.77	$1.45	$1.33
Discontinued operations	$—	$—	$—	$(0.01)
Net income	$0.82	$0.76	$1.45	$1.33

Income per share amounts may not sum since each is calculated independently.

Earnings per share is calculated by dividing the applicable earnings available to Discovery Communications, Inc. stockholders by the weighted-average number of shares outstanding. As a result of the redeemable noncontrolling interest in Discovery Japan, the Company began applying the two-class method for calculating earnings per share in the first quarter of 2013. The two-class method calculates earnings per share by distinguishing between the classes of securities based on the proportionate participation rights of each award type in the Company's undistributed income. Adjustments to the carrying amount of redeemable noncontrolling interest to redemption value, excluding currency translation adjustments, are reflected in earnings per share using the two-class method, similar to the treatment of a dividend.

At June 30, 2013 and 2012, the weighted-average number of basic and diluted shares outstanding included the Company’s outstanding Series A, Series B and Series C common stock, as well as its outstanding Series A and Series C convertible preferred stock, as the holder of each common and preferred series legally participates equally in any per share distributions. Diluted earnings per share adjusts basic earnings per share for the dilutive effect of the assumed exercise of outstanding equity awards using the treasury stock method. Only outstanding PRSUs whose performance targets have been achieved as of the last day of the most recent period are included in the dilutive effect calculation.

The table below presents the details of the equity-based awards that were excluded from the calculation of diluted earnings per share (in millions).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Anti-dilutive stock options, PRSUs and RSUs	1	1	1	1
PRSUs whose performance targets have not been achieved	1	2	1	2

NOTE 13. SUPPLEMENTAL DISCLOSURES

The table below presents the components of accrued expenses and other current liabilities (in millions).

	June 30, 2013	December 31, 2012
Accrued payroll and related benefits	$275	$275
Content rights payable	172	131
Accrued income taxes	56	59
Current portion of equity-based compensation liabilities	51	55
Accrued interest	45	30
Accrued other	142	171
Total accrued expenses and other current liabilities	$741	$721

The table below presents the components of other expense, net (in millions).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Remeasurement gain on previously held equity interest	$—	$—	$92	$—
Gains (losses) on derivative instruments	3	—	(56)	—
Other income (expense)	1	—	1	(2)
Total other income (expense), net	$4	$—	$37	$(2)

NOTE 14. RELATED PARTY TRANSACTIONS

In the normal course of business, the Company enters into transactions with related parties. The Company provides equity method investees, including unconsolidated VIEs, with content licenses and services such as distribution, sales and administrative support (see Note 3). Related parties also include entities that share common directorship, most prominently Liberty Global plc (“Liberty Global”), Liberty Media Corporation ("Liberty Media") and their subsidiaries and equity method investees (together the “Liberty Group”). Discovery’s Board of Directors includes three members who serve as directors of Liberty Global, including John C. Malone, who is Chairman of the Board of Liberty Global and beneficially owns approximately 36% of the aggregate voting power with respect to the election of directors of Liberty Global. Two members of the Company’s Board of Directors also serve as directors of Liberty Media. Dr. Malone is Chairman of the Board of Liberty Media and beneficially owns approximately 40% of the aggregate voting power with respect to the election of directors of Liberty Media. The majority of the revenue earned from the Liberty Group relates to multi-year network distribution arrangements. Other related party revenue and service charges included in the table below primarily consist of distribution revenue from J:COM earned by Discovery Japan. Following the consolidation of Discovery Japan (see Note 2), revenues earned from J:COM are reflected in related party revenues, while service fees from Discovery Japan, previously disclosed as revenue from equity method investees, are now eliminated upon consolidation and are no longer reflected in related party revenues.

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The table below presents a summary of the transactions with related parties (in millions).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenues and service charges:				
Liberty Group[a]	$28	$11	$40	$24
Equity method investees[b]	18	21	34	48
Other	4	—	8	—
Total revenues and service charges	$50	$32	$82	$72
Interest income[c]	$9	$7	$18	$13
Expenses	$6	$4	$16	$12

[a] The increase in revenue from transactions with the Liberty Group is primarily attributable to activity with Virgin Media, Inc. ("Virgin Media") and Charter Communications, Inc. ("Charter"). In June 2013 Liberty Global announced it had completed its acquisition of Virgin Media. In May 2013 Liberty Media completed its investment of 27.3% in Charter; Dr. Malone is on Charter's board of directors. Transactions with Virgin Media and Charter are reported as related party transactions from the date they became related parties
[b] The decrease in revenue from transactions with equity method investees is primarily attributable to the consolidation of Discovery Japan and lower sales of content to OWN.
[c] The Company records interest earnings from loans to equity method investees as a component of losses from equity method investees, net, in the consolidated statements of operations.

Of the revenues and service charges earned from equity method investees, the Company provided funding for $9 million and $17 million for the three and six months ended June 30, 2013, respectively, and $8 million and $22 million for the three and six months ended June 30, 2012, respectively.

The table below presents receivables due from related parties (in millions).

	June 30, 2013	December 31, 2012
Receivables	$32	$19
Note receivable (see Note 3)	$509	$482

NOTE 15. COMMITMENTS, CONTINGENCIES, AND GUARANTEES

Commitments

In the normal course of business, the Company enters into various commitments, which primarily include programming and talent arrangements, operating and capital leases, employment contracts, sponsorship commitments, arrangements to purchase various goods and services, future funding commitments to equity method investees (see Note 3), and the obligation to issue additional shares of preferred stock under the anti-dilution provisions of its outstanding preferred stock.

Contingencies

Put Right

The Company has granted put rights related to certain equity method investments and subsidiaries. Harpo has the right to require the Company to purchase its interest in OWN for fair value at various dates (see Note 3). No amounts have been recorded by the Company for the Harpo put right. TF1 has the right to require the Company to purchase its remaining shares in Eurosport at various dates should Discovery acquire a controlling interest in Eurosport. The TF1 put right is recorded at fair value (see Note 4). Additionally, J:COM has the right to require the Company to purchase its redeemable interest in Discovery Japan. The Company recorded the J:COM put right as redeemable noncontrolling interest (see Note 8).

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.

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Guarantees

The Company has guaranteed a certain level of operating performance for The Hub (see Note 3). There were no amounts recorded for guarantees associated with The Hub as of June 30, 2013 or December 31, 2012.

The Company may provide indemnities intended to protect others from certain business risks. Similarly, the Company may remain contingently liable for certain obligations 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 and estimable. There were no material amounts for indemnifications or other contingencies recorded as of June 30, 2013 or December 31, 2012.

NOTE 16. 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 for consolidation are not eliminated at the segment level. In determining segment performance, inter-segment transactions are treated as third-party transactions. Inter-segment transactions, which primarily include advertising and content purchases 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 equity-based compensation, (ii) depreciation and amortization, (iii) amortization of deferred launch incentives, (iv) exit and restructuring charges, (v) certain impairment charges and (vi) gains and 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. The Company excludes mark-to-market equity-based compensation, exit and restructuring charges, certain impairment charges, and gains and losses on business and asset dispositions from the calculation of Adjusted OIBDA due to their volatility. 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 and other measures of financial performance reported in accordance with GAAP. Certain corporate expenses are excluded from segment results to enable executive management to evaluate segment performance based upon the decisions of segment executives.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenues:				
U.S. Networks	$793	$700	$1,479	$1,381
International Networks	652	405	1,096	785
Education	24	21	51	45
Corporate and inter-segment eliminations	(2)	—	(3)	—
Total revenues	$1,467	$1,126	$2,623	$2,211

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Total Adjusted OIBDA:				
U.S. Networks	$472	$426	$849	$821
International Networks	265	176	449	347
Education	4	3	11	9
Corporate and inter-segment eliminations	(73)	(61)	(143)	(125)
Total Adjusted OIBDA	$668	$544	$1,166	$1,052

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Reconciliation of Total Adjusted OIBDA to Operating Income:				
Total Adjusted OIBDA	$668	$544	$1,166	$1,052
Amortization of deferred launch incentives	(5)	(5)	(10)	(10)
Mark-to-market equity-based compensation	(12)	(18)	(58)	(43)
Depreciation and amortization	(78)	(31)	(110)	(60)
Restructuring charges	(9)	(2)	(10)	(3)
Operating income	$564	$488	$978	$936

	June 30, 2013	December 31, 2012
Total assets:		
U.S. Networks	$3,031	$2,878
International Networks	4,516	1,984
Education	61	63
Corporate and inter-segment eliminations	7,079	8,005
Total assets	$14,687	$12,930

Total assets for corporate and inter-segment eliminations include goodwill that is allocated to the Company’s segments to account for goodwill. The presentation of segment assets in the table above is consistent with the financial reports that are reviewed by the Company’s CODM.

On April 9, 2013, the Company acquired certain television and radio business operations, SBS Nordic, from Prosiebensat.1 Media AG. During the year ended December 31, 2012, the Company also acquired Switchover Media, a group of five Italian television channels and a television station in Dubai (see Note 2). The operations of each of these acquisitions are included in the operations of the Company's International Networks segment and were included in the Company's consolidated financial statements as of each of their respective acquisition dates. As a result, newly acquired businesses have impacted the comparability of our results of operations between 2013 and 2012. Accordingly, to assist the reader in understanding the changes in our results of operations, the following table presents the calculation of Adjusted OIBDA for these acquisitions and a reconciliation to operating income, as reported within the Company's consolidated financial statements for the three and six months ended June 30, 2013 (in millions).

	Three Months Ended June 30, 2013	Six Months Ended June 30, 2013
Revenues:		
Distribution	$42	$43
Advertising	145	155
Other	8	8
Total revenues	195	206
Costs of revenues, excluding depreciation and amortization	(98)	(106)
Selling, general and administrative	(49)	(52)
Adjusted OIBDA	48	48
Depreciation and amortization	(46)	(47)
Restructuring charges	(4)	(4)

Eliminations	3	3
Operating income	$1	$—

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NOTE 17. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

Overview

As of June 30, 2013 and December 31, 2012, the senior notes outstanding (see Note 6) have been issued by DCL, a wholly-owned subsidiary of the Company, pursuant to Registration Statements on Form S-3 filed with the U.S. Securities and Exchange Commission (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 comprehensive income, 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 Discovery Channel and TLC networks in the U.S. The non-guarantor subsidiaries of DCL include 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.

The operations of certain of the Company's international subsidiaries are excluded from the Company's consolidated U.S. income tax return. Tax expense related to permanent differences has been allocated to the entity that created the difference. Tax expense related to temporary differences has been allocated to the entity that created the difference, where identifiable. The remaining temporary differences are allocated to each entity included in the Company's consolidated U.S. income tax return based on each entity's relative pretax income. Deferred taxes have been allocated based upon the temporary differences between the carrying amounts of the respective assets and liabilities of the applicable entities.

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

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Condensed Consolidating Balance Sheet
June 30, 2013
(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	$—	$—	$120	$ 255	$ —	$ —	$ 375
Receivables, net	—	—	442	892	—	(2)	1,332
Content rights, net	—	—	18	196	—	—	214
Deferred income taxes	—	—	28	47	—	—	75
Prepaid expenses and other current assets	37	—	133	99	—	—	269
Intercompany trade receivables, net	—	—	409	—	—	(409)	—
Total current assets	37	—	1,150	1,489	—	(411)	2,265
Investment in and advances to subsidiaries	6,234	6,238	6,993	—	4,170	(23,635)	—
Noncurrent content rights, net	—	—	646	1,135	—	—	1,781
Goodwill	—	—	3,769	3,509	—	—	7,278
Intangible assets, net	—	—	325	1,293	—	—	1,618
Equity method investments	—	—	337	760	—	—	1,097
Other noncurrent assets							