Discovery Holding CO
Form 10-Q
May 08, 2008

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

Form 10-Q

þ	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For the quarterly period ended March 31, 2008**
	OR
o	**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 000-51205

DISCOVERY HOLDING COMPANY
(Exact name of Registrant as specified in its charter)

State of Delaware *(State or other jurisdiction of incorporation or organization)*	**20-2471174** *(I.R.S. Employer Identification No.)*
12300 Liberty Boulevard **Englewood, Colorado** *(Address of principal executive offices)*	**80112** *(Zip Code)*

Registrant s telephone number, including area code:
(720) 875-4000

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 þ No o

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

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

The number of outstanding shares of Discovery Holding Company s common stock as of April 30, 2008 was:

Series A common stock 268,091,082 shares; and
Series B common stock 13,138,236 shares.

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DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Condensed Consolidated Balance Sheets
(unaudited)

		March 31, 2008	December 31, 2007
		amounts in thousands	
ASSETS			
Current assets:			
Cash and cash equivalents	$	222,577	209,449
Trade receivables, net		172,624	144,342
Prepaid expenses		15,324	14,815
Other current assets		3,752	3,101
Total current assets		414,277	371,707
Investments in marketable securities			23,545
Investment in Discovery Communications Holding, LLC (Discovery) (note 6)		3,330,030	3,271,553
Property and equipment, net		262,744	269,742
Goodwill (note 5)		1,909,823	1,909,823
Other assets, net		18,964	19,382
Total assets	$	5,935,838	5,865,752
LIABILITIES AND STOCKHOLDERS EQUITY			
Current liabilities:			
Accounts payable	$	48,555	26,298
Accrued payroll and related liabilities		22,839	26,127
Other accrued liabilities		42,536	42,761
Deferred revenue		23,472	24,951
Total current liabilities		137,402	120,137
Deferred income tax liabilities		1,252,033	1,228,942
Other liabilities		21,830	22,352
Total liabilities		1,411,265	1,371,431
Commitments and contingencies (note 8)			
Stockholders equity:			
Preferred stock, $.01 par value. Authorized 50,000,000 shares; no shares issued			
Series A common stock, $.01 par value. Authorized 600,000,000 shares; issued and outstanding 269,180,104 shares at March 31, 2008 and 269,159,928 shares at December 31, 2007		2,692	2,691
		119	119

Series B common stock, $.01 par value. Authorized 50,000,000 shares; issued and outstanding 11,869,696 shares at March 31, 2008 and December 31, 2007		
Series C common stock, $.01 par value. Authorized 600,000,000 shares; no shares issued		
Additional paid-in capital	5,728,701	5,728,213
Accumulated deficit	(1,219,492)	(1,253,483)
Accumulated other comprehensive earnings	12,553	16,781
Total stockholders equity	4,524,573	4,494,321
Total liabilities and stockholders equity	$ 5,935,838	5,865,752

See accompanying notes to condensed consolidated financial statements.

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DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Condensed Consolidated Statements of Operations and Comprehensive Earnings (unaudited)

	Three Months Ended March 31, 2008	2007
	amounts in thousands, except per share amounts	
Net revenue	$ 189,305	173,882
Operating expenses:		
Cost of services	138,060	121,542
Selling, general, and administrative, including stock-based compensation (notes 3 and 9)	41,155	38,004
Restructuring and other charges	1,257	
Gain on sale of operating assets	(78)	(34)
Depreciation and amortization	16,540	15,571
	196,934	175,083
Operating loss	(7,629)	(1,201)
Other income:		
Share of earnings of Discovery (note 6)	66,402	21,557
Other income, net	1,684	9,297
	68,086	30,854
Earnings before income taxes	60,457	29,653
Income tax expense	(26,466)	(9,189)
Net earnings	33,991	20,464
Other comprehensive earnings (loss), net of taxes:		
Foreign currency translation adjustments	4,009	1,354
Unrealized holding gains (losses) arising during the period	(8,237)	456
Other comprehensive earnings (loss)	(4,228)	1,810
Comprehensive earnings	$ 29,763	22,274
Basic and diluted earnings per common share Series A and Series B (note 4)	$ .12	.07

See accompanying notes to condensed consolidated financial statements.

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DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows
(unaudited)

	Three Months Ended March 31, 2008	2007
	amounts in thousands	
Cash flows from operating activities:		
Net earnings	$ 33,991	20,464
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	16,540	15,571
Stock-based compensation	(116)	966
Share of earnings of Discovery	(66,402)	(21,557)
Gain on lease buyout		(6,992)
Deferred income tax expense	25,754	8,508
Other non-cash credits, net	(502)	(487)
Changes in assets and liabilities, net of acquisitions:		
Trade receivables	(28,048)	(1,082)
Prepaid expenses and other current assets	(1,157)	(1,197)
Payables and other liabilities	17,769	(11,629)
Net cash provided by (used in) operating activities	(2,171)	2,565
Cash flows from investing activities:		
Capital expenditures	(8,552)	(13,407)
Cash proceeds from lease buyout		7,138
Net sales (purchases) of marketable securities	23,545	(665)
Other investing activities, net	145	90
Net cash provided by (used in) investing activities	15,138	(6,844)
Cash flows from financing activities:		
Net cash from option exercises	329	
Other financing activities, net	(168)	(19)
Net cash provided (used) by financing activities	161	(19)
Net increase (decrease) in cash and cash equivalents	13,128	(4,298)
Cash and cash equivalents at beginning of period	209,449	154,775
Cash and cash equivalents at end of period	$ 222,577	150,477

See accompanying notes to condensed consolidated financial statements.

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DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Condensed Consolidated Statement of Stockholders Equity
Three months ended March 31, 2008
(unaudited)

	Preferred Stock	Common stock Series A	Series B	Series C	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Earnings	Total Stockholders Equity
					amounts in thousands			
Balance at January 1, 2008	$	2,691	119		5,728,213	(1,253,483)	16,781	4,494,321
Net earnings						33,991		33,991
Other comprehensive loss							(4,228)	(4,228)
Stock compensation					160			160
Stock option exercises		1			328			329
Balance at March 31, 2008	$	2,692	119		5,728,701	(1,219,492)	12,553	4,524,573

See accompanying notes to condensed consolidated financial statements.

DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements
March 31, 2008
(unaudited)

(1) Basis of Presentation

The accompanying condensed consolidated financial statements include the accounts of Discovery Holding Company and its consolidated subsidiaries (DHC or the Company). DHC s two wholly-owned operating subsidiaries are Ascent Media Group, LLC (Ascent Media) and Ascent Media CANS, LLC (dba AccentHealth) (AccentHealth). DHC also has a 662/3% ownership interest in Discovery, previously a 50% interest through May 14, 2007, which it accounts for as an equity method investment (see note 6). All significant intercompany accounts and transactions have been eliminated in consolidation.

Ascent Media is comprised of two operating segments. Ascent Media s creative services group provides services necessary to complete the creation of original content, including feature films, mini-series, television shows, television commercials, music videos, promotional and identity campaigns, and corporate communications programming. The group manipulates or enhances original visual images or audio captured in principal photography and creates new three dimensional images, animation sequences, or sound effects. In addition, the creative services group provides a full complement of facilities and services necessary to optimize, archive, manage, and repurpose completed media assets for global distribution via freight, satellite, fiber and the Internet. The network services group provides the facilities and services necessary to assemble and distribute programming content for cable and broadcast networks via fiber, satellite and the Internet to programming providers in North America, Europe and Asia. Additionally, the network services group provides systems integration, design, consulting, engineering and project management services.

AccentHealth operates an advertising-supported captive audience television network in doctor office waiting rooms nationwide, and is included as part of the network services group for financial reporting purposes.

Discovery is a leading global media and entertainment company that provides original and purchased programming across multiple platforms in the United States and more than 170 other countries, including television networks offering customized programming in 35 languages. Discovery also develops and sells consumer and educational products and services in the United States and internationally, and owns and operates a diversified portfolio of website properties and other digital services.

The accompanying interim condensed consolidated financial statements are unaudited but, in the opinion of management, reflect all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of the results for such periods. The results of operations for any interim period are not necessarily indicative of results for the full year. These condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and notes thereto included in its Annual Report on Form 10-K, as amended, for the year ended December 31, 2007.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of revenue and expenses for each reporting period. The significant estimates made in preparation of the Company s condensed consolidated financial statements primarily relate to valuation of goodwill, other intangible assets, long-lived assets, deferred tax assets, and the amount of the allowance for doubtful accounts. Actual results could differ from the estimates upon which the carrying values were based.

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DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

(2) Newhouse Transaction and Ascent Spin Off

In December 2007, DHC announced that it had signed a non-binding letter of intent with Advance/Newhouse Programming Partnership (Advance/Newhouse) to combine their respective stakes in Discovery. As currently contemplated by the non-binding letter of intent, the transaction, if completed, would involve the following steps:

DHC will spin-off to its shareholders a wholly-owned subsidiary holding substantially all of DHC s cash, AccentHealth and Ascent Media, except for those businesses of Ascent Media that provide sound, music, mixing, sound effects and other related services (the Ascent Media Spin Off);

Immediately following the Ascent Media Spin Off, DHC will combine with a new holding company (New DHC), and DHC s existing shareholders will receive shares of common stock of New DHC;

As part of this transaction, Advance/Newhouse will contribute its interests in Discovery and Animal Planet to New DHC in exchange for preferred stock of New DHC that, immediately after the closing of the transactions, will be convertible at any time into shares initially representing one-third of the outstanding shares of common stock of New DHC on an as-converted basis. The preferred stock held by Advance/Newhouse will entitle it to elect three members to New DHC s board of directors and to exercise approval rights with respect to the taking of specified actions by New DHC and Discovery.

Although no assurance can be given, consummation of this transaction is expected in the third quarter of 2008. The Ascent Media Spin Off was approved in connection with the proposed transaction between DHC and Advance/Newhouse, and it is a condition of the Ascent Media Spin Off that the agreement between DHC and Advance/Newhouse be in effect and that all conditions precedent to that transaction (other than the Ascent Media Spin Off) shall have been satisfied.

It is currently expected that the Ascent Media Spin Off will be effected for federal income tax purposes as a tax-free distribution to DHC s shareholders and be accounted for at historical cost due to the pro rata nature of the distribution. Subsequent to the completion of the Ascent Media Spin Off, the historical results of operations of Ascent Media prior to the Ascent Media Spin Off will be included in discontinued operations in DHC s consolidated financial statements. The acquisition of Advance/Newhouse s interests in Discovery and Animal Planet will result in New DHC owning 100% of Discovery, and accordingly, New DHC will consolidate Discovery s financial position and results of operations effective with the closing of the transaction. Pursuant to FASB Technical Bulletin 85-5, the contribution of interests to New DHC will be treated as a non-substantive merger, and therefore, interests will be recorded at carry over basis.

(3) Stock Options and Other Long-Term Incentive Compensation

Stock Options

The Company records stock-based compensation for all stock incentive awards held by DHC s and its subsidiaries employees. The majority of these stock incentive awards were issued on or prior to DHC s spin off from Liberty Media Corporation (Liberty) on July 21, 2005 (the 2005 Spin Off). Stock option grants have also been issued to non-employee directors of DHC and to the president of DHC subsequent to that date. For the three months ended

March 31, 2008 and 2007, stock-based compensation related to these awards was $160,000 and $137,000, respectively.

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DISCOVERY HOLDING COMPANY AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

As of March 31, 2008, the following DHC options were outstanding and vested:

	DHC Series A	Weighted Average Exercise Price	DHC Series B	Weighted Average Exercise Price
Outstanding	1,132,036	$ 15.31	2,996,525	$ 18.87
Exercisable	908,002	$ 15.45	2,936,525	$ 18.93

As of March 31, 2008, the total compensation cost related to unvested equity awards was $379,000. Such amount will be recognized in the Company s consolidated statements of operations over a weighted average period of approximately 1.1 years.

2006 Ascent Media Long-Term Incentive Plan

Effective August 3, 2006, Ascent Media adopted its 2006 Long-Term Incentive Plan (the 2006 Plan). The 2006 Plan provides the terms and conditions for the grant of, and payment with respect to, Phantom Appreciation Rights (PARs) granted to certain officers and other key personnel of Ascent Media. The value of a single PAR (PAR Value) is equal to the positive amount (if any) of (a) the sum of (i) 6% of cumulative free cash flow (as defined in the 2006 Plan) over a period of up to six years, divided by 500,000; plus (ii) the calculated value of Ascent Media, based on a formula set forth in the 2006 Plan, divided by 10,000,000; over (b) a baseline value determined at the time of grant. The 2006 Plan is administered by a committee that consists of two individuals appointed by DHC. Grants are determined by the committee, with the first grant occurring on August 3, 2006. The maximum number of PARs that may be granted under the 2006 Plan is 500,000, and there were 483,500 PARs granted as of March 31, 2008. The PARs vest quarterly over a three year period, and are payable on March 31, 2012 (or, if earlier, on the six-month anniversary of a grantee s termination of employment without cause). Ascent Media records a liability and a charge to expense based on the PAR Value and percent vested at each reporting period.

(4) Earnings Per Common Share Series A and Series B

Basic earnings per common share (EPS) is computed by dividing net earnings by the weighted average number of common shares outstanding for the period. The weighted average number of shares outstanding for the three months ended March 31, 2008 and 2007 is 281,044,000 and 280,222,000, respectivel