Discovery Communications, Inc.
Form 10-Q
November 04, 2014

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

FORM 10-Q

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

For the quarterly period ended September 30, 2014

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 October 28, 2014:

Series A Common Stock, par value $0.01 per share	148,491,088
Series B Common Stock, par value $0.01 per share	6,542,457
Series C Common Stock, par value $0.01 per share	287,302,099

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)

	September 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$376	$408
Receivables, net	1,464	1,371
Content rights, net	379	277
Deferred income taxes	87	73
Prepaid expenses and other current assets	278	281
Total current assets	2,584	2,410
Noncurrent content rights, net	2,028	1,883
Property and equipment, net	525	514
Goodwill	8,320	7,341
Intangible assets, net	2,091	1,565
Equity method investments	667	1,087
Other noncurrent assets	158	179
Total assets	$16,373	$14,979
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$209	$141
Accrued liabilities	1,040	992
Deferred revenues	304	144
Current portion of debt	995	17
Total current liabilities	2,548	1,294
Noncurrent portion of debt	6,153	6,482
Deferred income taxes	692	637
Other noncurrent liabilities	310	333
Total liabilities	9,703	8,746
Commitments and contingencies (Note 15)		
Redeemable noncontrolling interests	785	36
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; 43 and 44 shares issued	1	1
Series A common stock: $0.01 par value; 1,700 shares authorized; 151 and 150 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; 375 and 151 shares issued	4	2
Additional paid-in capital	6,905	6,826
Treasury stock, at cost	(4,488)	(3,531)
Retained earnings	3,654	2,892

Accumulated other comprehensive (loss) income	(195)	4
Total Discovery Communications, Inc. stockholders' equity	5,883	6,196
Noncontrolling interests	2	1
Total equity	5,885	6,197
Total liabilities and equity	$16,373	$14,979

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenues:				
Distribution	$748	$651	$2,097	$1,896
Advertising	725	665	2,258	1,922
Other	95	59	234	180
Total revenues	1,568	1,375	4,589	3,998
Costs and expenses:				
Costs of revenues, excluding depreciation and amortization	529	435	1,526	1,214
Selling, general and administrative	432	390	1,247	1,149
Depreciation and amortization	85	80	243	190
Restructuring and other charges	11	1	19	11
Gain on disposition	—	(19)	(31)	(19)
Total costs and expenses	1,057	887	3,004	2,545
Operating income	511	488	1,585	1,453
Interest expense	(83)	(80)	(247)	(228)
Income (loss) from equity investees, net	13	—	34	(9)
Other income, net	1	11	11	61
Income from continuing operations before income taxes	442	419	1,383	1,277
Provision for income taxes	(155)	(163)	(481)	(490)
Net income	287	256	902	787
Net income attributable to noncontrolling interests	—	(1)	(2)	(1)
Net income attributable to redeemable noncontrolling interests	(7)	—	(11)	—
Net income available to Discovery Communications, Inc.	$280	$255	$889	$786
Net income per share available to Discovery Communications, Inc. Series A, B and C common stockholders (Note 12):				
Basic	$0.41	$0.36	$1.29	$1.09
Diluted	$0.41	$0.35	$1.28	$1.08
Weighted average Discovery Communications, Inc. Series A, B and C common shares outstanding:				
Basic	449	483	458	488
Diluted	682	719	693	727

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	$287	$256	$902	$787
Other comprehensive (loss) income, net of tax:				
Currency translation adjustments	(187)	104	(219)	(3)
Derivative and market value adjustments	3	—	(6)	6
Comprehensive income	103	360	677	790
Comprehensive income attributable to noncontrolling interests	—	(1)	(2)	(1)
Comprehensive loss attributable to redeemable noncontrolling interests	20	—	15	1
Comprehensive income attributable to Discovery Communications, Inc.	$123	$359	$690	$790

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

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

	Nine Months Ended September 30, 2014	2013
Operating Activities		
Net income	$902	$787
Adjustments to reconcile net income to cash provided by operating activities:		
Equity-based compensation expense	66	129
Depreciation and amortization	243	190
Content amortization and impairment expense	1,083	850
Gain on disposition	(31)	(19)
Remeasurement gain on previously held equity interest	(29)	(92)
Equity in (earnings) losses of investee companies, net of cash distributions	(15)	15
Deferred income tax (benefit) expense	(124)	144
Launch amortization expense	8	14
Loss from hedging instruments, net	—	55
Other, net	27	22
Changes in operating assets and liabilities, net of business combinations:		
Receivables, net	3	(92)
Content rights	(1,269)	(1,061)
Accounts payable and accrued liabilities	92	41
Equity-based compensation liabilities	(81)	(61)
Income tax receivable	53	50
Other, net	(35)	(42)
Cash provided by operating activities	893	930
Investing Activities		
Purchases of property and equipment	(85)	(76)
Business acquisitions, net of cash acquired	(369)	(1,832)
Hedging instruments, net	—	(55)
Proceeds from disposition	45	28
Distributions from equity method investees	58	23
Investments in equity method investees, net	(174)	(28)
Other investing activities, net	(4)	(1)
Cash used in investing activities	(529)	(1,941)
Financing Activities		
Borrowings from debt, net of discount and issuance costs	409	1,186
Borrowings under revolving credit facility	145	—
Commercial paper, net	126	—
Principal repayments of capital lease obligations	(13)	(21)
Repurchases of stock	(1,067)	(969)
Cash proceeds from equity-based plans, net	39	61
Other financing activities, net	(8)	(3)
Cash (used in) provided by financing activities	(369)	254
Effect of exchange rate changes on cash and cash equivalents	(27)	(5)
Net change in cash and cash equivalents	(32)	(762)
Cash and cash equivalents, beginning of period	408	1,201
Cash and cash equivalents, end of period	$376	$439

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

	Nine Months Ended September 30,	
	2014	2013
Supplemental Cash Flow Information		
Cash paid for taxes, net	$(500)	$(273)
Cash paid for interest, net	$(180)	$(158)
Noncash Investing and Financing Transactions		
Assets acquired under capital lease arrangements	$14	$86
Accrued purchases of property and equipment	$5	$4

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 September 30, 2014			Three Months Ended September 30, 2013		
	Discovery Stockholders	Noncontrolling Interests	Total Equity	Discovery Stockholders	Noncontrolling Interests	Total Equity
Beginning balance	$6,031	$ 3	$6,034	$6,269	$ 4	$6,273
Comprehensive income	123	—	123	359	1	360
Equity-based compensation	12	—	12	14	—	14
Issuance of common stock for equity-based plans	17	—	17	12	—	12
Excess tax benefits from equity-based compensation	9	—	9	14	—	14
Other adjustments for equity-based plans	(1)	—	(1)	—	—	—
Repurchases of stock	(298)	—	(298)	(448)	—	(448)
Redeemable noncontrolling interest adjustments to redemption value	(15)	—	(15)	—	—	—
Cash distributions to noncontrolling interests	—	(1)	(1)	—	—	—
Purchase of redeemable noncontrolling interest	5	—	5	—	—	—
Ending balance	$5,883	$ 2	$5,885	$6,220	$ 5	$6,225

	Nine Months Ended September 30, 2014			Nine Months Ended September 30, 2013		
	Discovery Stockholders	Noncontrolling Interests	Total Equity	Discovery Stockholders	Noncontrolling Interests	Total Equity
Beginning balance	$6,196	$ 1	$6,197	$6,291	$ 2	$6,293
Comprehensive income	690	2	692	790	1	791
Equity-based compensation	39	—	39	48	—	48
Issuance of common stock for equity-based plans	36	—	36	43	—	43
Excess tax benefits from equity-based compensation	30	—	30	40	—	40
Tax settlements associated with equity-based compensation	(27)	—	(27)	(22)	—	(22)
Other adjustments for equity-based plans	(2)	—	(2)	—	—	—
Repurchases of stock	(1,067)	—	(1,067)	(969)	—	(969)
Stock dividends declared to preferred interests	(1)	—	(1)	—	—	—
Redeemable noncontrolling interest adjustments to redemption value	(16)	—	(16)	(1)	—	(1)
Noncontrolling interests of acquired businesses	—	—	—	—	2	2
	—	(1)	(1)	—	—	—

Cash distributions to noncontrolling interests						
Purchase of redeemable noncontrolling interest	5	—	5	—	—	—
Ending balance	$5,883	$ 2	$5,885	$6,220	$ 5	$6,225

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

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

NOTE 1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Description of Business

Discovery Communications, Inc. ("Discovery" or the "Company") is a global media company that provides content across multiple distribution platforms, including television networks, digital distribution arrangements and a portfolio of web-native networks. The Company also develops and sells curriculum-based education products and services. The Company classifies its operations in three segments: U.S. Networks, consisting principally of domestic television networks and websites; International Networks, consisting principally of international television networks, radio stations 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

Transactions denominated in currencies other than subsidiaries' functional currencies are recorded based on exchange rates at the time such transactions arise. Changes in exchange rates with respect to amounts recorded in the consolidated balance sheets related to these items will result in unrealized foreign currency transaction gains and losses based upon period-end exchange rates. The Company also records realized foreign currency transaction gains and losses upon settlement of foreign currency transactions. Beginning January 1, 2014, the Company reclassified foreign currency gains (losses), net as described above from selling, general and administrative expense to other income, net on the consolidated statements of operations for all periods presented. For the three and nine months ended September 30, 2013, foreign currency gains of $11 million and $24 million, respectively, were reclassified from selling, general and administrative expense to other income, net to conform to the current year presentation.

Stock Split Effected in the Form of a Share Dividend

On May 16, 2014, Discovery's Board of Directors approved a stock split effected in the form of a share dividend (the "2014 Share Dividend") of one share of the Company's Series C common stock on each issued and outstanding share of Series A, Series B, and Series C common stock. The stock split did not change the number of treasury shares or the number of outstanding preferred shares but the conversion ratio on the preferred shares doubled (see Note 9). The 2014 Share Dividend resulted in a 2 for 1 stock split on August 6, 2014 to stockholders of record on July 28, 2014. All share and per share data for earnings per share and stock based compensation have been retroactively adjusted to give effect to the 2 for 1 split of the Company's common stock. The impact on the consolidated balance sheet was an increase of $2 million to common stock and an offsetting reduction in additional paid-in capital, which has been recognized in the current period only.

Unaudited Interim Financial Statements

These consolidated financial statements are unaudited; however, in the opinion of management, they reflect all adjustments consisting only of normal recurring adjustments necessary to state fairly the financial position, results of operations and cash flows for the periods presented in conformity with U.S. generally accepted accounting principles ("GAAP") applicable to interim periods. The results of operations for the interim periods presented are not necessarily indicative of results for the full year or future periods. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in Discovery's Annual Report on Form 10-K for the year ended December 31, 2013 (the "2013 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 materially from those estimates.

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

Accounting and Reporting Pronouncements Adopted

Reporting Discontinued Operations

In April 2014, the Financial Accounting Standards Board ("FASB") issued guidance that changes the criteria for reporting discontinued operations and requires additional disclosures about discontinued operations and disposals of components of an entity that do not qualify for discontinued operations reporting. Under the new pronouncement, disposal of a component of an entity representing a strategic shift with major effect on its operations and financial results is a discontinued operation. The Company prospectively adopted the new guidance effective July 1, 2014. The Company will assess future dispositions under the new guidance.

Presentation of Unrecognized Tax Benefits

In July 2013, the FASB issued guidance stating that a liability related to an unrecognized tax benefit should be presented as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carry forward to the extent such deferred tax asset is available at the reporting date to settle any additional income taxes that would result from the disallowance of a tax position. The Company prospectively adopted the new guidance effective January 1, 2014. Liabilities of $12 million related to unrecognized tax benefits are reducing deferred tax assets that are reflected in net noncurrent deferred income tax liabilities on the consolidated balance sheet as of September 30, 2014.

Accounting and Reporting Pronouncements Not Yet Adopted

Presentation of Financial Statements - Going Concern

In August 2014, the FASB issued guidance requiring management to perform interim and annual assessments regarding conditions or events that raise substantial doubt about the Company's ability to continue as a going concern and to provide related disclosures, if applicable. The new standard will be effective for reporting periods beginning after December 15, 2016, with early adoption permitted. The adoption of this standard is not expected to have a material effect on the Company's consolidated financial statements.

Revenue from Contracts with Customers

In May 2014, the FASB issued an accounting pronouncement related to revenue recognition, which applies a single, comprehensive revenue recognition model for all contracts with customers. This standard contains principles with respect to the measurement of revenue and timing of recognition. The Company will recognize revenue to reflect the transfer of goods or services to customers at an amount that it expects to be entitled to receive in exchange for those goods or services. This pronouncement is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Early adoption is not permitted. The Company is currently evaluating the impact that the pronouncement will have on the consolidated financial statements.

Concentrations Risk

Customers

The Company has long-term contracts with distributors around the world, including the largest distributors in the U.S. and major international distributors. In the U.S., approximately 90% of distribution revenues come from the top 10 distributors. Outside of the U.S., approximately 50% of distribution revenue comes from the top 10 distributors. Agreements in place with the major cable and satellite operators in the U.S. expire at various times beginning in 2014 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 distribution revenue, but it could also experience a reduction in advertising revenue, which is impacted by affiliate subscriber levels and viewership.

No individual customer accounted for more than 10% of total consolidated revenues for the three and nine months ended September 30, 2014 or 2013. As of September 30, 2014 and December 31, 2013, the Company's trade receivables do not represent a significant concentration of credit risk as the customers and markets in which the Company operates are varied and dispersed across many geographic areas.

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

Financial Institutions

Cash and cash equivalents are maintained with several financial institutions. The Company has deposits held with banks that exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and are maintained with financial institutions of reputable credit and, therefore, bear minimal credit risk.

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 and may have limited or no access to the commercial paper market. 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 September 30, 2014, the Company did not anticipate nonperformance by any of its counterparties.

NOTE 2. ACQUISITIONS AND DISPOSITIONS

Acquisitions

Hub Television Networks LLC

On September 23, 2014, the Company acquired an additional 10% ownership interest in the Hub Network from Hasbro, Inc. ("Hasbro") for $64 million. The Hub Network is a pay television network that provides children's and family entertainment and educational programming. The purchase increased the Company's ownership interest from 50% to 60%. As a result, the Company changed its accounting for the Hub Network from an equity method investment to a consolidated subsidiary (see Note 3). The acquisition of the Hub Network supports the Company's strategic priority of broadening the scope of the network to increase viewership, and the network was rebranded as the Discovery Family Channel on October 13, 2014.

The Company used discounted cash flow ("DCF") analyses, which represent Level 3 fair value measurements, to preliminarily assess certain components of its purchase price allocation. The table below presents the fair value of the assets acquired, liabilities assumed and noncontrolling interest as presented in the table below (in millions).

	September 23, 2014
Goodwill	$309
Intangible assets	301
Other assets acquired	97
Cash	33
Liabilities assumed	(125)
Redeemable noncontrolling interest	(238)
Carrying value of previously held equity interest	(313)
Net assets acquired	$64

There was no gain or loss recorded at the time of acquisition as the fair value was equal to the carrying amount of the Company's previously held equity interest in the Hub Network as of the acquisition date.

Hasbro has the right to put the entirety of its remaining 40% non-controlling interest to the Company for one year after December 31, 2021. As Hasbro's put right is outside the control of the Company, Hasbro's 40% noncontrolling interest is presented as redeemable noncontrolling interest outside of permanent equity on the Company's consolidated balance sheet (see Note 8). Embedded in the redeemable noncontrolling interest is the value of a Discovery call right exercisable for one year after December 31, 2021. Upon the exercise of the put or call options, the price to be paid for the interest being purchased is generally a function of the then fair market value of the interest, to which certain discounts and floor values may apply in specified situations, depending upon the party exercising the put or call, the basis for the exercise of the put or call, and the determined fair market value of the network at the time of exercise.

The goodwill reflects the workforce and synergies expected from combining the operations of the Hub Network and the Company's existing U.S. Networks. The goodwill recorded as part of this acquisition will be assigned to the U.S. Networks reporting unit. It is not amortizable for tax purposes. Intangible assets primarily consist of distribution customer relationships with an estimated useful life of 30 years and a weighted-average contractual renewal period of 3 years. The purchase price allocation presented above is preliminary as the Company is currently in the process of completing fair value estimates for intangible assets and income taxes.

Eurosport

On May 30, 2014, the Company acquired from TF1 a controlling interest in and began consolidating Eurosport International ("Eurosport"), a leading pan-European sports media platform, by increasing Discovery’s ownership stake from 20% to 51% for cash of approximately €257 million ($349 million) and recognized a gain of $29 million to account for the difference between the carrying value and the fair value of the previously held 20% equity interest. The gain is included in other income, net in the Company's consolidated statements of operations (see Note 13). Due to regulatory constraints, the acquisition initially excludes Eurosport France, formerly a subsidiary of Eurosport. The Company will retain a 20% equity interest in Eurosport France and has a conditional commitment to acquire another 31% ownership interest beginning in 2015 for approximately €35 million ($48 million), contingent upon resolution of all regulatory matters. The flagship Eurosport network focuses on regionally popular sports, such as tennis, skiing, cycling and motor sports. Eurosport’s brands and platforms also include Eurosport HD (high definition simulcast), Eurosport 2, Eurosport 2 HD (high definition simulcast), Eurosport Asia-Pacific, and Eurosportnews. The acquisition is intended to increase the growth of Eurosport and enhance the Company's pay television offerings in Europe.

The Company used DCF analyses, which represent Level 3 fair value measurements, to preliminarily assess certain components of its purchase price allocation. The fair value of the assets acquired, liabilities assumed and noncontrolling interest acquired and calculation of the remeasurement gain on previously held equity interest is presented in the table below (in millions).

	May 30, 2014	
Goodwill	$775	
Intangible assets	467	
Other assets acquired	165	
Cash	47	
Removal of TF1 put right	27	
Currency translation adjustment	7	
Remeasurement gain on previously held equity interest	(29	)
Liabilities assumed	(154	)
Deferred tax liabilities	(167	)
Redeemable noncontrolling interest	(558	)
Carrying value of previously held equity interest	(231	)
Net assets acquired	$349	

TF1 has the right to put the entirety of its remaining 49% non-controlling interest to the Company during two 90-day windows in the two and a half years after May 30, 2014. If the put right is exercised during the first 90-day window beginning July 1, 2015, it has a floor value equal to the fair value per share of Eurosport on May 30, 2014. If the put right is exercised during the second 90-day window beginning July 1, 2016, it will be priced at the then-current fair value per share of Eurosport, or as may be agreed between the Company and TF1. As TF1's put right is outside the control of the Company, TF1's 49% noncontrolling interest is presented as redeemable noncontrolling interest outside of permanent equity on the Company's consolidated balance sheet (see Note 8).

The goodwill reflects the workforce, synergies and increased pan-European market penetration expected from combining the operations of Eurosport and the Company as a component of the Company's international networks segment. The Company continues to evaluate the reporting unit determination for this acquisition. The goodwill recorded as part of this acquisition is not amortizable for tax purposes. Intangible assets primarily consist of distribution and advertising customer relationships, advertiser backlog and trademarks with a weighted average estimated useful life of 10 years. The purchase price allocation presented above is preliminary as the Company is

currently in the process of completing fair value estimates for intangible assets, certain liabilities and income taxes.
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 €1.4 billion ($1.8 billion) including closing purchase price adjustments. SBS Nordic has operations in Sweden, Norway, Denmark, Finland and England. The acquisition of SBS Nordic supports the

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

Company’s strategic priority of increasing its presence in key international markets and is a component of the Company's International Networks segment.

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

	April 9, 2013
Goodwill	$779
Intangible assets	1,001
Content	248
Other assets acquired	212
Cash	106
Liabilities assumed	(278)
Deferred tax liabilities	(243)
Redeemable noncontrolling interest	(6)
Net assets acquired	$1,819

The goodwill reflects the workforce, synergies and increased Nordic region market penetration expected from combining the operations of SBS Nordic and the Company. The goodwill recorded as part of this acquisition is not amortizable for tax purposes. Intangible assets primarily consist of broadcast licenses, distribution and advertising customer relationships, advertiser backlog and trademarks with a weighted average estimated useful life of 8 years.

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, 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 purchase price allocation. The table below presents the allocation of the purchase price to the assets and liabilities acquired and calculation of a remeasurement gain on previously held equity interest (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% noncontrolling interest beginning in 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 permanent equity on the Company's consolidated balance sheet (see Note 8).

DISCOVERY COMMUNICATIONS, INC.
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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

In 2014, the Company acquired other unrelated businesses for total consideration of $40 million, net of cash acquired. The Company recorded $34 million and $10 million of goodwill and intangible assets, respectively, in connection with these acquisitions. The acquisitions included a factual entertainment production company in the U.K. and cable networks in New Zealand. The goodwill reflects the synergies and market expansion from combining the operations of these acquisitions with the Company.

In 2013, the Company acquired several other unrelated businesses for total consideration of $88 million, net of cash acquired. The Company recorded $67 million and $24 million of goodwill and intangible assets, respectively, in connection with these acquisitions. The acquisitions included a television station in Sweden and an education business in the U.K. The goodwill reflects the synergies and market expansion expected from combining the operations of these acquisitions with the Company.

Consolidation of Business Combinations

The operations of each of the business combinations discussed above were included in the consolidated financial statements as of the respective acquisition dates. The following table presents the revenue and earnings of the businesses acquired as reported within the consolidated financial statements for the three and nine months ended September 30, 2014 and 2013 (in millions).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenues:				
Distribution	$146	$59	$294	$127
Advertising	162	126	499	266
Other	45	4	78	9
Total revenues	$353	$189	$871	$402
Net income	$12	$12	$42	$37

Pro Forma Financial Information

The following table presents the unaudited pro forma results of the Company as though all of the 2013 and 2014 business combinations discussed above had been made on January 1, 2013 (in millions). These pro forma results do not necessarily represent what would have occurred if all the business combinations above had taken place on January 1, 2013, nor do they represent the results that may occur in the future. This pro forma financial information includes the historical financial statement amounts of Discovery and its business combinations with the following adjustments: the Company converted the historical financial statements of its acquirees to GAAP, applied the Company's accounting policies, and the Company adjusted for amortization expense assuming the fair value adjustments to intangible assets had been applied beginning January 1, 2013 including the $29 million gain recognized upon the consolidation of Eurosport. The pro forma adjustments were based on available information and upon assumptions that the Company believes are reasonable to reflect the impact of these acquisitions on the Company's historical financial information on a supplemental pro forma basis.

	Pro forma Three Months Ended September 30,		Pro forma Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue	$1,590	$1,560	$4,883	$4,709
Net income	$298	$264	$916	$797

Equity Method Investment

On September 23, 2014, the Company acquired 50% equity ownership interest in All3Media, a production company, for a cash payment of approximately £90 million ($147 million).

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Dispositions

HSW

On May 30, 2014, Discovery sold HowStuffWorks, LLC, a commercial website which uses various media to explain complex concepts, terminology and mechanisms, to Blucora, Inc. (“Blucora”). Blucora paid Discovery $45 million, and Discovery recorded a pretax gain of $31 million upon completion of the sale. HowStuffWorks, LLC was part of the U.S. Networks operating segment.

Petfinder

On July 15, 2013, the Company sold the domain name and business operations of the Petfinder.com website ("Petfinder"). The sale of Petfinder resulted in a $19 million pretax gain which has been reflected in gain on disposition in the consolidated statements of operations.

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 September 30, 2014, the Company’s VIEs primarily consisted of OWN LLC. As of December 31, 2013, the Company’s VIEs primarily consisted of Hub Television Networks LLC and OWN LLC. Both OWN LLC and the Hub Television Networks LLC operate pay television networks in the U.S.

The Company accounted for its interests in VIEs using the equity method, as the Company is not the primary beneficiary of these entities. The aggregate carrying values of these VIE equity method investments were $457 million and $789 million as of September 30, 2014 and December 31, 2013, respectively. The Company recognized $13 million and $37 million in income during the three and nine months ended September 30, 2014, respectively, and zero and $13 million in losses during the three and nine months ended September 30, 2013, respectively, for its portion of net income and losses generated by VIEs.

As of September 30, 2014, the Company’s estimated risk of loss for investment carrying values, unfunded contractual commitments and guarantees made on behalf of VIEs was approximately $488 million. The estimated risk of loss excludes the Company’s expected non-contractual future funding of OWN, which is discussed below.

OWN LLC

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

The Company's combined advances to and note receivable from OWN, including accrued interest, were $452 million and $483 million as of September 30, 2014 and December 31, 2013, respectively. During the nine months ended September 30, 2014, the Company received net repayments of $56 million from OWN and accrued interest on the note receivable of $25 million. During the nine months ended September 30, 2013, the Company received net repayments of $11 million from OWN and accrued interest on the note receivable of $27 million. The note receivable is secured by the net assets of OWN. While the Company has no further funding commitments, the Company will provide additional funding to OWN, if necessary, and expects to recoup amounts funded. 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. OWN began repaying amounts owed to the Company during 2013. In accordance with the venture agreement, losses generated by OWN are generally allocated to both investors based on their proportionate ownership interests. However, the Company has recorded its portion of OWN’s losses based upon accounting policies for equity method investments. Prior to the contribution of the Discovery Health network to OWN at its launch, the Company had recognized $104 million or 100% of OWN’s net losses. During the three months ended March 31, 2012, accumulated operating losses at OWN exceeded the equity contributed to OWN, and Discovery began again to record 100% of OWN’s net losses. Although OWN has become profitable, the Company will record 100% of any net losses resulting from OWN's operations as long as Discovery has provided all funding to OWN and OWN’s accumulated losses continue to exceed the equity contributed. All of OWN's 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 of $420 million and $449 million as of September 30, 2014 and December 31, 2013, respectively, includes the Company's note receivable and accumulated investment losses. There is a possibility that the results of OWN’s future operations will fall below the long-term projections. The Company monitors the financial results of OWN along with other relevant business information to assess the recoverability of the OWN note receivable. No impairment was recorded during the nine months ended September 30, 2014.

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 a 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 not recorded amounts for the put right because the fair value of this put right was zero as of September 30, 2014 and December 31, 2013.

Hub Television Networks LLC

Prior to September 23, 2014, the Hub Network was a VIE because the the initial equity was not sufficient to fund the Hub Network's activities without additional subordinated financial support in the form of a funding commitment. Discovery and Hasbro shared equally in voting control and jointly consented to decisions about programming and marketing strategy and thereby jointly directed the activities of the Hub Network that most significantly impacted its economic performance. Accordingly, the Company determined that it was not the primary beneficiary of the Hub Network and accounted for its investment in the Hub Network using the equity method.

On September 23, 2014, the Company acquired 10% of Hasbro’s ownership in the Hub Network for $64 million. This was a reconsideration event, requiring a reassessment of the Hub Network as a VIE. As of the reconsideration date, the Hub Network is not expected to require additional subordinated financial support to fund its ongoing activities. Accordingly, the Hub Network is no longer considered to be a VIE. Since the transaction provided Discovery with control over the voting rights and operating activities of the Hub Network, the Company consolidated the Hub Network as of the acquisition date (see Note 2).

NOTE 4. FAIR VALUE MEASUREMENTS

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

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

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

		September 30, 2014			
Category	Balance Sheet Location	Level 1	Level 2	Level 3	Total
Assets:					
Trading securities:					
Mutual funds	Prepaid expenses and other current assets	$142	$—	$—	$142
Derivatives:					
Foreign exchange	Prepaid expenses and other current assets	—	9	—	9
Foreign exchange	Other noncurrent assets	—	7	—	7
Total		$142	$16	$—	$158
Liabilities:					
Deferred compensation plan	Accrued liabilities	$142	$—	$—	$142
Derivatives:					
Foreign exchange	Accrued liabilities	—	1	—	1
Interest rate	Accrued liabilities	—	10	—	10
TF1 put right	Accrued liabilities	—	—	4	4
Total		$142	$11	$4	$157

		December 31, 2013			
Category	Balance Sheet Location	Level 1	Level 2	Level 3	Total
Assets:					
Trading securities:					
Mutual funds	Prepaid expenses and other current assets	$129	$—	$—	$129
Available-for-sale securities:					
Common stock	Other noncurrent assets	4	—	—	4
Derivatives:					
Foreign exchange	Prepaid expenses and other current assets	—	4	—	4
Foreign exchange	Other noncurrent assets	—	9	—	9
Total		$133	$13	$—	$146
Liabilities:					
Deferred compensation plan	Accrued liabilities	$129	$—	$—	$129
Derivatives:					
Foreign exchange	Accrued liabilities	—	1	—	1
TF1 put right	Accrued liabilities	—	—	20	20
Total		$129	$1	$20	$150

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 equity investments in highly liquid instruments. 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 and interest rate contracts used by the Company to modify its exposure to market risks from foreign exchange rates and interest rates. The fair value of Level 2 derivative financial instruments was determined using a market-based approach.

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As of September 30, 2014, TF1 had the conditional right to require the Company to purchase its remaining shares in Eurosport France at various dates should Discovery complete its planned acquisition of a controlling interest in Eurosport France. Previously, TF1 had the conditional right to require the Company to purchase its remaining shares in Eurosport, inclusive of Eurosport France. Following the consolidation of Eurosport, excluding Eurosport France, TF1 retained a conditional right to require Discovery to purchase its remaining shares in Eurosport and a right to put a portion of its interest in Eurosport France to Discovery. The option on Eurosport, the value of which is embedded in the noncontrolling interest, has resulted in the classification of the noncontrolling interest in Eurosport as a component of redeemable equity (see Note 8). The separate written put for Eurosport France does not qualify for equity classification and is reported at fair value and subsequently marked to fair value through earnings regardless of associated contingencies. The fair value measurement as of September 30, 2014 of the TF1 put on Eurosport France of $4 million 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 for Eurosport France is based on unobservable estimates and judgments, and therefore represents a Level 3 fair value measurement. (See Note 2.)

In addition to the financial instruments listed in the tables above, the Company holds other financial instruments, including cash deposits, accounts receivable, accounts payable, commercial paper, borrowings under the revolving credit facility, capital leases and senior notes. The carrying values for such financial instruments, other than borrowings under the revolving credit facility and the senior notes, each approximated their fair values. The estimated fair value of the Company’s outstanding borrowings under the revolving credit facility and senior notes using quoted prices from over the counter markets, considered Level 2 inputs, was $7.4 billion and $6.6 billion as of September 30, 2014 and December 31, 2013, respectively.

NOTE 5. CONTENT RIGHTS

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

	September 30, 2014	December 31, 2013
Produced content rights:		
Completed	$3,509	$3,566
In-production	398	334
Coproduced content rights:		
Completed	671	637
In-production	89	84
Licensed content rights:		
Acquired	1,054	880
Prepaid	101	48
Content rights, at cost	5,822	5,549
Accumulated amortization	(3,415)	(3,389)
Total content rights, net	2,407	2,160
Current portion	(379)	(277)
Noncurrent portion	$2,028	$1,883

Content expense, which consists of content amortization, impairments and other production charges, is included in costs of revenues on the consolidated statements of operations.

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Content expense consisted of the following (in millions).

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Content amortization	$372	$301	$1,061	$831
Other production charges	41	24	108	71
Content impairments	6	7	22	19
Total content expense	$419	$332	$1,191	$921

NOTE 6. DEBT

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

	September 30, 2014	December 31, 2013
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
2.375% Senior Notes, euro denominated, annual interest, due March 2022	380	—
3.30% Senior Notes, semi-annual interest, due May 2022	500	500
3.25% Senior Notes, semi-annual interest, due April 2023	350	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	850
Revolving credit facility	145	—
Capital lease obligations	163	165
Commercial paper	126	—
Total debt	7,164	6,515
Unamortized discount	(16)	(16)
Debt, net	7,148	6,499
Current portion of debt	(995)	(17)
Noncurrent portion of debt	$6,153	$6,482

Senior Notes

On March 7, 2014, Discovery Communications, LLC ("DCL"), a wholly-owned subsidiary of the Company, issued €300 million principal amount ($417 million, at issuance based on the exchange rate of $1.39 per euro at March 7, 2014) of 2.375% Senior Notes due March 7, 2022 (the "2014 Notes"). The proceeds received by DCL from the offering were net of a $3 million issuance discount and $2 million of deferred financing costs. The current balance reflects changes in exchange rates; there have been no other changes to the balance.

DCL has the option to redeem some or all of the 2014 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 2014 Notes is payable annually on March 7 of each year. The 2014 Notes are unsecured and rank equally in right of payment with all of DCL's other unsecured senior indebtedness. All of DCL's outstanding senior notes are fully and unconditionally guaranteed on an unsecured and unsubordinated basis by Discovery and contain certain nonfinancial covenants, events of default and other customary provisions. The Company and DCL were in compliance with all covenants and customary provisions under the Senior Notes, and there were no events of default as of September 30, 2014.

The 2014 Notes are denominated in euro and expose Discovery to fluctuations in foreign exchange rates in that currency. Discovery has reported the change in remeasurement for these 2014 Notes as a component of other income, net in the consolidated statements of operations.

Revolving Credit Facilities

On June 20, 2014, DCL revised its $1.0 billion revolving credit facility to allow DCL and certain designated foreign subsidiaries of DCL to borrow up to $1.5 billion, including a $750 million sublimit for multi-currency borrowings, a $100 million sublimit for the issuance of standby letters of credit and a $50 million sublimit for swing line loans. Borrowing capacity under this agreement is reduced by the outstanding borrowings under the commercial paper program discussed below. DCL also has the ability to request an increase of the revolving credit facility up to an aggregate additional $1.0 billion, upon the satisfaction of certain conditions. The revolving credit facility agreement provides for a maturity date of June 20, 2019. The Company had outstanding borrowings of $145 million under the revolving credit facility as of September 30, 2014 at an effective interest rate of 1.25%. There were no amounts borrowed under the revolving credit facility as of December 31, 2013. The interest rate on borrowings under the revolving credit facility is variable based on DCL's then-current credit ratings. For dollar-denominated borrowings, the interest rate is based, at the Company's option, on adjusted LIBOR, plus a margin, or an alternate base rate, plus a margin. The current margins are 1.10% and 0.10%, respectively, per annum for adjusted LIBOR and alternate base rate borrowings. A monthly facility fee is charged based on the total capacity of the facility, and interest is charged based on the amount borrowed on the facility. The current facility fee rate is 0.15% per annum and subject to change based on DCL's then-current credit ratings. All obligations of DCL and the other borrowers under the revolving credit facility are unsecured and are fully and unconditionally guaranteed by Discovery.

The credit agreement governing the revolving credit facility contains customary representations, warranties and events of default, as well as affirmative and negative covenants. As of September 30, 2014, the Company, DCL and the other borrowers were in compliance with all covenants, and there were no events of default under the revolving credit facility.

Commercial Paper

On May 22, 2014, the Company entered into a commercial paper program. The commercial paper issued under this program is supported by the revolving credit facility described above. Outstanding commercial paper borrowings were $126 million as of September 30, 2014 and had a weighted average interest rate of approximately 0.3% and maturities of less than 90 days.

NOTE 7. DERIVATIVE FINANCIAL INSTRUMENTS

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

During the nine months ended September 30, 2014 and 2013, the Company designated foreign currency forward contracts to hedge anticipated third-party revenue and exposures arising from inter-company licensing agreements as cash flow hedges. The Company also designated interest rate contracts used to hedge the pricing for certain senior notes as cash flow hedges. Gains and losses on the effective portion of designated cash flow hedges are initially recorded in accumulated other comprehensive (loss) income on the consolidated balance sheet and reclassified to the statements of operations when the hedged item is recognized.

During the nine months ended September 30, 2013, the Company acquired foreign currency forward contracts in its business combinations that did not qualify for hedge accounting. During the nine months ended September 30, 2013, the Company entered into foreign exchange contracts in connection with the planned acquisition of SBS Nordic (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. There were no unsettled foreign exchange contracts held by the Company in connection with potential business combinations as of September 30, 2014 and December 31, 2013. Realized and unrealized gains and losses on foreign currency forward contracts that do not qualify for hedge accounting are reflected in other income, net on the consolidated statements of operations.

As of December 31, 2013, TF1 had the conditional right to require the Company to purchase its remaining shares in Eurosport. On May 30, 2014, the Company acquired a controlling interest in Eurosport, excluding Eurosport France, and the put right applicable to the acquired business became a component of redeemable equity recorded at fair value on the consolidated balance sheet as of September 30, 2014 (see Note 8). The value of the written put for Eurosport France is not included in noncontrolling interest and does not qualify for equity classification. It is a free-standing financial instrument reported as a fair value liability and subsequently marked to fair value through earnings regardless of associated contingencies (see Note 4).

The Company records all unsettled 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 September 30, 2014 and December 31, 2013.

The following table summarizes the notional amount and fair value of the Company's derivative positions (in millions).

		September 30, 2014		December 31, 2013	
	Balance Sheet Location	Notional	Fair Value	Notional	Fair Value
Derivatives designated as hedges:					
Foreign exchange	Prepaid expenses and other current assets	$247	$9	$16	$4
Foreign exchange	Other noncurrent assets	$98	$7	$36	$9
Foreign exchange	Accrued liabilities	$41	$1	$—	$—
Interest rate	Accrued liabilities	$425	$10	$—	$—
Derivatives not designated as hedges:					
Foreign exchange	Prepaid expenses and other current assets	$4	$—	$—	$—
Foreign exchange	Accrued liabilities	$3	$—	$4	$1
Foreign exchange	Other noncurrent liabilities	$—	$—	$3	$—
TF1 put right	Accrued liabilities	$76	$4	$574	$20

The following table presents the pretax impact of derivatives designated as cash flow hedges on income and other comprehensive (loss) income (in millions).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Gains (losses) recognized in accumulated other comprehensive (loss) income				
Foreign exchange	$7	$(1)	$3	$5
Interest rate	$(3)	$—	$(10)	$—
(Losses) gains reclassified into income from accumulated other comprehensive (loss) income (effective portion)				
Foreign exchange - distribution revenue	$(1)	$—	$(2)	$—
Foreign exchange - other income, net	$1	$1	$2	$1

The following table presents the pretax gains (losses) on derivatives not designated as hedges and the TF1 put recognized in other income, net in the consolidated statements of operations (in millions).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Foreign exchange derivatives	$1	$—	$1	$(56)
TF1 put right	—	—	(7)	—
Total	$1	$—	$(6)	$(56)

NOTE 8. REDEEMABLE NONCONTROLLING INTERESTS

In connection with the acquisition of a controlling interest in the Hub Network on September 23, 2014, the Company recognized $238 million for Hasbro's noncontrolling interest in the Hub Network. Hasbro has the right to put the entirety of its remaining 40% non-controlling interest to the Company for one year after December 31, 2021.

Embedded in the redeemable noncontrolling interest is a Discovery call right exercisable for one year after December 31, 2021. Upon the exercise of the put or call options, the price to be paid for the interest being purchased is generally a function of the then fair market value of the interest, to which certain discounts and floor values may apply in specified situations depending upon the party exercising the put or call, the basis for the exercise of the put or call, and the determined fair market value of the network at the time of

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exercise. As Hasbro's put right is outside the control of the Company, Hasbro's 40% noncontrolling interest is presented as redeemable noncontrolling interest outside of permanent equity on the Company's consolidated balance sheet (see Note 2).

In connection with the acquisition of a controlling interest in Eurosport on May 30, 2014, the Company recognized $558 million for TF1's noncontrolling interest in Eurosport. TF1 has the right to put the entirety of its remaining 49% non-controlling interest to the Company during two 90-day windows in the two and a half years after May 30, 2014. If the put right is exercised during the first 90-day window beginning July 1, 2015, it has a floor value equal to the fair value per share of Eurosport on May 30, 2014. If the put right is exercised during the second 90-day window beginning July 1, 2016, it will be priced at the then-current fair value per share of Eurosport, or as may be agreed between the Company and TF1. As TF1's put right is outside the control of the Company, TF1's 49% noncontrolling interest is presented as redeemable noncontrolling interest outside of permanent equity on the Company's consolidated balance sheet. (See Note 2.)

In connection with the acquisition of SBS Nordic on April 9, 2013, the Company recognized $6 million for the fair value of a noncontrolling interest in one of its Danish subsidiaries (see Note 2). The noncontrolling interest holder had a conditional right from November 20, 2014 through May 31, 2015 to put its 20% ownership interest to SBS. On September 16, 2014, the Company entered into an agreement with the noncontrolling interest holder to purchase their remaining 20% ownership interest. As the noncontrolling interest is contractually payable, it has been reclassified to accrued liabilities in the consolidated balance sheet as of September 30, 2014. The difference between the consideration transferred and the recorded value of the previous redeemable noncontrolling interest was recorded to additional paid-in capital.

In connection with the acquisition of a controlling interest in 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 redemption 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.

Redeemable noncontrolling interests reflected as of the balance sheet date are the greater of the noncontrolling interest balances adjusted for comprehensive income items and distributions or the redemption values remeasured at the period end foreign exchange rates (i.e., the "floor"). Adjustments to the carrying amount of redeemable noncontrolling interests 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, such currency translation adjustments to redemption value are allocated to Discovery stockholders only. Redeemable noncontrolling interest adjustments of redemption value to the floor are reflected in retained earnings. The adjustment of redemption value to the floor that reflects a redemption in excess of fair value is included as an adjustment to income from continuing operations available to Discovery Communications, Inc. stockholders in the calculation of earnings per share. None of the current period adjustments reflect a redemption in excess of fair value. (See Note 12.)

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

	Nine Months Ended September 30,	
	2014	2013
Beginning balance	$36	$—
Initial fair value of redeemable noncontrolling interests of acquired businesses	796	35
Purchase of subsidiary shares at fair value	(6)	—
Cash distributions to redeemable noncontrolling interests	(2)	—
Comprehensive income (loss) adjustments:		

Net income attributable to redeemable noncontrolling interests	11	—
Other comprehensive loss attributable to redeemable noncontrolling interests	(26)	(1)
Currency translation on redemption values	(40)	(3)
Retained earnings adjustments:		
Adjustments to redemption value	16	1
Ending balance	$785	$32

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NOTE 9. EQUITY

Common Stock Repurchase Program

Under the Company's stock repurchase program, management is authorized to purchase shares of the Company's common stock from time to time through open market purchases or privately negotiated transactions at prevailing prices or pursuant to one or more accelerated stock repurchase agreements or other derivative arrangements 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 $5.5 billion. As of September 30, 2014, the Company had remaining authorization of $1.0 billion for future repurchases under the stock repurchase program, which will expire on February 3, 2016.

Repurchased common stock is recorded in treasury stock on the consolidated balance sheet. The stock split in the form of a share dividend was not applied to the Company's treasury shares (see Note 1). Accordingly, the number of common shares repurchased under the common stock repurchase program has not been retroactively adjusted to give effect to the stock split.

All repurchases during the three and nine months ended September 30, 2014 and 2013 were made through open market transactions and were funded using cash on hand. As of September 30, 2014, the Company had repurchased over the life of the program 2.8 million and 83.4 million shares of Series A and Series C common stock for the aggregate purchase price of $171 million and $4.3 billion, respectively.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Series A Common Stock:				
Shares repurchased	—	0.8	—	0.8
Purchase price	$—	$62	$—	$62
Series C Common Stock:				
Shares repurchased	3.3	5.2	13.4	9.0
Purchase price	$188	$386	$957	$651
Total shares repurchased	3.3	6.0	13.4	9.8
Total purchase price	$188	$448	$957	$713

Preferred Stock Conversion and Repurchase

The Company has an agreement with Advance/Newhouse Programming Partnership (“Advance/Newhouse”) to repurchase, on a quarterly basis, a number of shares of Series C convertible preferred stock convertible into a number of shares of Series C common stock equal to 3/7 of all shares of Series C common stock purchased under the Company’s stock repurchase program during the then most recently completed fiscal quarter. The price paid per share is calculated as 99% of the average price paid for the Series C common shares repurchased by the Company during the applicable fiscal quarter multiplied by the Series C conversion rate. The Series C conversion rate changed from one to two upon the August 6, 2014 effective date of the stock split in the form of a share dividend (see Note 1). The Advance/Newhouse repurchases are made outside of the Company’s publicly announced stock repurchase program. During the three months ended September 30, 2014, the Company retired 1.5 million shares of its Series C convertible preferred stock under the preferred stock conversion and repurchase arrangement for an aggregate purchase price of $110 million. Based on the number of shares of Series C common stock purchased during the three months ended September 30, 2014, the Company expects Advance/Newhouse to effectively convert and sell to the Company 1.0 million shares of its Series C convertible preferred stock for an aggregate purchase price of $80 million on or about November 6, 2014. The repurchase transactions are recorded as a decrease of par value of preferred stock and retained earnings upon settlement using cash on hand.

On April 5, 2013, the Company repurchased and retired 4 million shares of its Series C convertible preferred stock from Advance/Newhouse 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.

Common Stock

On February 13, 2014, John C. Malone, a member of Discovery’s Board of Directors, entered into an agreement granting David Zaslav, the Company’s President and Chief Executive Officer, certain voting and purchase rights with respect to the approximately 5.9 million shares of the Company’s Series B common stock owned by Dr. Malone. The agreement gives Mr.

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Zaslav the right to vote the Series B shares if Dr. Malone is not otherwise voting or directing the vote of those shares. The agreement also provides that if Dr. Malone proposes to sell the Series B shares, Mr. Zaslav will have the first right to negotiate for the purchase of the shares. If that negotiation is not successful and Dr. Malone proposed to sell the Series B shares to a third party, Mr. Zaslav will have the exclusive right to match that offer. The rights granted under the agreement will remain in effect for as long as Mr. Zaslav is either employed as the principal executive officer of the Company or serving on its Board of Directors.

Other Comprehensive (Loss) Income

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

	Three Months Ended September 30, 2014			Three Months Ended September 30, 2013		
	Pretax	Tax Benefit (Provision)	Net-of-tax	Pretax	Tax Benefit (Provision)	Net-of-tax
Currency translation adjustments:						
Unrealized (losses) gains	$(195)	$8	$(187)	$117	$(13)	$104
Derivative and market value adjustments:						
Unrealized gains	4	(1)	3	1	—	1
Reclassifications to distribution revenue	1	—	1	—	—	—
Reclassifications to other income, net	(1)	—	(1)	(1)	—	(1)
Other comprehensive (loss) income	$(191)	$7	$(184)	$117	$(13)	$104

	Nine Months Ended September 30, 2014			Nine Months Ended September 30, 2013		
	Pretax	Tax Benefit (Provision)	Net-of-tax	Pretax	Tax Benefit (Provision)	Net-of-tax
Currency translation adjustments:						
Unrealized (losses) gains	$(211)	$(1)	$(212)	$3	$—	$3
Reclassifications to other income, net	(7)	—	(7)	(9)	3	(6)
Derivative and market value adjustments:						
Unrealized (losses) gains	(5)	2	(3)	10	(3)	7
Reclassifications to distribution revenue	2	—	2	—	—	—
Reclassifications to loss on disposition	(5)	2	(3)	—	—	—
Reclassifications to other income, net	(2)	—	(2)	(1)	—	(1)
Other comprehensive (loss) income	$(228)	$3	$(225)	$3	$—	$3

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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 September 30, 2014			Three Months Ended September 30, 2013		
	Currency Translation Adjustments	Derivative and Market Value Adjustments	Accumulated Other Comprehensive Loss	Currency Translation Adjustments	Derivative and Market Value Adjustments	Accumulated Other Comprehensive (Loss) Income
Beginning balance	$(41)	$3	$(38)	$(106)	$10	$(96)
Other comprehensive (loss) income before reclassifications	(187)	3	(184)	104	1	105
Reclassifications from accumulated other comprehensive (loss) income to net income	—	—	—	—	(1)	(1)
Other comprehensive (loss) income	(187)	3	(184)	104	—	104
Other comprehensive loss attributable to redeemable noncontrolling interests	28	(1)	27	—	—	—
Ending balance	$(200)	$5	$(195)	$(2)	$10	$8
	Nine Months Ended September 30, 2014			Nine Months Ended September 30, 2013		
	Currency Translation Adjustments	Derivative and Market Value Adjustments	Accumulated Other Comprehensive Income (Loss)	Currency Translation Adjustments	Derivative and Market Value Adjustments	Accumulated Other Comprehensive Income (Loss)
Beginning balance	$(8)	$12	$4	$(1)	$5	$4
Other comprehensive (loss) income before reclassifications	(212)	(3)	(215)	3	7	10
Reclassifications from accumulated other comprehensive (loss) income to net income	(7)	(3)	(10)	(6)	(1)	(7)
Other comprehensive (loss) income	(219)	(6)	(225)	(3)	6	3
Other comprehensive loss attributable to redeemable noncontrolling interests	27	(1)	26	2	(1)	1
Ending balance	$(200)	$5	$(195)	$(2)	$10	$8

NOTE 10. EQUITY-BASED COMPENSATION

The Company has various incentive plans under which performance-based restricted stock units ("PRSUs"), time-based restricted stock units ("RSUs"), stock options, unit awards and stock appreciation rights ("SARs") have been issued. As of September 30, 2014, the Company has reserved a total of 126 million shares of its Series A and Series C common stock for future exercises of outstanding and future grants of stock options and SARs and future vesting of outstanding and future grants of PRSUs and RSUs. Upon exercise of stock options and SARs or vesting of PRSUs and RSUs, the Company issues new shares from its existing authorized but unissued shares. There were 105 million shares of common stock in reserves that were available for future grant under incentive plans as of September 30, 2014.

As a result of the 2014 Share Dividend (see Note 1), the Company adjusted historical per share data, the number of shares and the exercise or grant price of its equity-based compensation.

During the nine months ended September 30, 2014, the vesting and service requirements of equity-based awards granted were consistent with the arrangements disclosed in the 2013 Form 10-K.

Equity-Based Compensation Expense

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
PRSUs and RSUs	$ 17	$ 7	$ 42	$ 28
Stock options	4	6	19	19
Unit awards	5	14	6	42
SARs	6	17	(2)	39
ESPP	1	1	1	1
Total equity-based compensation expense	$ 33	$ 45	$ 66	$ 129
Tax benefit recognized	$ 11	$ 12	$ 23	$ 34

Compensation expense for all awards is recorded in selling, general and administrative expense in the consolidated statements of operations. As of September 30, 2014 and December 31, 2013, the Company recorded total liabilities for cash-settled and certain equity-based awards of $83 million and $138 million, respectively. The current portion of the liability for cash-settled awards was $38 million and $85 million as of September 30, 2014 and December 31, 2013, respectively.

Equity-Based Award Activity

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, 2013	4.8	$ 23.00		
Granted	3.2	41.60		
Converted	(1.4)	19.41		$ 59
Forfeited	(0.2)	35.91		
Outstanding as of September 30, 2014	6.4	$ 32.67	1.1	$ 242
Vested and expected to vest as of September 30, 2014	6.2	$ 32.52	1.0	$ 233

PRSUs represent the contingent right to receive shares of the Company’s Series A and C common stock based on continuous service and the Company's achievement of certain operating performance targets. As of September 30, 2014, there were approximately 5 million outstanding PRSUs with a weighted-average grant price of $32.18. As of September 30, 2014, unrecognized compensation cost, net of expected forfeitures, related to PRSUs was $74 million, which is expected to be recognized over a weighted-average period of 0.7 years.

RSUs represent the contingent right to receive shares of the Company’s Series A and C common stock based on continuous service. As of September 30, 2014, there were less than 2 million outstanding RSUs with a weighted-average grant price of $34.09. As of September 30, 2014, unrecognized compensation cost, net of expected forfeitures, related to RSUs was $34 million, which is expected to be recognized over a weighted-average period of 2.5 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, 2013	15.2	$ 18.23		
Granted	2.0	41.23		
Exercised	(2.2)	13.77		$ 60
Forfeited	(0.2)	30.04		
Outstanding as of September 30, 2014	14.8	$ 21.91	4.1	$ 243
Vested and expected to vest as of September 30, 2014	14.4	$ 21.53	4.1	$ 238
Exercisable as of September 30, 2014	10.5	$ 16.79	3.6	$ 221

The Company received cash payments from the exercise of stock options totaling $31 million and $40 million during the nine months ended September 30, 2014 and 2013, respectively. The weighted average grant date fair value of stock options granted during the nine months ended September 30, 2014 was $20.98 per option. As of September 30, 2014, there was $31 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 2.1 years.
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, 2013	3.3	$ 19.23		
Settled	(2.1)	18.48		$ 52
Outstanding as of September 30, 2014	1.2	$ 20.59	0.3	$ 21
Vested and expected to vest as of September 30, 2014	1.2	$ 20.59	0.3	$ 21

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 September 30, 2014, the weighted-average fair value of unit awards outstanding was $17.97 per unit award. The Company made cash payments to settle vested unit awards totaling $52 million and $50 million during the nine months ended September 30, 2014 and 2013, respectively. As of September 30, 2014, there was $4 million of unrecognized compensation cost related to unit awards, which is expected to be recognized over a weighted-average period of 0.3 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, 2013	6.4	$27.60		
Granted	7.5	43.24		
Settled	(1.8)	26.78		$29
Outstanding as of September 30, 2014	12.1	$37.38	1.5	$45
Vested and expected to vest as of September 30, 2014	12.1	$37.38	1.5	$45

As of September 30, 2014, the weighted-average fair value of SARs outstanding was $5.72 per award. The Company made cash payments of $29 million and $11 million to settle exercised SARs during the nine months ended September 30, 2014 and 2013, respectively. As of September 30, 2014, there was $28 million of unrecognized compensation cost related to SARs, which is expected to be recognized over a weighted-average period of 1.5 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 nine months ended September 30, 2014 and 2013, the Company issued 145 thousand and 106 thousand shares under the DESPP and received cash totaling $5 million and $3 million, respectively.

NOTE 11. INCOME TAXES

The Company's provisions for income taxes on income from continuing operations were $155 million and $481 million, and the effective income tax rate was 35% for each of the three and nine months ended September 30, 2014, respectively. The Company's provisions for income taxes on income from continuing operations were $163 million and $490 million, and the effective income tax rates were 39% and 38% for the three and nine months ended September 30, 2013, 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 September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
U.S. federal statutory income tax rate	35%	35%	35%	35%
State and local income taxes, net of federal tax benefit	2%	3%	3%	3%
Effect of foreign operations	1%	1%	1%	1%
Domestic production activity deductions	(3)%	(2)%	(3)%	(1)%
Change in uncertain tax positions	—%	—%	(1)%	—%
Remeasurement gain on previously held equity interest	—%	(2)%	—%	(2)%
Other, net	—%	4%	—%	2%
Effective income tax rate	35%	39%	35%	38%

The Company and its subsidiaries file income tax returns in the U.S. and various state and foreign jurisdictions. 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 September 30, 2014 and December 31, 2013 totaled $186 million and $185 million, respectively. 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 $50 million within the next twelve months as a result of ongoing audits, lapses of statutes of limitations or regulatory developments.

As of September 30, 2014 and December 31, 2013, the Company had accrued approximately $16 million and $11 million, respectively, of total interest and penalties payable related to unrecognized tax benefits. The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense.

NOTE 12. EARNINGS PER SHARE

The Company follows the two-class method in calculating earnings per share. The two-class method calculates earnings per share by distinguishing between the classes of common securities based on the proportionate participation rights of each security type in the Company's undistributed income. The Company's Series A, B and C common stock are treated as one class for purposes of applying the two-class method, because they have identical economic rights. The second class is the Company's Series C convertible preferred stock. Holders of Series C convertible preferred stock have substantially equal rights as holders of Series C common stock and share equally on an as converted to Series C common stock basis with holders of Series A, B and C common stock with respect to income available to Discovery Communications, Inc. Following the 2014 Share Dividend on August 6, 2014, each share of Series C convertible preferred stock was convertible into two shares of Series C common stock. As a result of the change in conversion ratio, which did not impact the economic rights of any of the stockholders, the Company recast all prior period earnings per share presentations to be consistent with the current period.

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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 September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Numerator:				
Net income	$287	$256	$902	$787
Less:				
Allocation of undistributed income to Series A convertible preferred stock	(58)	(51)	(183)	(154)
Net income attributable to noncontrolling interests	—	(1)	(2)	(1)
Net income attributable to redeemable noncontrolling interests	(7)	—	(11)	—
Redeemable noncontrolling interest adjustments to redemption value	—	—	(1)	(1)
Net income available to Discovery Communications, Inc. Series A, B and C common and Series C convertible preferred stockholders for basic net income per share	$222	$204	$705	$631
Net income allocable to Discovery Communications Inc. Series A, B and C common stockholders and Series C convertible preferred stockholders for basic net income per share:				
Series A, B and C common stockholders	186	173	592	533
Series C convertible preferred stockholders	36	31	113	98
Total	222	204	705	631
Add back:				
Allocation of undistributed income to Series A convertible preferred stock	58	51	183	154
Net income available to Discovery Communications, Inc. Series A, B and C common stockholders for diluted net income per share	$280	$255	$888	$785
Denominator:				
Weighted average Series A, B and C common shares outstanding — basic	449	483	458	488
Weighted average impact of assumed preferred stock conversion	227	229	228	231
Weighted average dilutive effect of equity awards	6	7	7	8
Weighted average Series A, B and C common shares outstanding — diluted	682	719	693	727
Weighted average Series C convertible preferred stock outstanding — basic and diluted	43	44	44	45
Basic net income per share available to Discovery Communications, Inc. Series A, B and C common and Series C convertible preferred stockholders:				
Series A, B and C common stockholders	$0.41	$0.36	$1.29	$1.09
Series C convertible preferred stockholders	$0.82	$0.72	$2.58	$2.18
Diluted net income per share available to Discovery Communications, Inc. Series A, B and C common and Series C convertible preferred stockholders:				
Series A, B and C common stockholders	$0.41	$0.35	$1.28	$1.08
Series C convertible preferred stockholders[a]	$0.82	$0.70	$2.56	$2.16

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[a] Net income available to Discovery Communications, Inc. Series C convertible preferred stockholders for diluted net income per share is included in net income available to Discovery Communications, Inc. Series A, B and C common stockholders for diluted net income per share. For the three months ended September 30, 2014 and 2013, net income available to Discovery Communications, Inc. Series C convertible preferred stockholders for diluted net income per share was $35 million and $31 million, respectively. For the nine months ended September 30, 2014 and 2013, net income available to Discovery Communications, Inc. Series C convertible preferred stockholders for diluted net income per share was $112 million and $97 million, respectively.

The weighted average number of diluted shares outstanding adjusts the weighted average number of shares of Series A, B and C common stock outstanding for the potential dilution that would occur if common stock equivalents, including convertible preferred stock and equity-based awards, were converted into common stock or exercised, calculated using the treasury stock method. Series A, B and C diluted common stock includes the impact of the conversion of Series A preferred stock, the impact of the conversion of Series C preferred stock, and the impact of stock-based compensation. 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 weighted-average number of diluted shares outstanding of Series C convertible preferred stock is equal to the weighted-average number of basic shares, as there are no securities that are convertible into Series C convertible preferred stock.

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 September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Anti-dilutive stock options, PRSUs and RSUs	4	2	3	1
PRSUs whose performance targets have not been achieved	4	2	3	2

NOTE 13. SUPPLEMENTAL DISCLOSURES

Accrued Liabilities

Accrued liabilities consisted of the following (in millions).

	September 30, 2014	December 31, 2013
Accrued payroll and related benefits	$376	$373
Content rights payable	218	212
Accrued interest	109	43
Accrued income taxes	97	71
Current portion of equity-based compensation liabilities	38	85
Other accrued liabilities	202	208
Total accrued liabilities	$1,040	$992

Other Income, Net

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Foreign currency gains (losses), net	$7	$11	$(5)	$24
Gain (loss) on derivative instruments	1	—	(6)	(56)
Remeasurement gain on previously held equity interest	—	—	29	92

Other, net	(7	) —	(7	) 1
Total other income, net	$ 1	$ 11	$ 11	$ 61

Cash Proceeds from Equity-Based Plans, Net

Cash proceeds from equity-based plans, net consisted of the following (in millions).

	Nine Months Ended September 30,	
	2014	2013
Tax settlements associated with equity-based plans	$(27)	$(22)
Excess tax benefits from equity-based compensation	30	40
Proceeds from issuance of common stock for equity-based plans	36	43
Total cash proceeds from equity-based plans, net	$39	$61

NOTE 14. RELATED PARTY TRANSACTIONS

In the normal course of business, the Company enters into transactions with related parties. Related parties include entities that share common directorship, such as 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 Dr. Malone, who is Chairman of the Board of Liberty Global and beneficially owns approximately 28% of the aggregate voting power with respect to the election of directors of Liberty Global. Dr. Malone is Chairman of the Board of Liberty Media and beneficially owns approximately 46% 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 transactions include revenues for content and services provided to and from equity method investees, such as OWN and All3 Media. On September 23, 2014, Liberty Global and the Company each acquired 50% of All3Media, a production company and jointly control the equity method investment.

Other related party revenue and service charges during the three and nine months ended September 30, 2014 and 2013 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.

Following the Company's consolidation of the Hub Network on September 23, 2014, transactions with Hasbro Studios for content are reflected as related party expenses. The Hub has a seven year programming arrangement with Hasbro Studios.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenues and service charges:				
Liberty Group[(a)]	$39	$39	$118	$79
Equity method investees	31	17	79	55
Other	9	8	26	18
Total revenues and service charges	$79	$64	$223	$152
Interest income[(b)]	$8	$9	$25	$27
Expenses	$10	$4	$28	$16

[(a)] The increase in revenue from transactions with the Liberty Group for the nine months ended September 30, 2014 is primarily attributable to activity with Charter Communications, Inc. ("Charter") and Virgin Media, Inc. ("Virgin Media"). In May 2013, Liberty Media completed its equity method investment in Charter; Dr. Malone is on Charter's board of directors. In June 2013, Liberty Global announced it had completed its acquisition of Virgin Media. Transactions with Charter and Virgin Media have been reported as related party transactions since the date that they became related parties.

(b) The Company records interest earnings from loans to equity method investees as a component of income (loss) from equity investees, net, in the consolidated statements of operations.

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

	September 30, 2014	December 31, 2013
Receivables	$52	$41
Note receivable (see Note 3)	$452	$483

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, arrangements to purchase various goods and services, future funding commitments to equity method investees (see Note 3), and the conditional obligation to issue or acquire additional shares of preferred stock (see Note 9). In connection with the Company's business combinations in 2014 (see Note 2), the Company assumed or entered into various commitments, which include primarily programming arrangements and operating and capital leases.
Contingencies
Put Rights
The Company has granted put rights related to certain equity method investments and consolidated subsidiaries: Harpo has the right to require the Company to purchase its interest in OWN for fair value at various dates (see Note 3); TF1 has the conditional right to require the Company to purchase its remaining shares in Eurosport France (see Note 4); and noncontrolling interests, including Hasbro, TF1 and J:COM, hold put rights that obligate the Company to purchase redeemable noncontrolling interests in consolidated subsidiaries if the put right is exercised (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.
Other
The Company may provide indemnities intended to allocate 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 and estimable. There were no material amounts for indemnifications or other contingencies recorded as of September 30, 2014 and December 31, 2013.
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 as they are treated as a third-party sales transactions in determining segment performance. 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 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

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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, amortization of intangible assets and deferred launch incentives, as these amounts do not represent cash payments in the current reporting period. Certain corporate expenses are excluded from segment results to enable executive management to evaluate segment performance based upon the decisions of segment executives. 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. The tables below present summarized financial information for each of the Company's reportable segments and corporate and inter-segment eliminations (in millions).

Revenues by Segment

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
U.S. Networks	$724	$733	$2,209	$2,212
International Networks	818	620	2,291	1,716
Education	27	22	90	73
Corporate and inter-segment eliminations	(1)	—	(1)	(3)
Total revenues	$1,568	$1,375	$4,589	$3,998

Adjusted OIBDA by Segment

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
U.S. Networks	$425	$425	$1,274	$1,274
International Networks	278	223	796	659
Education	3	2	15	13
Corporate and inter-segment eliminations	(72)	(64)	(232)	(207)
Total Adjusted OIBDA	$634	$586	$1,853	$1,739

Reconciliation of Total Adjusted OIBDA to Total Operating Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Total Adjusted OIBDA	$634	$586	$1,853	$1,739
Amortization of deferred launch incentives	(4)	(4)	(8)	(14)
Mark-to-market equity-based compensation	(23)	(32)	(29)	(90)
Depreciation and amortization	(85)	(80)	(243)	(190)
Restructuring and other charges	(11)	(1)	(19)	(11)
Gain on disposition	—	19	31	19
Operating income	$511	$488	$1,585	$1,453

DISCOVERY COMMUNICATIONS, INC.
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Total Assets by Segment

	September 30, 2014	December 31, 2013
U.S. Networks	$ 3,377	$ 2,978
International Networks	5,921	4,792
Education	136	125
Corporate and inter-segment eliminations	6,939	7,084
Total assets	$ 16,373	$ 14,979

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.

NOTE 17. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

Overview

As of September 30, 2014 and December 31, 2013, the senior notes outstanding (see Note 6) have been issued by DCL, a wholly-owned subsidiary of the Company, in transactions registered with the U.S. Securities and Exchange Commission. 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"), have an effective Registration Statement on Form S-3 (the "Shelf Registration") and may issue additional debt securities under the Shelf Registration that are fully and unconditionally guaranteed by one or both of 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.

DISCOVERY COMMUNICATIONS, INC.
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(unaudited)

Condensed Consolidating Balance Sheet
September 30, 2014
(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	$—	$—	$32	$ 344	$ —	$ —	$ 376
Receivables, net	—	—	434	1,030	—	—	1,464
Content rights, net	—	—	10	369	—	—	379
Deferred income taxes	—	—	38	49	—	—	87
Prepaid expenses and other current assets	—	—	162	116	—	—	278
Intercompany trade receivables, net	—	—	54	—	—	(54)	—
Total current assets	—	—	730	1,908	—	(54)	2,584
Investment in and advances to subsidiaries	5,931	5,943	8,015	—	3,967	(23,856)	—
Noncurrent content rights, net	—	—	639	1,389	—	—	2,028
Goodwill	—	—	3,769	4,551	—	—	8,320
Intangible assets, net	—	—	310	1,781	—	—	2,091
Equity method investments	—	—	20	647	—	—	667
Other noncurrent assets	—	20	154	529	—	(20)	683
Total assets	$5,931	$5,963	$13,637	$ 10,805	$ 3,967	$ (23,930)	$ 16,373
LIABILITIES AND EQUITY							
Current liabilities:							
Current portion of debt	$—	$—	$980	$ 15	$ —	$ —	$ 995
Other current liabilities	44	12	460	1,037	—	—	1,553
Intercompany trade payables, net	—	—	—	54	—	(54)	—
Total current liabilities	44	12	1,440	1,106	—	(54)	2,548
Noncurrent portion of debt	—	—	5,871	282	—	—	6,153
Other noncurrent liabilities	4	—	383	615	20	(20)	1,002
Total liabilities	48	12	7,694	2,003	20	(74)	9,703
Redeemable noncontrolling interests	—	—	—	785	—	—	785
Equity attributable to Discovery Communications, Inc.	5,883	5,951	5,943	8,016	3,947	(23,857)	5,883
Noncontrolling interests	—	—	—	1	—	1	2
Total equity	5,883						