Warner Bros Discovery

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# Executive Summary

Ticker Symbol: WBD

Sector: Communication/Entertainment

Price Target: $15.50

Current Price: $7.72

Recommendation: Buy

Investment Thesis:

With an unprecedented 70% decline over the past 5 years where the company has almost doubled its FCF and successfully merged with one its biggest competitors, WBD stock seems to be overlooked by stock market players who only care about EPS and the headlines but forget to check the real fundamentals of the underlying company.

# Company Overview

Business Description:

WBD is a leading global media and entertainment company formed through the merger of WarnerMedia and Discovery. It operates across multiple platforms, including television, film, and streaming, with a portfolio that includes brands like Warner Bros., HBO, CNN and Discovery Channel. The company is structured around three main segments: Studios, Networks, and Direct-to-Consumer (DTC) streaming

Management:

Management is currently very focused on growing their DTC segment of business, specially in services like HBO max, by increasing market share in the overcrowded and competitive streaming space, with increasing subscribers YoY. Their Ad revenue has doubled YoY, which could be a way to make the service cheaper and penetrate more of the market. However, this strategy has been flimsy, with this segment’ EBITDA decreasing $104M YoY

Management has been focusing on repaying their substantial debt of 41B dollars. This debt has an average duration of 13.7 years and an average cost of 4.3%. This quarter they repaid $1.8B of debt. However, it's important to notice that $45B of debt was acquired in 2022 to finance the purchase of Discovery.

Management has been, successfully, focused on using their franchises to generate revenue both in distribution and in their DTC service. Dune 2 and Godzilla v Kong have generated strong theatrical returns, with $1,2B in revenue combined. This approach, though successful, makes the company spend a lot into content production.

# Industry Overview and Competitive Positioning

The whole entertainment industry has been through very turbulent times in the past years, with the rise of DTC and Covid, which shut down a lot of their revenue sources. WBD’s extremely diversified portfolio allows them to generate cash on several fronts, be it TV network with CNN, content with Warner Bros studios, or DTC with HBO max. The strength and durability of their intellectual property and intangible assets allows them to have an economic Moat only challenged by Disney, and some would argue that the House of the Mouse has been destroying their brands in the past few years. Warner Bros has the ability to repackage and sell their content/products in so many different ways that they will navigate out of this mess in the long term as one of the only big entertainment conglomerates in a high barrier to entry oligopoly.

# Financial Analysis

Income Statement Highlights:

- **Revenue** for First 6 months of 2024 x First 6 months of 2023: 19,671M x 21,058M. Driven by a lower DTC and content profits

- **EBITDA** Q2 2024 x Q2 2023: 1,795M x 2,149M, driven by a lower DTC and content profits

- **Net Income Q2 2024 x Q2 2023: -9,996M x -1,240M** was severely affected by the $9.3B impairment cost. This extraordinary expense dragged down the EPS but without it, the net income would be more than last year’s (this year would be **-$591M**)

Balance Sheet Overview:

- **Current Ratio**: 0.76

- **Debt to Equity Ratio**: 115%, with most of that related to the Discovery acquisition. With long time to repay this debt and not high interest rates

- **$1.8B** Debt reduction in the quarter

Cash Flow Analysis:

- **Cash Provided by operating activities**: 2024 x 2024: $1,813M v $1,383M

- **Free Cash Flow**: 6M 2024 x 6M 2023: $1,366M x $792M (\*see “valuation” point 3 for more), strong free cash flow generation was better than last year even if EPS was hurt by impairment

- FCF in the TTM = $6,735M

# Valuation:

- **EV/FCF analysis**: WBD: 12.3 /// DIS: 28.8 /// CMCSA: 14.8 /// PARA: 32.8

Method Used: Reverse DCF valuation

- Assuming it’s FCF in the TTM of 6,735 Billion USD, a 0% FCF growth over the next 10 years, a terminal growth rate of 1.5% (in line with the US’s GDP growth) and an extremely conservative discount rate of 18% per year (average of market being 10%), the stock should be trading at $15.57

- Using its current share price and assuming the same stats for WACC, FCF and TGR, We calculate that the market is intrinsically projecting a -14% CAGR in the next 10 years. However, according to Yahoo Finance, the lower end of Wall Street analysts actually project positive EPS growth from $-4.92 to $-0.71 from full year 2024 to 2025. In other words, if FCF grows more than -14% CAGR in the next 10y, the stock should be fundamentally undervalued.

- The increase in FCF compared to the first 6 months last year (of about 72%) does not correlate with the stock performance of -23% in the last 12 months and -71% in the last 5 years. Possibly the uncertainties around its DTC future or fluctuations of EPS have scared investors away

# Risks

- If the company does not do a good job in preserving the relevance of their intellectual properties or is not able to create new, future-iconic IPs, a large part of its Economic moat will be taken away and its loyal fanbase will stop being loyal. However, they haven’t made any mistakes on that front as of late (at least not as terrible mistakes as Disney)

- If their focus on the DTC market does not generate expressive results, unlike we’ve seen this quarter, the market’s perception of the management team and the company as a whole will not improve, stagnating the stock price for longer

- If the company fails to deleverage and reduce its debt, or even fail to justify such an expensive acquisition of Discovery with more long term increase inFCF coming from the acquired company, they can be over buried with debt and the market will judge the company poorly for spending this much money in something that won’t generate profits or can’t pay itself. With its current FCF generation and duration of the debt, however, this seems not to be the case

# Conclusion

**BUY.**

WBD stock has been one of the worst performing stocks of the S&P 500 over the past 5 years, declining over 70% because of debt concerns and streaming uncertainty. However, analyzing the fundamentals of the company, we see that Free Cash Flow generation, that does not depend on impairment charges that impact net income, has increased almost 100% compared to 2019, and doing so without burning their Intellectual properties which is the biggest invisible asset of the company. Their future is uncertain and the market concerns are valid, but their valuation as it stands today is extremely cheap to overlook and the company hasn’t harmed itself to make such a discount justifiable. For a great company, although not a perfect one, this seems like a great price to get onboard.

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Sources: All the informations were taken from WBD’s Investors relations website except for the EV/FCF values, which were looked up on Finbox.com