EGAIN COMMUNICATIONS CORP
Form 10-K
September 27, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended June 30, 2011

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to .

Commission File Number: 0-30260

eGain Communications Corporation

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**77-0466366** (I.R.S. Employer Identification No.)
345 E. Middlefield Road, Mountain View, California 94043 (Address of principal executive offices, including zip code)	**(650)230-7500** (Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value $0.001 per share

Indicate by check mark if registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or 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 ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes ¨ No x.

The aggregate market value of the voting and non-voting common equity held by non-affiliates, on the OTC Bulletin Board on December 31, 2010 (the last business day of registrant s second quarter of fiscal 2011), was approximately $4.4 million. For purposes of the foregoing calculation only, the registrant has included in the shares owned by affiliates the beneficial ownership of voting and non-voting common equity of officers and directors, and affiliated entities, of the registrant and members of their families. Such inclusion shall not be construed as an admission that any such person is an affiliate for any other purpose.

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	**Outstanding at September 22, 2011**
Common Stock $0.001 par value	24,408,981

DOCUMENTS INCORPORATED BY REFERENCE

Items 10 (as to directors), 11, 12, 13 and 14 of Part III incorporate by reference information from the registrant s proxy statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for the registrant s 2011 Annual Meeting of Stockholders.

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CAUTIONARY NOTE ON FORWARD-LOOKING STATEMENTS

This report on Form 10-K and the documents incorporated herein by reference contain forward-looking statements that involve risks and uncertainties. These statements may be identified by the use of the words such as anticipates, believes, continue, could, would, estimates, expects, intends, may, might, plans, potential, should, or will and similar expressions or the negative of those terms. The forward-looking statements include, but are not limited to, risks stemming from: our failure to compete successfully in the markets in which we do business; the adequacy of our capital resources and need for additional financing; continued lengthy and delayed sales cycles; the development and expansion of our strategic and third party distribution partnership and relationships with systems integrators; our ability to improve our current products; our ability to innovate and respond to rapid technological change and competitive challenges; legal and regulatory uncertainties and other risks related to protection of our intellectual property assets; our ability to anticipate our competitors; the operational integrity and maintenance of our systems; the uncertainty of demand for our products; the anticipated customer benefits from our products; the actual mix in new business between hosting and license transactions when compared with management s projections; the ability to continue increasing investment in sales and marketing; our ability to hire additional personnel and retain key personnel; our ability to manage our expenditures and estimate future expenses, revenue, and operational requirements; our ability to manage our business plans, strategies and outlooks and any business-related forecasts or projections; risks from our substantial international operations; our ability to manage future growth; the trading price of our common stock; and geographical and currency fluctuations. Our actual results could differ materially from those discussed in statements relating to our future plans, product releases, objectives, expectations and intentions, and other assumptions underlying or relating to any of these statements. These forward-looking statements represent our estimates and assumptions and speak only as of the date hereof. We expressly disclaim any obligation or understanding to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based unless required by law.

All references to eGain , the Company , our , we or us mean eGain Communications Corporation and its subsidiaries, except where it is clear the context that such terms mean only this parent company and excludes subsidiaries.

PART I

ITEM 1. BUSINESS

Overview

The Company was incorporated in Delaware in September 1997. eGain is one of the premier providers of cloud (or hosting) and on-site customer interaction software for sales and service. For over a decade, eGain solutions have helped improve customer experience, grow sales, and optimize service processes across the web, social, and phone channels. Hundreds of global enterprises rely on eGain to transform fragmented sales engagement and customer service operations into unified Customer Interaction Hubs.

Industry Background

As products get commoditized in a digitally connected global economy, business differentiation increasingly depends on brands built on high-quality customer interactions. For Business to Consumer (B2C) enterprises, delivering smart customer interactions is vital as customer perceptions based on individual interactions can get magnified through the social megaphone and always on mobile connectivity. Consumers, especially the younger generation, expect businesses to serve them conveniently across all touch points, while catering to their social-enabled lifestyle. We have found that making customer interactions easy, seamless, and consistent can be difficult. In our experience, executives across industries are looking for efficient, modular, and scalable solutions to rapidly enable smart customer interactions.

The eGain Solution

Our solution is designed to provide clients with the following benefits:

Build profitable long-term customer relationships. Enabled by an always on mobile lifestyle, customers are spending more time conducting business on the web and social channels. Our solution helps businesses design brand-aligned experiences at every touch point. Whether a customer is looking to buy, ask a question, or pay a bill, our solution helps businesses provide customers personalized, consistent responses.

Increase revenue through improved sales conversion and cross-sell. In addition to strengthening customer relationships, our solution helps businesses convert website visitors into buyers. It also helps agents to contextually up-sell and cross-sell products in the course of customer interactions. A visitor to a website that uses eGain can be proactively offered personalized promotional content or real-time assistance based on a configurable business rule which is informed by visitor behavior and history. Visitors can interact with a customer service representative live over the web through click to call, chat and cobrowse to inquire about and buy a product. Customers calling into a service center can be offered powerful cross-sell offers by agents using the expert reasoning capability of eGain.

Reduce operating costs through improved agent productivity and self-service automation. Our solution helps companies to provide highly effective customer service while reducing operating costs. Our intelligent routing, auto-response, tracking, and reporting features, complemented with agent-facing knowledge tools, measurably enhance the productivity of service agents. Our robust online self-service tools, with integrated escalation paths and sophisticated artificial intelligence, help resolve customer inquiries without human assistance.

Reduce total cost of ownership through an open architecture, integration adapters, and scalable design. Our solution is designed to easily integrate with business data and processes residing in legacy systems and other enterprise data sources. By integrating out of the box with leading business applications, our platform allows clients to leverage existing data, content, and communication assets.

Offer rapid time to value through flexible deployment options. Our solution can be deployed on-site, on-demand, or as a managed service. In addition, we offer eGain Solution-as-a-Service (SLaaS), a package that enables clients to use our solution without a long-term contract or upfront implementation fee. Moreover, our clients have the flexibility to move from one deployment model to another when their needs change.

Products and Services

eGain 10 Suite

Recognized by industry analysts and trusted by leading companies worldwide, eGain 10 helps businesses engage, acquire, and serve customers through multiple interaction channels. It offers modular, best-of-breed applications built on a one-of-a-kind customer interaction hub platform that provides 360-degree customer context and actionable knowledge to enhance every customer interaction. Built for rapidly implementing next-generation customer interaction strategies, eGain 10 consists of:

eGain Interactive Sales Suite to transform B2C websites into interactive shopping destinations.
eGain Service Suite to transform traditional call centers into knowledge-powered multichannel customer interaction hubs.
eGain CIH , a multichannel customer interaction hub (CIH) platform that provides centralized business rules, interactions, knowledge, workflow, analytics, administration, and integrations to all applications.
eGain Adapters for integrating with leading call center, business, content, and email systems.

A special edition of eGain 10, **eGain 10 for Cisco Unified CCX ,** provides a pre-integrated, multichannel interaction solution for use with Cisco Unified Contact Center Express.

eGain 10 includes the following best-of-breed applications for web, social and contact center interactions:

Web Customer Interaction Applications

- **eGain Offers** helps businesses engage visitors on the company website and Facebook fan pages with proactive, targeted offers. Using browsing behavior and other attributes, the solution anticipates visitor needs and proactively serves a personalized offer. It leapfrogs existing proactive chat point solutions by providing coupons, promotions, surveys, personalized content and contextual help in the form of FAQ, chatbot, chat, click to call, and cobrowse options.
- **eGain Chatbot** enables businesses to offer text and speech chat interactions with one or more virtual assistants (chatbots). Multilingual, emotionally and culturally intelligent, the eGain Chatbot is capable of understanding natural language. It can be deployed on websites and mobile devices and supports seamless integration with assisted chat channels.
- **eGain Cobrowse** enables phone and chat reps to show customers around the website, help locate information, and hand-hold them during complex, anxiety-ridden tasks such as completing forms or checking out shopping carts. It offers true collaborative browsing without any customer download requirement. Access to web page views and actions is controlled through user roles and business rules.
- **eGain Chat** enables website visitors to conduct text and video chats with agents. It gives representatives a comprehensive set of tools for serving customers in real- time. eGain Chat supports two-way, follow me web browsing so that agents and customers can lead each other to specific web pages for faster issue resolution. The system s powerful, query-specific routing and workflow maximize both agent productivity and interaction quality.
- **eGain ClickToCall** provides website visitors the ability to request a callback while browsing. Callbacks can be scheduled according to the customer s convenience or be established in real-time.

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eGain SelfService is a comprehensive solution supporting what we believe to be the broadest set of self-service access options in the industry dynamic FAQs, topic-based browsing, natural language search, guided help, virtual assistant technology, and case tracking. eGain SelfService offers a unique combination of rich, multi-access self-service capabilities built on a collaborative knowledge management framework within eGain OpenCIH Platform. This framework makes it easy for organizations to create, maintain, and enhance common content in a distributed manner, as well as leverage existing content from across the enterprise. The key modules of this application are:

- **eGain Portals** enables organizations to provide distinctive, productive and brand-aligned self-service experiences. Powered by eGain Multisearch knowledge access technology, it brings together the power of a broad set of knowledge access methods, federated search, process intelligence, multilingual capabilities, and flexible look and feel all behind a single search box for distinctive, on-target self-service. Customers can also view frequently asked questions, manage their own accounts, review open tickets, and review their communications with the company within a secure, personalized environment.

- **eGain Guided Help** gives customers interactive access to the company s knowledge base, allowing them to find answers and troubleshoot problems by themselves at their convenience. It uses patented search and reasoning technology, coupled with natural language and advanced linguistic processing to search, suggest additional questions, and recommend solutions.

- **eGain MessageCenter** enables secure and authenticated messaging between a business and its customers. eGain MessageCenter is a secure web-based portal for customers to read confidential messages, including attachments.

- **eGain Widgets** enable contextual access to knowledge and account information through mobile devices and web pages.

- **eGain Survey** helps contact centers, ecommerce sites, and customer portals connect with their customers in a vital and immediate way by eliciting feedback at various points of contact. It enables them to measure and improve the quality of service across all interaction channels, thereby maximizing customer retention.

Social Customer Interaction Applications

eGain Social is a one-of-a-kind application for social customer service knowledge harvesting and single-sourced social publishing, and reputation management. It enables businesses to monitor social networks such as Facebook, Twitter and blogs for customer queries, analyze their content, analyze search results for sentiment, route them intelligently, and post responses privately or back to the social cloud in media appropriate format.

eGain Community enables the creation and management of online communities or forums, community knowledge harvesting, and single-sourced publishing. Forum posts are searchable from portals, and can be submitted as content for the Knowledge Base Adapters allow integration with existing forums.

Contact Center Applications

eGain Mail is an industry-leading application for processing inbound customer emails and providing mission-critical email customer response, incorporating hundreds of best practices developed over years of serving innovative global enterprises. Secure messaging, lifecycle audits, and real-time archival are some of the features that provide our customers a next-generation email management platform for their enterprises. Designed to process very high volumes of email and webform requests, eGain Mail allows companies to deliver consistent, high-quality service through flexible process automation, optimized user interface, and powerful reports. Additional modules include:

- **eGain SecureMail** for authenticated web-based access to confidential emails. It is widely used in financial services sector and other regulated industries.

- **eGain EncryptedMail** for encrypted email payload delivered to the customer s mailbox (push), complementing eGain SecureMail (invitation to secure website to share payload).
- **eGain Fax** and **eGain SMS** to enable timely responses to faxes (and postal mail) and SMS with the same infrastructure that is used to handle emails. Optical Character Recognition (OCR) technology is used to process faxes and postal mail.

eGain CallTrack is a comprehensive and a flexible phone call logging system. Together with **eGain KnowledgeAgent** , it provides an integrated application for phone call logging, tracking and resolution as well as follow-on task management for service fulfillment.

eGain KnowledgeAgent empowers contact center agents with best-practice knowledge management and is designed to make every agent as productive and capable as the enterprise s best agent. This application delivered fast, consistent, and accurate answers to agents as they use the rich conversational interface while engaging customers over the phone. eGain KnowledgeAgent uses patented search and reasoning technology coupled with natural language and advanced linguistic processing to search, suggest additional questions, and recommend solutions. eGain Multisearch enables simple search-based access to various types of federated content and guided help.

eGain IVR enables superior phone self-service experiences by adding human-like intelligence to interactive voice response, or IVR and unifying it with other interaction channels, including web self-service. Unlike traditional voice self-service applications, it offers intelligent dialogs driven by eGain s patented case-based reasoning technology and seamless movement across channels.

eGain Notify is a flexible, easy-to-use application for managing and delivering automatic reminders, alerts, and updates at all stages of the customer relationship cycle. It is used to provide proactive customer service by sending alerts to customers via multiple interaction channels such as email, phone and SMS. These alerts could span various stages of a service transaction, a customer s life event, or a customer s overall life progression where a business may want to add value by providing contextual customer service.

eGain SME is an enterprise collaboration tool that allows subject matter experts, or SMEs, to participate in the process of resolving customer queries. SMEs, both internal in the contact center and external in other departments or companies, are able to fully participate in both solving ongoing problems and suggesting new solutions for inclusion in the knowledge base.

Flexible Deployment Options

eGain s deployment options, we believe, are unmatched in the industry. eGain customers can choose from multiple options: on-site, cloud, managed, and solution as a service. They can even choose a hybrid model or switch from one deployment type to another. eGain is one of the few vendors that has consistently offered both cloud and on-site deployments for more than a decade.

Customers

We serve a worldwide customer base across a wide variety of industry sectors including: telecommunications, financial services, insurance, outsourced services, retail, technology, utilities, government, manufacturing and consumer electronics. Our product is sold primarily to large enterprises (over $250 million in annual revenue). Recently, we began to build out sales capability to reach medium sized enterprises (companies with up to $250 million in annual revenue). For the fiscal year ended June 30, 2011, international revenue accounted for 53% and domestic revenue for 47% of total revenue, compared to 47% and 53% respectively for fiscal year 2010 and 50% and 50% respectively for fiscal year 2009.

One customer accounted for about 22% of total revenue in fiscal year 2011. One customer accounted for 14% of total revenue in both fiscal years 2010 and 2009.

Competition

We compete with other application software vendors including Avaya, Inc., Consona Corporation, Genesys Telecommunications (a wholly-owned subsidiary of Alcatel), Kana Software, Inc., LivePerson, Inc., Moxie

Software, Inc. and RightNow Technologies, Inc. In addition, we face actual or potential competition from larger software companies such as Microsoft Corporation, Oracle Corporation, Salesforce.com, Inc. and SAP Inc. that may attempt to sell customer interaction software to their installed base. We also compete with internally developed applications within large enterprises. Finally, we face, or expect to face, competition from software vendors who may develop toolsets and products that allow customers to build new applications that run on the customers infrastructure or as hosted services.

We believe the principal competitive factors in our market include the following:

- proven track record of customer success;
- speed and ease of implementation;
- product functionality;
- financial stability and viability of the vendor;
- product adoption;
- ease of use and rates of user adoption;
- low total cost of ownership and demonstrable cost-effective benefits for customers;
- performance, security, scalability, flexibility and reliability of the service;
- ease of integration with existing applications;
- quality of customer support;
- availability and quality of implementation, consulting and training services; and
- vendor reputation and brand awareness.

Sales and Marketing

Sales Strategy

Our sales strategy is to pursue targeted accounts, mostly Business to Consumer (B2C) enterprises , through a combination of our direct sales force and partners. We target our sales efforts at Enterprise and Mid-market companies. Our North American direct sales organization is based at our corporate headquarters in Mountain View, California, with field sales presence throughout the United States. Internationally, we have field offices in Ireland, Italy, India, the Netherlands, and the United Kingdom.

The direct sales force is organized into teams that include sales representatives and sales consultants. Our direct sales force is made up of two components, field sales and inside sales representatives. It is complemented by lead generation representatives.

We also complement our direct sales force with reseller and sales alliances. We believe we are able to leverage additional sales, marketing and deployment capabilities through these alliances.

Marketing and Partner Strategy

Our marketing strategy is to build brand around innovative and robust products trusted by leading enterprises. Our marketing organization focuses on public relations, analyst relations, marketing communications and demand generation. We employ a wide range of marketing avenues to deliver our message, including print and Internet advertising, targeted electronic and postal mailing, email newsletters, and a variety of trade shows, seminars, webinars, and interest groups.

Our marketing group also produces sales tools, including product collateral, customer case studies, demonstrations, presentations, and competitive analyses. In addition, the group performs market analyses and conducts focus group and customer reviews to identify and develop key partnership opportunities and product capabilities.

We believe that our partners help extend the breadth and depth of our product offerings, drive market penetration, and augment our professional service capabilities. We believe these relationships are important to delivering successful, integrated products and services to our customers, and scaling our business. Our partner

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portal, EcoNet , enables us to provide comprehensive sales, support and services information for channel partners, while enabling them to collaborate with one another through an online forum. Partner enablement is a key focus area for our consulting and training teams too.

As of fiscal year ended June 30, 2011, there were approximately 94 employees engaged in worldwide sales and marketing activities.

Consulting and Education

Our worldwide professional services organization provides consulting and education services designed to facilitate customer success and build customer loyalty.

Consulting Services. Our consulting services group offers rapid implementation services, custom solution development, and systems integration services. Consultants work with customers to understand their specific requirements, analyze their business needs, and implement integrated solutions. We provide these services independently or in partnership with system integrators who have developed consulting expertise on our platform.

Education Services. Our education services group provides a comprehensive set of basic and customized training programs to our customers and partners in addition to online tutorial modules for ongoing refresher courses. Training programs are offered either in-person at the customer site, or at one of our worldwide training centers.

As of fiscal year ended June 30, 2011, we had approximately 56 professionals providing worldwide services for systems installation, solutions development, application management, and education.

Customer Support

We offer a comprehensive collection of support services designed to rapidly respond to inquiries. Our technical support services are available to customers worldwide under maintenance agreements. Our customer support strategy is to provide dedicated customer support account managers for large enterprise customers. The customer support team uses eGain s own software suite to provide world-class service to all our customers through support centers located in California, the United Kingdom, and India.

As of fiscal year ended June 30, 2011, there were approximately 30 employees engaged in worldwide customer support services.

Research and Development

The market for our products changes rapidly and is characterized by evolving industry standards, swift changes in customer requirements, and frequent new product introductions and enhancements. We believe that strong product development capabilities are essential to our strategy of maintaining technology leadership. This includes enhancing current technology, providing excellent quality, performance, and functionality, as well as developing additional applications, and maintaining the competitiveness of our product and service offerings. We have invested significant time and resources to set up a comprehensive software development process that involves several functional groups at all levels within our organization and is designed to provide a framework for defining and addressing the activities required in bringing product concepts and development projects to market successfully.

In addition, we continuously analyze market and customer requirements and evaluate technology that we believe will enhance platform acceptance in the market.

As of fiscal year ended June 30, 2011, there were approximately 82 employees engaged in worldwide product development activities. We spent approximately $5.6 million on research and development in fiscal year 2011, and $5.5 million in fiscal years 2010 and 2009.

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Intellectual Property

We regard our copyrights, service marks, trademarks and similar intellectual property as critical to our success. We rely on patent, trademark, copyright, trade secret and other laws, as well as confidentiality procedures and licensing arrangements, to protect the proprietary aspects of our technology and business.

We continually assess the propriety of seeking patent and other intellectual property protection for those aspects of our technology that we believe constitute innovations providing significant competitive advantages. Future applications may or may not receive the issuance of valid patents and trademarks.

We routinely require our employees, customers, and potential business partners to enter into confidentiality and nondisclosure agreements before we will disclose any sensitive aspects of our products, technology, or business plans. In addition, we require employees to agree to surrender to us any proprietary information, inventions or other intellectual property they generate or come to possess while employed by us. Despite our efforts to protect our proprietary rights through confidentiality and license agreements, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. These precautions may not prevent misappropriation or infringement of our intellectual property. In addition, some of our license agreements with certain customers and partners require us to place the source code for our products into escrow. These agreements typically provide that some party will have a limited, non-exclusive right to access and use this code as authorized by the license agreement if there is a bankruptcy proceeding instituted by or against us, or if we materially breach a contractual commitment to provide support and maintenance to the party.

Third parties may infringe or misappropriate our copyrights, trademarks and similar proprietary rights. In addition, other parties may assert infringement claims against us. Our products may infringe issued patents that may relate to our products. In addition, because patent applications in the United States are not publicly disclosed until the patent is issued, applications may have been filed which relate to our software products. We may be subject to legal proceedings and claims from time to time in the ordinary course of our business, including claims of alleged infringement of the trademarks and other intellectual property rights of third parties. Intellectual property litigation is expensive and time consuming and could divert management s attention away from running our business. This litigation could also require us to develop non-infringing technology or enter into royalty or license agreements. These royalty or license agreements, if required, may not be available on acceptable terms, if at all, in the event of a successful claim of infringement. Our failure or inability to develop non-infringing technology or license the proprietary rights on a timely basis would harm our business.

Employees

As of fiscal year ended June 30, 2011, we had 321 full-time employees, of which 82 were in product development, 109 in services and support, 94 in sales and marketing, and 36 in finance and administration.

None of our employees are covered by collective bargaining agreements. While we believe our relations with our employees are good, our future performance depends largely upon the continued service of our key technical, sales and marketing, and senior management personnel, none of whom are bound by employment agreements requiring service for a defined period of time. The loss of services of one or more of our key employees could have a material adverse effect on our business.

We may not be successful in attracting, training and retaining qualified personnel, and the failure to do so, particularly in key functional areas such as product development and sales, could materially and adversely affect our business, results of operations and financial condition. Our future success will likely depend largely on our ability to attract and retain experienced sales, technical, marketing and management personnel.

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ITEM 1A. RISK FACTORS

The risks and uncertainties described below are not the only ones facing us. Other events that we do not currently anticipate or that we currently deem immaterial also may affect our results of operations, cash flows and financial condition.

Our business is influenced by a range of factors that are beyond our control and that we have no comparative advantage in forecasting. These include:

- general economic and business conditions;
- currency exchange rate fluctuations;
- the overall demand for enterprise software and services;
- governmental budgetary constraints or shifts in government spending priorities; and
- general political developments.

The recent recession and global economic crisis caused a general tightening in the credit markets, lower levels of liquidity, increases in the rates of default and bankruptcy, and extreme volatility in credit, equity and fixed income markets. These macroeconomic developments negatively affected, and could continue to negatively affect, our business, operating results or financial condition which, in turn, could adversely affect our stock price. A general weakening of, and related declining corporate confidence in, the global economy or the curtailment in government or corporate spending could cause current or potential customers to reduce their technology budgets or be unable to fund software or services purchases, which could cause customers to delay, decrease or cancel purchases of our products and services or cause customers not to pay us or to delay paying us for previously purchased products and services.

Our lengthy sales cycles and the difficulty in predicting timing of sales or delays may impair our operating results

The long sales cycle for our products may cause license revenue and operating results to vary significantly from period to period. The sales cycle for our products can be six months or more and varies substantially from customer to customer. Because we sell complex and deeply integrated solutions, it can take many months of customer education to secure sales. While our potential customers are evaluating our products before, if ever, executing definitive agreements, we may incur substantial expenses and spend significant management effort in connection with the potential customer. Our multi-product offering and the increasingly complex needs of our customers contribute to a longer and unpredictable sales cycle. Consequently, we often face difficulty predicting the quarter in which expected sales will actually occur. This contributes to the uncertainty and fluctuations in our future operating results. In particular, the corporate decision-making and approval process of our customers and potential customers has become more complicated. This has caused our average sales cycle to further increase and, in some cases, has prevented the closure of sales that we believed were likely to close. In addition, historically our license sales have comprised a relatively small number of high value transactions; consequently, we may miss our revenue forecasts and may incur expenses that are not offset by corresponding revenue from the delay in even one transaction.

Our hybrid revenue model may impact our operating results

We have a hybrid delivery model meaning that we offer our solutions on a hosted or license basis to our customers. For license transactions, the license revenue amount is generally recognized in the quarter delivery and acceptance of our software takes place whereas, for hosting transactions, hosting revenue is recognized ratably over the term of the hosting contract, which is typically one to two years. As a result, our total revenue may increase or decrease in future periods as a result of the timing and mix of license and hosting transactions.

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We must compete successfully in our market segment

The market for customer interaction software is intensely competitive. Other than product innovation and existing customer relationships, there are no substantial barriers to entry in this market, and established or new entities may enter this market in the future. While software internally developed by enterprises represents indirect competition, we also compete directly with packaged application software vendors, including Avaya, Inc., Consona Corporation, Genesys Telecommunications (a wholly-owned subsidiary of Alcatel), Kana Software, Inc, LivePerson, Inc., Moxie Software, Inc., and RightNow Technologies, Inc. In addition, we face actual or potential competition from larger software companies such as Microsoft Corporation, Oracle Corporation, Salesforce.com, Inc. and SAP Inc. and similar companies that may attempt to sell customer interaction software to their installed base.

We believe competition will continue to be fierce as current competitors increase the sophistication of their offerings and as new participants enter the market. Many of our current and potential competitors have longer operating histories, larger customer bases, broader brand recognition, and significantly greater financial, marketing and other resources. With more established and better-financed competitors, these companies may be able to undertake more extensive marketing campaigns, adopt more aggressive pricing policies, and make more attractive offers to businesses to induce them to use their products or services.

If we fail to expand and improve our sales performance and marketing activities, we may be unable to grow our business, negatively impacting our operating results and financial condition

Expansion and growth of our business is dependent on our ability to expand our sales force and on the ability of our sales force to become more productive. If we are not able to effectively develop and maintain awareness of our products in a cost-effective manner, we may not achieve widespread acceptance of our existing and future products. This may result in a failure to expand and attract new customers and enhance relationships with existing customers. This may impede our efforts to improve operations in other areas of the Company and may result in a decline of the market price of our common stock.

Due to the complexity of our customer interaction hub platform and related products and services, we must utilize highly trained sales personnel to educate prospective customers regarding the use and benefits of our products and services as well as provide effective customer support. If we have turnover in our sales and marketing forces and because we have fewer resources than those of our competitors, we may not be able to successfully compete with those of our competitors.

We have experienced growth in recent periods and expect to continue to grow. If we fail to manage our growth effectively, we may be unable to execute our business plan, maintain high levels of service or adequately address competitive challenges

To achieve our business objectives, we will need to continue to expand our business at an appropriate pace. This expansion has placed, and is expected to continue to place, a significant strain on our managerial, administrative, operational, financial and other resources. We anticipate that expansion will require substantial management effort and additional investment in our infrastructure and headcount. If we are unable to successfully manage our growth, our business, financial condition and results of operations will be adversely affected.

Part of the challenge that we expect to face in the course of our expansion is increased staffing which is being used primarily towards developing new sales strategies and expanding into different markets. We have considerable need to recruit, train, and retain qualified staff and any delays or difficulties we encounter in these staffing efforts could impair our ability to grow.

We intend to continue to expand our distribution channels into international markets and to spend significant financial and managerial resources to do so. If our revenue from international operations does not exceed the expense associated with establishing and maintaining these channels, our business and operating results will suffer.

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Our failure to develop and expand strategic and third-party distribution channels would impede our revenue growth

Our success and future growth depends in part upon the skills, experience, performance and continued service of our distribution partners, including software and hardware vendors and resellers. We engage with distribution partners in a number of ways, including assisting us to identify prospective customers, to distribute our products in geographies where we do not have a physical presence and to distribute our products where they are considered complementary to other third party products distributed by the partner. We believe that our future success depends in part upon our ability to develop and expand strategic, long term and profitable partnerships and reseller relationships. If we are unable to do so, or if any existing or future distribution partners fail to successfully market, resell, implement or support our products for their customers, or if distribution partners represent multiple providers and devote greater resources to market, resell, implement and support competing products and services, our future revenue growth could be impeded. Our failure to develop and expand relationships with systems integrators could harm our business.

We sometimes rely on system integrators to recommend our products to their customers and to install and support our products for their customers. We likewise depend on broad market acceptance by these system integrators of our product and service offerings. Our agreements generally do not prohibit competitive offerings and system integrators may develop, market, or recommend software applications that compete with our products. Moreover, if these firms fail to implement our products successfully for their customers, we may not have the resources to implement our products on the schedule required by their customers. To the extent we devote resources to these relationships and the partnerships do not proceed as anticipated or provide revenue or other results as anticipated, our business may be harmed. Once partnerships are forged, there can be no guarantee that such relationships will be renewed in the future or available on acceptable terms. If we lose strategic third party relationships, fail to renew or develop new relationships, or fail to fully exploit revenue opportunities within such relationships, our results of operations and future growth may suffer.

Our international operations involve various risks

We derived 53% of our revenue from international sales for fiscal year 2011 compared to 47% for fiscal year 2010, and 50% for fiscal year 2009. Including those discussed above, our international sales operations are subject to a number of specific risks, such as:

- general economic conditions in each country or region in which we do or plan to do business;
- foreign currency fluctuations and imposition of exchange controls;
- expenses associated with complying with differing technology standards and language translation issues;
- difficulty and costs in staffing and managing our international operations;
- difficulties in collecting accounts receivable and longer collection periods;
- health or similar issues, such as a pandemic or epidemic;
- various trade restrictions and tax consequences;
- hostilities in various parts of the world; and

reduced intellectual property protections in some countries.

About 48% of our workforce is employed in India. Of these employees, more than 41% are allocated to research and development. Although the movement of certain operations internationally was principally motivated by cost cutting, the continued management of these remote operations requires significant management attention and financial resources that could adversely affect our operating performance. In addition, with the significant increase in the numbers of foreign businesses that have established operations in India, the

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competition to attract and retain employees there has increased significantly. As a result of the increased competition for skilled workers, we experienced increased compensation costs and expect these costs to increase in the future. Our reliance on our workforce in India makes us particularly susceptible to disruptions in the business environment in that region. In particular, sophisticated telecommunications links, high speed data communications with other eGain offices and customers, and overall consistency and stability of our business infrastructure are vital to our day-to-day operations, and any impairment of such infrastructure will cause our financial condition and results to suffer. The maintenance of stable political relations between the United States, European Union and India are also of great importance to our operations.

Any of these risks could have a significant impact on our product development, customer support, or professional services. To the extent the benefit of maintaining these operations abroad does not exceed the expense of establishing and maintaining such activities, our operating results and financial condition will suffer.

Our revenue and operating expenses are unpredictable and may fluctuate, which may harm our operating results and financial condition

Due to the emerging nature of the multichannel contact center market and other similar factors, our revenue and operating results may fluctuate from quarter to quarter. Our revenue could fall short of expectations if we experience delays or cancellations of even a small number of orders. It is possible that our operating results in some periods will be below the expectations of financial analysts or investors. In this event, the market price of our common stock is also likely to decline.

A number of factors are likely to cause fluctuations in our operating results, including, but not limited to, the following:

- demand for our software and budget and spending decisions by information technology departments of our customers;
- the mix of hosted and license transactions;
- seasonal trends in technology purchases;
- our ability to attract and retain customers; and
- litigation relating to our intellectual proprietary rights.

In addition, we base our expense levels in part on expectations regarding future revenue levels. In the short term, expenses, such as employee compensation and rent, are relatively fixed. If revenue for a particular quarter is below expectations, we may be unable to reduce our operating expenses proportionately for that quarter. Accordingly, such a revenue shortfall would have a disproportionate effect on expected operating results for that quarter. For this reason, period-to-period comparisons of our operating results may also not be a good indication of our future performance.

Net income per share available to Discovery Communications, Inc. stockholders:

Basic	$0.60	$0.44	$1.97	$1.08
Diluted	$0.59	$0.43	$1.95	$1.07

Weighted average shares outstanding:

Basic	398	426	404	425
Diluted	401	431	408	431

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

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

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DISCOVERY COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited; in millions)

	$0,000	$0,000
	Nine Months Ended September 30,	
	2011	**2010**
Operating Activities		
Net income	$ 796	$ 472
Adjustments to reconcile net income to cash provided by operating activities:		
Content expense	623	526
Intangible impairment charges		11
Stock-based compensation	70	153
Depreciation and amortization	90	100
Gains on dispositions	(129)	(12)
Deferred income tax expense (benefit)	71	(89)
Noncash portion of loss on extinguishment of debt		12
Other noncash expenses, net	48	46
Changes in operating assets and liabilities:		
Receivables, net	(127)	(41)
Content rights	(653)	(558)
Accounts payable and accrued liabilities	8	(8)
Stock-based compensation liabilities	(107)	(128)
Income tax receivable	91	(11)
Other, net	(21)	(28)
Cash provided by operating activities	760	445
Investing Activities		
Purchases of property and equipment	(42)	(29)
Proceeds from dispositions, net		24
Business acquisitions, net of cash acquired		(38)
Investments in and advances to equity method investees	(93)	(71)
Cash used in investing activities	(135)	(114)
Financing Activities		
Borrowings from long-term debt, net of discount and issuance costs	639	2,970
Principal repayments of long-term debt		(2,883)
Principal repayments of capital lease obligations	(16)	(8)
Repurchases of common stock	(732)	(38)
Cash distributions to noncontrolling interests	(7)	(21)
Proceeds from stock option exercises	43	27
Excess tax benefits from stock-based compensation	18	9
Cash (used in) provided by financing activities	(55)	56
Effect of exchange rate changes on cash and cash equivalents	(4)	6
Net change in cash and cash equivalents	566	393
Cash and cash equivalents, beginning of period	466	623

Cash and cash equivalents, end of period	$	1,032	$	1,016

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

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DISCOVERY COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(unaudited; in millions)

Supplemental Cash Flow Information		
Cash paid for interest, net:		
Periodic interest payments for debt, interest rate swaps and capital lease obligations	$ 115	$ 136
Make-whole premiums, termination payments, and repayment of original issue discount		148
Total cash paid for interest, net	$ 115	$ 284
Cash paid for taxes, net	$ 206	$ 282
Noncash Investing and Financing Transactions		
Investment in OWN	$ 273	$
Assets acquired under capital lease arrangements	$	$ 20
Stock dividends to preferred interests	$	$ 1

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

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DISCOVERY COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF EQUITY

(unaudited; in millions)

	Three Months Ended September 30, 2011			Three Months Ended September 30, 2010		
	Discovery Stockholders	Noncontrolling Interests	Total Equity	Discovery Stockholders	Noncontrolling Interests	Total Equity
Beginning balance	$ 6,513	$ 1	$ 6,514	$ 6,486	$ 28	$ 6,514
Comprehensive income:						
Net income	237		237	186	3	189
Other comprehensive (loss) income:						
Foreign currency translation adjustments, net	(12)		(12)	21		21
Total comprehensive income	225		225	207	3	210
Stock-based compensation	13		13	11		11
Excess tax benefits from stock-based compensation	1		1	5		5
Issuance of common stock in connection with stock-based plans	5		5	12		12
Repurchases of common stock	(355)		(355)	(38)		(38)
Cash distributions to noncontrolling interests					(19)	(19)
Ending balance	$ 6,402	$ 1	$ 6,403	$ 6,683	$ 12	$ 6,695

	Nine Months Ended September 30, 2011			Nine Months Ended September 30, 2010		
	Discovery Stockholders	Noncontrolling Interests	Total Equity	Discovery Stockholders	Noncontrolling Interests	Total Equity
Beginning balance	$ 6,225	$ 8	$ 6,233	$ 6,197	$ 23	$ 6,220
Comprehensive income:						
Net income	796		796	462	10	472
Other comprehensive income (loss):						
Foreign currency translation adjustments, net	11		11	(9)		(9)
Market value adjustments and reclassifications for securities and derivatives				7		7
Total comprehensive income	807		807	460	10	470
Stock dividends declared to preferred interests				(1)		(1)
Stock-based compensation	41		41	29		29
Excess tax benefits from stock-based compensation	18		18	9		9
Issuance of common stock in connection with stock-based plans	43		43	27		27
Repurchases of common stock	(732)		(732)	(38)		(38)
Cash distributions to noncontrolling interests		(7)	(7)		(21)	(21)
Ending balance	$ 6,402	$ 1	$ 6,403	$ 6,683	$ 12	$ 6,695

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

Basis of Presentation

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

Unaudited Interim Financial Statements

These consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) applicable to interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. These consolidated financial statements are unaudited; however, in the opinion of management, they reflect all adjustments, consisting only of those of a normal recurring nature, necessary to state fairly the financial position, results of operations, and cash flows for the periods presented in conformity with GAAP applicable to interim periods. The results of operations for the interim periods presented are not necessarily indicative of results for the full year or future periods. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in Discovery s Annual Report on Form 10-K for the year ended December 31, 2010 (the 2010 Form 10-K).

Use of Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates, judgments, and assumptions that affect the amounts and disclosures reported in the consolidated financial statements and accompanying notes. Management continually evaluates its estimates, judgments, and assumptions, and management s assessments could change. Actual results may differ from management s estimates and could have a material impact on the consolidated financial statements.

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

Reclassifications

The Company expanded the types of revenue included in distribution revenue in its consolidated statements of operations for the three and nine months ended September 30, 2011 and reclassified prior year amounts. Distribution revenues include fees charged for the right to view Discovery network branded content made available to customers through a variety of distribution platforms and viewing devices. The largest component of distribution revenue continues to be fees charged to cable, direct-to-home (DTH) satellite and telecommunications service providers for distribution rights to Discovery s television networks. Beginning July 1, 2011, distribution revenues also include fees charged for certain licensing arrangements, including those for digital streaming of library content, which totaled $83 million and $93 million for the three and nine months ended September 30, 2011, respectively. Such fees, which totaled $4 million and $17 million for the three and nine months ended September 30, 2010, respectively, and $10 million for the six months ended June 30, 2011, were previously classified as other revenue and have been reclassified to distribution revenue to conform to the current presentation.

DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Accounting and Reporting Pronouncements Adopted

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

In April 2011, the Financial Accounting Standards Board (FASB) issued new accounting guidance related to identifying and disclosing troubled debt restructurings (TDRs). This guidance provides clarification in assessing whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for the purpose of determining whether a restructuring constitutes a TDR. The Company adopted this new guidance effective July 1, 2011. The adoption of the new guidance did not impact the Company s consolidated financial statements.

Fair Value Measurements

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

Revenue Recognition for Multiple-Element Revenue Arrangements

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

Accounting and Reporting Pronouncements Not Yet Adopted

Fair Value Measurements

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

Comprehensive Income

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

Testing for Goodwill Impairment

In September 2011, the FASB issued guidance which is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The revised standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, but early adoption is permitted. The Company is currently assessing the impact of this guidance on its

DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

consolidated financial statements. The Company s 2010 goodwill impairment testing did not indicate that there were any reporting units for which a 20% decline in fair value would result in the reporting unit s carrying value exceeding its fair value. The assumptions used in the Company s fair value modeling at the time of the Company s impairment review have not changed significantly. There is no change or trigger event that indicates an impairment of the Company s reporting units exists as of September 30, 2011.

Concentrations Risk

Receivables

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

Financial Institutions

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

Lender Counterparties

There is a risk that the counterparties associated with the Company s revolving credit facility will not be available to fund as obligated. If funding under the revolving credit facility is unavailable, the Company may have to acquire a replacement credit facility from a different counterparty at a higher cost or may be unable to find a suitable replacement. Typically, the Company seeks to manage these exposures by contracting with experienced large financial institutions and monitoring the credit quality of its lenders. As of September 30, 2011, the Company did not anticipate nonperformance by any of its counterparties.

NOTE 2. ACQUISITIONS AND DISPOSITIONS

Acquisitions

London Uplink Facility

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

Dispositions

Discovery Health Network

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

Antenna Audio

On September 1, 2010, the Company sold its Antenna Audio business for net cash proceeds of $24 million, which resulted in a $9 million gain, net of taxes. During the three months ended September 30, 2010, the Company recorded a $12 million gain, net of taxes, in its results of operations in income (loss) from discontinued operations, net of taxes on the consolidated statements of operations. However, during the three months ended December 31, 2010, the Company recorded an adjustment to a deferred tax asset, which reduced the gain by $3 million. Antenna Audio s operating results are classified as discontinued operations in the consolidated statements of operations. Excluding the impact of the net gain on the sale of the business, Antenna Audio s revenues were $9 million and $30 million for the three and nine months ended September 30, 2010, respectively. Excluding the impact of the net gain on the sale of the business, Antenna Audio s income before taxes and net income were not significant for the three and nine months ended September 30, 2010.

DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Ascent Capital Group, Inc. (formally known as Ascent Media Corporation)

In September 2010, the Company received a tax refund, which eliminated a $12 million obligation to repay amounts to Ascent Capital Group, Inc. (ACG), an entity spun off in 2008. The reversal of this obligation has been recorded as a benefit in income (loss) from discontinued operations, net of taxes on the consolidated statements of operations.

NOTE 3. VARIABLE INTEREST ENTITIES

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

As of September 30, 2011 and December 31, 2010, the Company accounted for its interests in joint venture VIEs using the equity method. The aggregate carrying values of these equity method investments were $816 million and $453 million as of September 30, 2011 and December 31, 2010, respectively. During the three and nine months ended September 30, 2011, the Company recognized losses of $3 million and $10 million, respectively, for its portion of net losses generated by VIEs accounted for using the equity method, which were recorded in other expense, net on the consolidated statements of operations. During the three and nine months ended September 30, 2010, the Company recognized losses of $11 million and $27 million, respectively, for its portion of net losses generated by VIEs accounted for using the equity method, which were recorded in other expense, net on the consolidated statements of operations.

The Company s estimated risk of loss for investments in VIEs was approximately $851 million as of September 30, 2011, which includes the carrying value of its investments, the unfunded portion of contractual funding commitments to joint ventures, and guarantees made on behalf of joint ventures. Actual amounts funded to the joint ventures exceed contractual funding commitments, and the Company intends to continue to fund significant amounts to OWN. The Company has not recorded any amounts for future funding. The estimated risk of loss excludes the Company s operating performance guarantee for Hub Television Networks LLC disclosed below.

Hub Television Networks LLC

Hub Television Networks LLC operates The Hub, which is a pay-television network that provides children s and family entertainment and educational programming that launched October 10, 2010. The Company is obligated to provide the joint venture with funding up to $15 million and services such as distribution, sales, and administrative support. The Company has not provided funding as of September 30, 2011. See Note 12 for further discussion of services provided to the joint venture.

Based upon the level of equity investment at risk, the joint venture is a VIE. Discovery and its joint venture partner, together, direct the activities of The Hub that most significantly impact its economic performance, because decisions about programming and marketing strategy require the consent of both joint venture partners. The joint venture partners share equally in voting control and jointly consent to operating, financing and investing decisions, neither has special governance rights, and both are equally represented on the Board of The Hub. The joint venture partners also share equally in the profits, losses, and funding of the joint venture. The Company has determined that it is not the primary beneficiary of The Hub. Accordingly, the Company accounts for its investment in The Hub using the equity method.

Through December 31, 2015, the Company has guaranteed a certain level of operating performance for the joint venture that requires compensation to the joint venture partner to the extent that distribution metrics decline versus levels historically achieved by the Discovery Kids channel. This guarantee extends on a declining basis through the period of guarantee. Upon inception of the joint venture, the maximum amount potentially due under this guarantee was $300 million. As of September 30, 2011, the maximum amount potentially due under this guarantee was less than $175 million. The maximum exposure to loss is expected to decline to zero during 2015. As the joint venture s distribution is generally provided under long-term contracts with stable subscriber levels, the Company believes the likelihood is remote that the performance levels will not be achieved and, therefore, the performance guarantee is unlikely to have a material adverse impact on the Company s financial position, operating results, or cash flows. Accordingly, the fair value of the guarantee was not material as of September 30, 2011.

DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

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

The carrying values of the Company s investment in The Hub were $338 million and $344 million as of September 30, 2011 and December 31, 2010, respectively.

OWN LLC

OWN LLC operates OWN, which is a pay-television network and website that provides adult lifestyle content focused on self-discovery and self-improvement that launched on January 1, 2011. In connection with the launch of OWN, the Company contributed the domestic Discovery Health network to the joint venture. The contribution did not impact the Company s ownership interest, voting control, or governance rights related to OWN. The Company no longer consolidates the domestic Discovery Health network subsequent to the contribution, which was a component of its U.S. Networks segment. The assets of the Discovery Health network included goodwill and other identifiable assets with carrying values of $136 million and $8 million, respectively.

The Company recorded the contribution at fair value, which resulted in a pretax gain of $129 million. The fair value of the Company s retained equity interest in OWN was estimated to be $273 million. The gain represents the fair value of the equity investment retained less the carrying values of contributed assets. The gain resulted in tax expense of $27 million. The fair value of the contribution of the Discovery Health network to OWN was determined utilizing customary valuation methodologies including discounted cash flows. The underlying assumptions, such as future cash flows, weighted average costs of capital, long-term growth rates, marketplace valuation methodologies, and market comparable transactions and multiples were generally not observable in the marketplace, and therefore, involved significant judgment. The early results of OWN s operations have been below its initial long-term business plan, and there is a possibility that future results may vary from the current assumptions in the long-term business plan. If these trends continue, the Company will monitor such financial results along with other relevant business information to determine the recoverability and valuation of its investment in accordance with GAAP, which requires an impairment charge when there is an other-than-temporary decline in the investment s value.

Based upon the level of equity investment at risk, OWN is a VIE. While the joint venture partners share equally in voting control, power is not shared because certain activities that significantly impact OWN s economic performance are directed by Harpo Inc. (Harpo). Harpo holds operational rights related to programming and marketing, as well as selection and retention of key management personnel. The Company has determined that it is not the primary beneficiary of OWN, because it does not control these activities that are critical to OWN s operating performance and success. Accordingly, the Company accounts for its investment in OWN using the equity method.

Net losses generated by OWN are allocated to both joint venture partners based on their proportionate ownership interests, which are 50-50. Prior to the contribution of the Discovery Health network to OWN at its launch, the Company recognized 100% of OWN s net losses. Future net income generated by OWN will initially be allocated 100% to the Company up to $104 million, the amount of pre-contribution net losses recognized. After the Company has recouped its losses, any excess net income will be allocated to both joint venture partners based on their proportionate ownership interests.

The Company provides the joint venture funding and services such as distribution, licensing, sales, and administrative support. See Note 12 for further discussion. As the Company has provided all required funding as of September 30, 2011, the Company s total funding to OWN, including interest accrued on outstanding borrowings, was $254 million, which is in excess of its commitment of $189 million. While the Company expects to provide significant additional funding to OWN, the Company also expects to recoup amounts funded. 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. The funding is secured by the assets acquired by OWN. OWN will distribute its initial excess cash to the Company to repay funding then due. Following repayment of funding then due, OWN s subsequent cash distributions will be shared equally between the Company and Harpo.

DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

The carrying value of the Company s investment in OWN, including its equity method investment and note receivable balance, was $394 million and $52 million as of September 30, 2011 and December 31, 2010, respectively.

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

NOTE 4. FAIR VALUE MEASUREMENTS

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 valuation techniques in which one or more significant inputs are unobservable.

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

		September 30, 2011			
Category	**Balance Sheet Location**	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:					
Trading securities:					
Mutual funds	Prepaid expenses and other current assets	$ 71	$	$	$ 71
Available-for-sale securities:					
Money market mutual funds	Cash and cash equivalents	657			657
Total assets		$ 728	$	$	$ 728
Liabilities:					
Deferred compensation plan	Accrued liabilities	$ 71	$	$	$ 71
Other	Other current liabilities		1	1	2
Total liabilities		$ 71	$ 1	$ 1	$ 73

		December 31, 2010			
Category	**Balance Sheet Location**	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:					
Trading securities:					

Mutual funds	Prepaid expenses and other current assets	$ 55	$	$	$ 55
Available-for-sale securities:					
Money market mutual funds	Cash and cash equivalents	172			172
U.S. Treasury securities	Cash and cash equivalents		200		200
Other	Cash and cash equivalents		3		3
Total assets		$ 227	$ 203	$	$ 430
Liabilities:					
Deferred compensation plan	Accrued liabilities	$ 55	$	$	$ 55
Other	Other current liabilities		6		6
Total liabilities		$ 55	$ 6	$	$ 61

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Trading securities are comprised of investments in mutual funds held in a separate trust, which are owned as part of the Company s deferred compensation plan. The fair value of Level 1 trading securities was determined by reference to the quoted market price per unit in active markets multiplied by the number of units held without consideration of transaction costs. The fair value of the related deferred compensation plan liability was determined based on the fair value of the related investments elected by employees.

Available-for-sale securities represent investments in highly liquid instruments with original maturities of 90 days or less. The fair value of Level 1 available-for-sale securities was determined by reference to the quoted market price per unit in active markets multiplied by the number of units held without consideration of transaction costs.

In addition to the financial instruments listed in the tables above, the Company holds other financial instruments, including cash, accounts receivable, accounts payable, and debt. The carrying values for cash, accounts receivable, and accounts payable approximated their fair values. The estimated fair value of the Company s outstanding senior notes using quoted market prices was $4.5 billion and $3.7 billion as of September 30, 2011 and December 31, 2010, respectively.

NOTE 5. CONTENT RIGHTS

Content rights consisted of the following (in millions).

	September 30, 2011	December 31, 2010
Produced content rights:		
Completed	$ 2,260	$ 1,963
In-production	237	229
Coproduced content rights:		
Completed	492	446
In-production	77	76
Licensed content rights:		
Acquired	362	297
Prepaid	18	19
Content rights, at cost	3,446	3,030
Accumulated amortization	(2,070)	(1,702)
Total content rights, net	1,376	1,328
Current portion	(83)	(83)
Noncurrent portion	$ 1,293	$ 1,245

Content amortization and impairments, components of costs of revenues, totaled $242 million and $176 million for the three months ended September 30, 2011 and 2010, respectively, and $623 million and $526 million for the nine months ended September 30, 2011 and 2010, respectively. Content impairments were $33 million and $11 million for the three months ended September 30, 2011 and 2010, respectively. Content impairments were $43 million and $42 million for the nine months ended September 30, 2011 and 2010, respectively. Content payables were $81 million and $57 million as of September 30, 2011 and December 30, 2010, respectively.

NOTE 6. DEBT

Outstanding debt consisted of the following (in millions).

	September 30, 2011	December 31, 2010
3.70% Senior Notes, semi-annual interest, due June 2015	$ 850	$ 850
5.625% Senior Notes, semi-annual interest, due August 2019	500	500
5.05% Senior Notes, semi-annual interest, due June 2020	1,300	1,300
4.375% Senior Notes, semi-annual interest, due June 2021	650	

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	September 30, 2011	December 31, 2010
6.35% Senior Notes, semi-annual interest, due June 2040	850	850
Capital lease obligations	110	126
Total long-term debt	4,260	3,626
Unamortized discount	(11)	(8)
Long-term debt, net	4,249	3,618
Current portion of long-term debt	(20)	(20)
Noncurrent portion of long-term debt	$ 4,229	$ 3,598

Senior Notes

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

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

Revolving Credit Facility

On August 8, 2011, DCL modified its $1.0 billion revolving credit agreement to extend the expiration date two years to October 12, 2015 and to reduce interest rates and fees. The terms of the arrangement are otherwise consistent with the previous arrangement, as DCL continues to be the borrower, Discovery continues to be the guarantor, and the lenders named therein, are consistent with the original credit agreement. The obligations under the credit agreement are unsecured and are fully and unconditionally guaranteed by Discovery.

If DCL draws on the new revolving credit facility, outstanding balances will bear interest at one of the following rates as elected by DCL. Each Libor loan will bear interest at the applicable Libor rate based on the term selected by DCL, plus a margin ranging from 75 basis points to 145 basis points based on DCL s credit rating. Each Base Rate loan and Swing Line loan will bear interest at the Base Rate plus a margin ranging from zero basis points to 45 basis points based on DCL s credit rating. The Base Rate is the highest of (i) the Federal funds rate as published by the Federal Reserve Bank of New York plus 50 basis points, (ii) Bank of America s prime rate as publicly announced, and (iii) the one month Eurocurrency rate plus 100 basis points.

DCL is required to pay a facility fee, which ranges from 12.5 basis points to 30 basis points, based on DCL s credit rating, multiplied by the actual daily amount of the lender s aggregate commitments under the senior credit facility, regardless of usage. The facility fee is payable quarterly in arrears. DCL will also pay a letter of credit fee equal to the applicable margin for Eurocurrency rate loans multiplied by the dollar equivalent of the daily amount available to be drawn under such letter of credit.

DCL may optionally prepay the loans or irrevocably reduce or terminate the unutilized portion of the commitments under the revolving credit facility, without premium or penalty at any time by the delivery of a notice to that effect as provided under the credit agreement.

There were no amounts drawn under the revolving credit facility as of September 30, 2011 and December 31, 2010.

The revolving credit facility contains affirmative and negative covenants, including an interest coverage ratio and leverage ratio, events of default and other customary provisions. The Company was in compliance with all covenants and there were no events of default as of September 30, 2011 and December 31, 2010.

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NOTE 7. EQUITY

Stock Repurchase Program

On August 3, 2010, the Company implemented a stock repurchase program with authorization to purchase up to $1.0 billion of its common stock. On July 27, 2011, the Company s Board of Directors authorized the Company to purchase an additional $1.0 billion of its common stock under this stock repurchase program. In total, the Company has been authorized to purchase $2.0 billion of its common stock under its repurchase program. The repurchase program has no expiration date. During the three and nine months ended September 30, 2011, the Company repurchased 10 million and 20 million shares, respectively, of its Series C common stock for an aggregate purchase price of $355 million and $732 million, respectively, through open market transactions. During the three and nine months ended September 30, 2010, the Company repurchased 1 million shares of its Series C common stock for an aggregate purchase price of $38 million through open market transactions. The repurchases were funded using cash on hand. As of September 30, 2011, the Company had remaining authorization of $1.2 billion for future repurchases of its common stock. The stock repurchases were recorded in a separate account at cost, which was reported as a reduction in equity.

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NOTE 8. STOCK-BASED COMPENSATION

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

Stock-Based Compensation Expense

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Unit awards	$ 8	$ 48	$ 29	$ 111
Stock options	8	8	26	23
PRSUs and RSUs	5	3	15	6
Other				13
Total stock-based compensation expense	$ 21	$ 59	$ 70	$ 153
Tax benefit recognized	$ 8	$ 22	$ 26	$ 57

Compensation expense for all awards was recorded in selling, general and administrative expense on the consolidated statements of operations. As of September 30, 2011 and December 31, 2010, the Company recorded total liabilities for cash-settled awards of $45 million and $125 million, respectively.

Stock-Based Award Activity

Unit Awards

Unit award activity was as follows (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, 2010	8.8	$ 21.98	0.79	$ 198
Granted	2.3	41.17		

Settled	(4.2)	19.34		106
Forfeited	(0.1)	21.64		
Outstanding as of September 30, 2011	6.8	30.28	1.05	73
Vested and expected to vest as of September 30, 2011	6.3	30.21	1.03	69
Vested and unpaid as of September 30, 2011	0.1	23.08		1

Unit awards represent the contingent right to receive a cash payment for the amount by which the vesting price exceeds the grant price. Because unit awards are cash-settled, the Company remeasures the fair value and compensation expense of outstanding unit awards as of the last day of the most recent fiscal period until settlement. As of September 30, 2011, the weighted-average fair value of unit awards outstanding was $13.60 per unit award. The Company made cash payments to settle vested unit awards totaling $106 million and $72 million during the nine months ended September 30, 2011 and 2010, respectively. As of September 30, 2011, there was $43 million of unrecognized compensation cost, net of estimated forfeitures, related to unit awards, which is expected to be recognized over a weighted-average period of 1.95 years.

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Stock Options

Stock option activity was as follows (in millions, except years and weighted-average grant price).

	Stock Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2010	15.7	$ 19.26	5.21	$ 350
Granted	1.2	39.20		
Exercised	(2.6)	16.61		68
Forfeited	(0.9)	22.44		
Outstanding as of September 30, 2011	13.4	21.41	5.20	223
Vested and expected to vest as of September 30, 2011	13.1	21.29	5.27	219
Exercisable as of September 30, 2011	4.3	17.15	4.96	88

The Company received cash payments from the exercise of stock options totaling $43 million and $27 million during the nine months ended September 30, 2011 and 2010, respectively. The weighted average grant date fair value of stock options granted during the nine months ended September 30, 2011 was $14.45 per option. As of September 30, 2011, there was $52 million of unrecognized compensation cost, net of expected forfeitures, related to stock options, which is expected to be recognized over a weighted-average period of 1.45 years.

PRSUs and RSUs

PRSU and RSU activity was as follows (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, 2010	1.5	$ 32.66	2.29	$ 61
Granted	1.0	38.87		
Converted				
Forfeited	(0.1)	35.51		
Outstanding as of September 30, 2011	2.4	35.26	2.05	89

Vested and expected to vest as of September 30, 2011	2.0	35.02	2.04	74

PRSUs represent the contingent right to receive shares of the Company s Series A common stock based on continuous service and whether the Company achieves certain operating performance targets. During the nine months ended September 30, 2011, the Company granted 0.7 million PRSUs with a weighted-average grant date fair value of $38.79 per PRSU. As of September 30, 2011, there was $28 million of unrecognized compensation cost, net of expected forfeitures, related to PRSUs, which is expected to be recognized over a weighted-average period of 1.74 years based on the Company s current probability assessment of the PRSUs that will vest, which may differ from actual results.

RSUs represent the contingent right to receive shares of the Company s Series A common stock based on continuous service. During the nine months ended September 30, 2011, the Company granted 0.3 million RSUs with a weighted-average grant date fair value of $39.04 per RSU. As of September 30, 2011, there was $16 million of unrecognized compensation cost, net of expected forfeitures, related to RSUs, which is expected to be recognized over a weighted-average period of 2.68 years.

SARs

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

Employee Stock Purchase Plan

On May 17, 2011, the Company s stockholders approved the Discovery Communications, Inc. 2011 Employee Stock Purchase Plan (the DESPP), which enables eligible employees to purchase shares of the Company s common stock through payroll deductions or other permitted means. Unless otherwise determined by the Company s Board of Directors, the purchase price for shares offered under the DESPP is 85% of the closing price of the Company s common stock on the purchase date. The Company will record an estimated charge to selling, general and administrative costs over the service period. The Company has authorized 5.0 million shares of the Company s common stock to be issued under the DESPP. No shares were issued under the DESPP during the three and nine months ended September 30, 2011.

NOTE 9. INCOME TAXES

The Company s provisions for income taxes were $127 million and $83 million, and the effective tax rates were 35% and 34% for the three months ended September 30, 2011 and 2010, respectively. The effective tax rate for the three months ended September 30, 2011 was consistent with the U.S. federal statutory income tax rate of 35% as production activity deductions were offset by state taxes. The effective tax rate for the three months ended September 30, 2010 differed from the U.S. federal statutory income tax rate of 35% due primarily to production activity deductions partially offset by state taxes.

The Company s provisions for income taxes were $417 million and $171 million, and the effective tax rates were 34% and 28% for the nine months ended September 30, 2011 and 2010, respectively. The effective tax rate for the nine months ended September 30, 2011 differed from the U.S. federal statutory income tax rate of 35% principally because the Company was not required to record a deferred tax liability of $21 million with respect to the portion of the outside basis in the OWN joint venture attributable to the nondeductible goodwill contributed to OWN and production activity deductions. These items were partially offset by state taxes. The effective tax rate for the nine months ended September 30, 2010 differed from the U.S. federal statutory income tax rate of 35% primarily due to the reversal of a $28 million previously established foreign tax reserve recorded in connection with the completion of a tax audit, production activity deductions and a $16 million tax expense reduction for a change in the Company s election to claim foreign tax credits that were previously taken as deductions, which were partially offset by state taxes.

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

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NOTE 10. NET INCOME PER SHARE

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

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Numerator:				
Income from continuing operations, net of taxes	$ 238	$ 164	$ 797	$ 447
Less:				
Net income attributable to noncontrolling interests		(3)		(10)
Stock dividends to preferred interests				(1)
Income from continuing operations available to Discovery Communications, Inc. stockholders	238	161	797	436
(Loss) income from discontinued operations, available to Discovery Communications, Inc. stockholders	(1)	25	(1)	25
Net income available to Discovery Communications, Inc. stockholders	$ 237	$ 186	$ 796	$ 461
Denominator:				
Weighted average shares outstanding basic	398	426	404	425
Weighted average dilutive effect of equity awards	3	5	4	6
Weighted average shares outstanding diluted	401	431	408	431
Income (Loss) Per Share::				
Income per share from continuing operations available to Discovery Communications, Inc. stockholders:				
Basic	$ 0.60	$ 0.38	$ 1.97	$ 1.03
Diluted	$ 0.59	$ 0.37	$ 1.95	$ 1.01
(Loss) income per share from discontinued operations available to Discovery Communications, Inc. stockholders:				
Basic	$	$ 0.06	$	$ 0.06
Diluted	$	$ 0.06	$	$ 0.06
Net income per share available to Discovery Communications, Inc. stockholders:				
Basic	$ 0.60	$ 0.44	$ 1.97	$ 1.08
Diluted	$ 0.59	$ 0.43	$ 1.95	$ 1.07

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

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

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For the three and nine months ended September 30, 2011, the computation of diluted income per share excluded 3 million and 2 million options, respectively, because their inclusion would have been anti-dilutive. For the three and nine months ended September 30, 2011, the computation of diluted income per share excluded 2 million and 1 million PRSUs, respectively, because their performance targets were not achieved. Additionally for the three and nine months ended September 30, 2011, the computation of diluted income per share excluded 1 million contingently issuable preferred shares for which specific release criteria were not met.

For the three and nine months ended September 30, 2010, the computation of diluted income per share excluded 2 million and 3 million options, respectively, because their inclusion would have been anti-dilutive. For the three and nine months ended September 30, 2010, the computation of diluted income per share excluded 1 million PRSUs for both periods, because their performance targets were not achieved. Additionally for the three and nine months ended September 30, 2010, the computation of diluted income per share excluded 1 million contingently issuable preferred shares for which specific release criteria were not met.

Employee Stock Purchase Plan

The Company s common stock to be issued under the DESPP as discussed in Note 8. The initial offering period for the DESPP had not begun as of September 30, 2011. In future periods, the Company will include expected shares issued under the DESPP in diluted EPS using the treasury stock method.

NOTE 11. SUPPLEMENTAL DISCLOSURES

Other Expense, Net

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Unrealized (losses) gains on derivative instruments, net	$ (1)	$ 3	$ 1	$ 8
Realized losses on derivative instruments, net		(4)	(2)	(37)
Losses from equity investees, net	(4)	(12)	(12)	(29)
Other, net		(3)	3	1
Total other expense, net	$ (5)	$ (16)	$ (10)	$ (57)

NOTE 12. RELATED PARTY TRANSACTIONS

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

DIRECTV, Liberty Global, Inc., Liberty Interactive Corporation, Liberty Media Corporation, and Ascent Capital Group, Inc.

The Company s Board of Directors includes two members who served as directors of DIRECTV through June 16, 2010, including John C. Malone, the former Chairman of the Board of DIRECTV. Prior to June 16, 2010, Dr. Malone owned approximately 24% of the aggregate voting power of DIRECTV. Effective June 16, 2010, Dr. Malone converted his DIRECTV Class B common stock into DIRECTV Class A common stock, which reduced his voting interest to 3% of DIRECTV, and Dr. Malone and the other member of the Company s Board of Directors who served as a DIRECTV director resigned from the DIRECTV Board. Through June 16, 2010, transactions with DIRECTV are reported as related party transactions. Related party revenues from transactions with DIRECTV were $104 million, or 4%, of total revenues, for the nine months ended September 30, 2010. There were no related party revenues with DIRECTV during the three months ended September 30, 2010. Expenses from transactions with DIRECTV were not material for the three and nine months ended September 30, 2010.

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

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On September 23, 2011 Liberty Interactive Corporation (Liberty Interactive formerly known as Liberty Media Corporation) completed the split-off of Liberty Media Corporation (Liberty Media formerly known as Liberty CapStarz, Inc.), which became a separate publicly traded company. Three members of the Company s Board of Directors also serve as directors of Liberty Interactive and two members of the Company s Board of Directors serve as directors of Liberty Media. Dr. Malone is the Chairman of the Board of both Liberty Interactive and Liberty Media and beneficially owns shares representing approximately 33% and 39% of the aggregate voting power of each company, respectively.

Revenues from transactions with Liberty Global, Liberty Interactive, and Liberty Media (the Liberty Group) totaled $9 million, or 1% of total revenues, and $5 million, or 1% of total revenues, for the three months ended September 30, 2011 and 2010, respectively. Revenues from transactions with the Liberty Group totaled $27 million, or 1% of total revenues, and $19 million, or 1% of total revenues, for the nine months ended September 30, 2011 and 2010, respectively. Expenses from transactions with the Liberty Group for the three and nine months ended September 30, 2011 and 2010 were not material. The Company s receivables, net balances included insignificant amounts due from the Liberty Group as of September 30, 2011 and December 31, 2010.

Effective January 25, 2010, Dr. Malone joined the Board of Directors of ACG. Dr. Malone owns 1% of ACG s Series A common stock and 94% of ACG s Series B common stock, effectively providing him approximately 32% of the voting power with respect to the general election of ACG directors.

Beginning January 25, 2010, transactions with ACG are reported as related party transactions as a result of Dr. Malone joining ACG s board. Operating expenses from transactions with ACG were $4 million, or 1% of total operating expenses, and $5 million, or 1% of total operating expenses, for the three months ended September 30, 2011 and 2010, respectively. Operating expenses from transactions with ACG were $12 million, or 1% of total operating expenses, and $19 million, or 1% of total operating expenses for the nine months ended September 30, 2011 and 2010, respectively. Payable balances as of September 30, 2011 and December 31, 2010 and revenues for the three and nine months ended September 30, 2011 and 2010 from transactions with ACG were not material.

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

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

Other Related Parties

Other related parties primarily include unconsolidated equity method investees, including unconsolidated VIEs described in Note 3. The Company provides equity method investees with content licensing arrangements and services such as distribution, sales, and administrative support. Revenues from other related parties were $21 million, or 2% of total revenues, and $20 million, or 2% of total revenues, for the three months ended September 30, 2011 and 2010, respectively. Revenues from other related parties were $66 million, or 2% of total revenues, and $45 million, or 2% of total revenues, for the nine months ended September 30, 2011 and 2010, respectively. Operating expenses for services acquired from other related parties were $2 million, or less than 1% of total operating expenses, and $4 million, or 1% of operating expenses, for the three months ended September 30, 2011 and 2010, respectively. Operating expenses for services acquired from other related parties were $9 million, or 1% of total operating expenses, and $10 million, or 1% of total operating expenses, for the nine months ended September 30, 2011 and 2010, respectively. The Company s receivables, net balances include $14 million and $9 million due from the Company s other related parties as of September 30, 2011 and December 31, 2010, respectively.

The Company s investments balance includes notes receivable, net of earnings and losses absorbed from equity method investees as described in Note 3. The Company records interest earnings from loans to joint ventures as a component of losses from equity investees, net which is a component of other expense, net. Interest earnings from related parties recorded by the Company totaled $4 million and $2 million for the three months ended September 30, 2011 and 2010, respectively. Interest earnings from related parties recorded by the Company totaled $12 million and $4 million for the nine months ended September 30, 2011 and 2010, respectively.

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NOTE 13. COMMITMENTS, CONTINGENCIES, AND GUARANTEES

Commitments

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

Contingencies

Put Right

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

Legal Matters

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

Guarantees

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

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

NOTE 14. REPORTABLE SEGMENTS

The Company s reportable segments are determined based on (i) financial information reviewed by its chief operating decision maker (CODM), the Chief Executive Officer, (ii) internal management and related reporting structure, and (iii) the basis upon which the CODM makes resource allocation decisions. The accounting policies of the reportable segments are the same as the Company s, except that certain inter-segment transactions that are eliminated at the consolidated level are not eliminated at the segment.

The Company evaluates the operating performance of its segments based on financial measures such as revenues and adjusted operating income before depreciation and amortization (Adjusted OIBDA). Adjusted OIBDA is defined as revenues less costs of revenues and selling, general and administrative expenses excluding: (i) mark-to-market stock-based compensation, (ii) depreciation and amortization, (iii) amortization of deferred launch incentives, (iv) exit and restructuring charges, (v) certain impairment charges, and (vi) gains (losses) on business and asset dispositions. The Company uses this measure to assess the operating results and performance of its segments, perform analytical comparisons, identify strategies to improve performance, and allocate resources to each segment. The Company believes Adjusted OIBDA is relevant to investors because it allows them to analyze the operating performance of each segment using the same metric management uses. The Company excludes mark-to-market stock-based compensation, exit and restructuring charges, certain impairment charges, and gains (losses) on business and asset dispositions from the calculation of Adjusted OIBDA due to their volatility. The Company also excludes depreciation of fixed assets and amortization of intangible assets and deferred launch incentives as these amounts do not represent cash payments in the current reporting period. Adjusted OIBDA should be considered in addition to, but not a substitute for, operating income, net income, and other measures of financial performance reported in accordance with GAAP.

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

Revenues by Segment

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
U.S. Networks	$ 695	$ 585	$ 1,942	$ 1,751
International Networks	363	304	1,054	893
Education and Other	37	38	117	108
Corporate and inter-segment eliminations		(1)		6
Total revenues	$ 1,095	$ 926	$ 3,113	$ 2,758

Adjusted OIBDA by Segment

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
U.S. Networks	$ 378	$ 346	$ 1,107	$ 1,018
International Networks	156	130	473	384
Education and Other	3	1	16	7
Corporate and inter-segment eliminations	(58)	(59)	(180)	(171)
Total Adjusted OIBDA	$ 479	$ 418	$ 1,416	$ 1,238

Reconciliation of Total Adjusted OIBDA to Consolidated Operating Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Total Adjusted OIBDA	$ 479	$ 418	$ 1,416	$ 1,238
Amortization of deferred launch incentives	(13)	(11)	(39)	(32)
Mark-to-market stock-based compensation	(8)	(48)	(31)	(124)
Depreciation and amortization	(30)	(32)	(90)	(98)
Restructuring and impairment charges	(2)	(15)	(7)	(18)
Gain on disposition			129	

Total operating income	$ 426	$ 312	$ 1,378	$ 966

Total Assets by Segment

	September 30, 2011	December 31, 2010
U.S. Networks	$ 2,623	$ 2,218
International Networks	1,183	1,127
Education and Other	80	74
Corporate and inter-segment eliminations	7,915	7,600
Total assets	$ 11,801	$ 11,019

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

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DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 15. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

Overview

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

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

Basis of Presentation

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

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

As of September 30, 2011 and December 31, 2010, the cash and cash equivalents of the non-guarantor subsidiaries of DCL included $2 million and $12 million, respectively, of cash related to a consolidated joint venture that is only available for use by the joint venture.

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

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DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Condensed Consolidating Balance Sheet

September 30, 2011

(in millions)

	Discovery	DCH	DCL	Non-Guarantor Subsidiaries of DCL	Other Non-Guarantor Subsidiaries of Discovery	Reclassifications and Eliminations	Discovery and Subsidiaries
ASSETS							
Current assets:							
Cash and cash equivalents	$	$	$ 966	$ 65	$ 1	$	$ 1,032
Receivables, net			407	558	13	(2)	976
Content rights, net			6	77			83
Prepaid expenses and other current assets	19		110	78	1		208
Total current assets	19		1,489	778	15	(2)	2,299
Investment in and advances to subsidiaries	8,772	6,379	4,572		6,631	(26,354)	
Noncurrent content rights, net			559	734			1,293
Goodwill			3,767	2,532			6,299
Other noncurrent assets		20	849	1,054	7	(20)	1,910
Total assets	$ 8,791	$ 6,399	$ 11,236	$ 5,098	$ 6,653	$ (26,376)	$ 11,801
LIABILITIES AND EQUITY							
Current liabilities:							
Accounts payable and accrued liabilities	$ 22	$ 3	$ 241	$ 216	$ 6	$ (2)	$ 486
Current portion of long-term debt			6	14			20
Other current liabilities			75	125	1		201
Total current liabilities	22	3	322	355	7	(2)	707
Long-term debt			4,155	74			4,229
Other noncurrent liabilities			380	96	6	(20)	462
Inter-company contributions and advances between Discovery Communications, Inc. and subsidiaries	2,367	1,254	(599)	4,198	746	(7,966)	
Equity attributable to Discovery Communications, Inc.	6,402	5,142	6,978	375	5,894	(18,389)	6,402
Equity and advances attributable to Discovery Communications, Inc.	8,769	6,396	6,379	4,573	6,640	(26,355)	6,402
Noncontrolling interests						1	1
Total equity	8,769	6,396	6,379	4,573	6,640	(26,354)	6,403

Total liabilities and equity	$ 8,791	$ 6,399	$ 11,236	$ 5,098	$ 6,653	$ (26,376)	$ 11,801

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DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Condensed Consolidating Balance Sheet

December 31, 2010

(in millions)

	Discovery	DCH	DCL	Non-Guarantor Subsidiaries of DCL	Other Non-Guarantor Subsidiaries of Discovery	Reclassifications and Eliminations	Discovery and Subsidiaries
ASSETS							
Current assets:							
Cash and cash equivalents	$	$	$ 369	$ 93	$ 4	$	$ 466
Receivables, net			391	476	13		880
Content rights, net			8	75			83
Prepaid expenses and other current assets	109	3	105	89	1	(1)	306
Total current assets	109	3	873	733	18	(1)	1,735
Investment in and advances to subsidiaries	8,530	6,091	4,129		6,484	(25,234)	
Noncurrent content rights, net			557	688			1,245
Goodwill			3,876	2,558			6,434
Other noncurrent assets		12	872	726	7	(12)	1,605
Total assets	$ 8,639	$ 6,106	$ 10,307	$ 4,705	$ 6,509	$ (25,247)	$ 11,019
LIABILITIES AND EQUITY							
Current liabilities:							
Accounts payable and accrued liabilities	$	$	$ 216	$ 260	$ 5	$ (1)	$ 480
Current portion of long-term debt			6	14			20
Other current liabilities		1	121	162	1		285
Total current liabilities		1	343	436	6	(1)	785
Long-term debt			3,513	85			3,598
Other noncurrent liabilities			360	47	8	(12)	403
Inter-company contributions and advances between Discovery Communications, Inc. and subsidiaries	2,414	1,777	(57)	4,702	1,143	(9,979)	
Equity (deficit) attributable to Discovery Communications, Inc.	6,225	4,328	6,148	(565)	5,352	(15,263)	6,225
Equity and advances attributable to Discovery Communications, Inc.	8,639	6,105	6,091	4,137	6,495	(25,242)	6,225
Noncontrolling interests						8	8
Total equity	8,639	6,105	6,091	4,137	6,495	(25,234)	6,233

Total liabilities and equity	$ 8,639	$ 6,106	$ 10,307	$ 4,705	$ 6,509	$ (25,247)	$ 11,019

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DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Condensed Consolidating Statement of Operations

Three Months Ended September 30, 2011

(in millions)

	Discovery	DCH	DCL	Non-Guarantor Subsidiaries of DCL	Other Non-Guarantor Subsidiaries of Discovery	Reclassifications and Eliminations	Discovery and Subsidiaries
Revenues	$	$	$ 431	$ 652	$ 16	$ (4)	$ 1,095
Costs of revenues, excluding depreciation and amortization			127	203	14	(2)	342
Selling, general and administrative	2		92	200	3	(2)	295
Depreciation and amortization			10	19	1		30
Restructuring and impairment charges				2			2
Total costs and expenses	2		229	424	18	(4)	669
Operating (loss) income	(2)		202	228	(2)		426
Equity in earnings of subsidiaries	238	239	139		159	(775)	
Interest expense, net			(54)	(2)			(56)
Other expense, net				(5)			(5)
Income before income taxes	236	239	287	221	157	(775)	365
Benefit from (provision for) income taxes	1		(48)	(81)	1		(127)
Income from continuing operations, net of taxes	237	239	239	140	158	(775)	238
Loss from discontinued operations, net of taxes				(1)			(1)
Net income	$ 237	$ 239	$ 239	$ 139	$ 158	$ (775)	$ 237

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DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Condensed Consolidating Statement of Operations

Three Months Ended September 30, 2010

(in millions)

	Discovery	DCH	DCL	Non-Guarantor Subsidiaries of DCL	Other Non-Guarantor Subsidiaries of Discovery	Reclassifications and Eliminations	Discovery and Subsidiaries
Revenues	$	$	$ 408	$ 503	$ 18	$ (3)	$ 926
Costs of revenues, excluding depreciation and amortization			82	165	15	(1)	261
Selling, general and administrative	3		105	196	3	(1)	306
Depreciation and amortization			10	21	1		32
Restructuring and impairment charges			1	3	11		15
Total costs and expenses	3		198	385	30	(2)	614
Operating (loss) income	(3)		210	118	(12)	(1)	312
Equity in earnings of subsidiaries	188	184	64		123	(559)	
Interest expense, net			(47)	(2)			(49)
Other income (expense), net			6	(22)			(16)
Income before income taxes	185	184	233	94	111	(560)	247
Benefit from (provision for) income taxes	1	1	(58)	(31)	4		(83)
Income from continuing operations, net of taxes	186	185	175	63	115	(560)	164
Income from discontinued operations, net of taxes			9	4	12		25
Net income	186	185	184	67	127	(560)	189
Less net income attributable to noncontrolling interests				(3)			(3)
Net income attributable to Discovery Communications, Inc.	$ 186	$ 185	$ 184	$ 64	$ 127	$ (560)	$ 186

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DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Condensed Consolidating Statement of Operations

Nine Months Ended September 30, 2011

(in millions)

	Discovery	DCH	DCL	Non-Guarantor Subsidiaries of DCL	Other Non-Guarantor Subsidiaries of Discovery	Reclassifications and Eliminations	Discovery and Subsidiaries
Revenues	$	$	$ 1,301	$ 1,769	$ 51	$ (8)	$ 3,113
Costs of revenues, excluding depreciation and amortization			321	545	43	(6)	903
Selling, general and administrative	8		271	578	9	(2)	864
Depreciation and amortization			29	59	2		90
Restructuring and impairment charges			4	3			7
Gain on disposition				(129)			(129)
Total costs and expenses	8		625	1,056	54	(8)	1,735
Operating (loss) income	(8)		676	713	(3)		1,378
Equity in earnings of subsidiaries	801	803	452		535	(2,591)	
Interest expense, net			(150)	(4)			(154)
Other income (expense), net			3	(13)			(10)
Income before income taxes	793	803	981	696	532	(2,591)	1,214
Benefit from (provision for) income taxes	3		(178)	(243)	1		(417)
Income from continuing operations, net of taxes	796	803	803	453	533	(2,591)	797
Loss from discontinued operations, net of taxes				(1)			(1)
Net income	$ 796	$ 803	$ 803	$ 452	$ 533	$ (2,591)	$ 796

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DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Condensed Consolidating Statement of Operations

Nine Months Ended September 30, 2010

(in millions)

	Discovery	DHC	DCL	Non-Guarantor Subsidiaries of DCL	Other Non-Guarantor Subsidiaries of Discovery	Reclassifications and Eliminations	Discovery and Subsidiaries
Revenues	$	$	$ 1,223	$ 1,491	$ 50	$ (6)	$ 2,758
Costs of revenues, excluding depreciation and amortization			271	471	45	(5)	782
Selling, general and administrative	9		296	582	8	(1)	894
Depreciation and amortization			30	66	2		98
Restructuring and impairment charges			1	6	11		18
Total costs and expenses	9		598	1,125	66	(6)	1,792
Operating (loss) income	(9)		625	366	(16)		966
Equity in earnings of subsidiaries	468	530	259		311	(1,568)	
Interest expense, net		(48)	(102)	(5)			(155)
Loss on extinguishment of debt		(20)	(116)				(136)
Other expense, net		(32)	(12)	(13)			(57)
Income before income taxes	459	430	654	348	295	(1,568)	618
Benefit from (provision for) income taxes	3	37	(133)	(83)	5		(171)
Income from continuing operations, net of taxes	462	467	521	265	300	(1,568)	447
Income from discontinued operations, net of taxes			9	4	12		25
Net income	462	467	530	269	312	(1,568)	472
Less net income attributable to noncontrolling interests				(7)		(3)	(10)
Net income attributable to Discovery Communications, Inc.	462	467	530	262	312	(1,571)	462
Stock dividends to preferred interests	(1)						(1)
Net income available to Discovery Communications, Inc. stockholders	$ 461	$ 467	$ 530	$ 262	$ 312	$ (1,571)	$ 461

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DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Condensed Consolidating Statement of Cash Flows

Nine Months Ended September 30, 2011

(in millions)

	Discovery	DCH	DCL	Non-Guarantor Subsidiaries of DCL	Other Non-Guarantor Subsidiaries of Discovery	Eliminations	Discovery and Subsidiaries
Operating Activities							
Cash provided by (used in) operating activities	$ 108	$ (3)	$ 255	$ 401	$ (1)	$	$ 760
Investing Activities							
Purchases of property and equipment			(11)	(30)	(1)		(42)
Investments in and advances to equity investees				(93)			(93)
Cash used in investing activities			(11)	(123)	(1)		(135)
Financing Activities							
Borrowings from long term debt, net of discount and issuance costs			639				639
Principal repayments of capital lease obligations			(4)	(12)			(16)
Repurchases of common stock	(732)						(732)
Cash distributions to noncontrolling interests						(7)	(7)
Proceeds from stock option exercises, including excess tax benefits	61						61
Inter-company contributions and other financing activities, net	563	3	(282)	(290)	(1)	7	
Cash (used in) provided by financing activities	(108)	3	353	(302)	(1)		(55)
Effect of exchange rate changes on cash and cash equivalents				(4)			(4)
Net change in cash and cash equivalents			597	(28)	(3)		566
Cash and cash equivalents, beginning of period			369	93	4		466
Cash and cash equivalents, end of period	$	$	$ 966	$ 65	$ 1	$	$ 1,032

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DISCOVERY COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Condensed Consolidating Statement of Cash Flows

Nine Months Ended September 30, 2010

(in millions)

	Discovery	DCH	DCL	Non-Guarantor Subsidiaries of DCL	Other Non-Guarantor Subsidiaries of Discovery	Eliminations	Discovery and Subsidiaries
Operating Activities							
Cash (used in) provided by operating activities	$ (26)	$ (52)	$ 149	$ 372	$ 2	$	$ 445
Investing Activities							
Purchases of property and equipment			(7)	(21)	(1)		(29)
Business acquisitions, net of cash acquired				(38)			(38)
Proceeds from dispositions, net			13	11			24
Investments in and advances to equity investees			(68)	(3)			(71)
Cash used in investing activities			(62)	(51)	(1)		(114)
Financing Activities							
Borrowings from long-term debt, net of discount and issuance costs			2,970				2,970
Principal repayments of long-term debt		(1,948)	(935)				(2,883)
Inter-company contributions and other financing activities, net	26	2,000	(1,676)	(378)	(3)		(31)
Cash provided by (used in) financing activities	26	52	359	(378)	(3)		56
Effect of exchange rate changes on cash and cash equivalents				6			6
Net change in cash and cash equivalents			446	(51)	(2)		393
Cash and cash equivalents, beginning of period			476	144	3		623
Cash and cash equivalents, end of period	$	$	$ 922	$ 93	$ 1	$	$ 1,016

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ITEM 2. Management s Discussion and Analysis of Results of Operations and Financial Condition.

Management s discussion and analysis of results of operations and financial condition is a supplement to and should be read in conjunction with the accompanying consolidated financial statements and related notes. This section provides additional information regarding Discovery Communications, Inc. s (Discovery, Company, we, us, or our) businesses, recent developments, results of operations, and financial conditio Additional context can also be found in our Annual Report on Form 10-K for the year ended December 31, 2010 (the 2010 Form 10-K).

CAUTIONARY NOTE CONCERNING FORWARD-LOOKING STATEMENTS

Certain statements in this Quarterly Report on Form 10-Q constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding our business, marketing and operating strategies, integration of acquired businesses, new service offerings, financial prospects, and anticipated sources and uses of capital. Words such as anticipates, estimates, expects, projects, intends, plans, believes, and words and terms of similar substance used in connection with any discussion of future operating or financial performance identify forward-looking statements. Where, in any forward-looking statement, we express an expectation or belief as to future results or events, such expectation or belief is expressed in good faith and believed to have a reasonable basis, but there can be no assurance that the expectation or belief will result or be achieved or accomplished. The following include some but not all of the factors that could cause actual results or events to differ materially from those anticipated: the inability of advertisers or affiliates to remit payment to us in a timely manner or at all; general economic and business conditions; industry trends, including the timing of, and spending on, feature film, television, and television commercial production; spending on domestic and foreign television advertising, and foreign first-run and existing content libraries; the regulatory and competitive environment of the industries in which we, and the entities in which we have interests, operate; continued consolidation of the broadband distribution and movie studio industries; uncertainties inherent in the development of new business lines and business strategies; financial performance of our joint ventures and investments; integration of acquired operations; uncertainties associated with product and service development and market acceptance, including the development and provision of programming for new television and telecommunications technologies; changes in the distribution and viewing of television programming, including the expanded deployment of personal video recorders, video on demand, internet protocol television, mobile devices and personal tablets and their impact on television advertising revenue; rapid technological changes; future financial performance, including availability, terms, and deployment of capital; fluctuations in foreign currency exchange rates and political unrest in international markets; the ability of suppliers and vendors to deliver products, equipment, software, and services; the outcome of any pending or threatened litigation; availability of qualified personnel; the possibility of an industry-wide strike or other job action affecting a major entertainment industry union, or the duration of any existing strike or job action; changes in, or failure or inability to comply with, government regulations, including, without limitation, regulations of the Federal Communications Commission and adverse outcomes from regulatory proceedings; changes in income taxes applicable to our operations due to regulatory changes or changes in our corporate structures; changes in the nature of key strategic relationships with partners and joint venture partners; competitor responses to our products and services and the products and services of the entities in which we have interests; threatened terrorist attacks and ongoing military action in the Middle East and other parts of the world; reduced access to capital markets or significant increases in costs to borrow; and a failure to secure affiliate agreements or renewal of such agreements on less favorable terms. For additional risk factors, refer to Item 1A, Risk Factors, in our 2010 Form 10-K. These forward-looking statements and such risks, uncertainties, and other factors speak only as of the date of this Quarterly Report and we expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement contained herein, to reflect any change in our expectations with regard thereto, or any other change in events, conditions or circumstances on which any such statement is based.

BUSINESS OVERVIEW

We are a global nonfiction media and entertainment company that provides programming across multiple distribution platforms throughout the world. We distribute customized programming in over 40 languages in the U.S. and over 200 other countries and territories. Our global portfolio of networks includes prominent television brands such as Discovery Channel, one of the first nonfiction networks and our most widely distributed global brand, TLC, Animal Planet, Science Channel, and Investigation Discovery. We also have a diversified portfolio of websites and other digital media services, develop and sell curriculum-based products and services, and provide postproduction audio services.

Our objectives are to invest in content for our networks to build viewership, optimize distribution revenue, capture advertising sales, and create or reposition additional branded channels and businesses that can sustain long-term growth and occupy a desired programming niche with strong consumer appeal. Our strategy is to optimize the distribution, ratings, and profit potential of each of our branded networks. In addition to growing distribution and advertising revenue for our branded networks, we are extending content distribution across new platforms, including brand-aligned websites, mobile devices, video-on-demand (VOD), broadband channels and on-line streaming, which provide promotional platforms for our television programming and serve as additional outlets for advertising and affiliate sales.

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Our content spans genres including science, exploration, survival, natural history, sustainability of the environment, technology, docu-series, anthropology, paleontology, history, space, archaeology, health and wellness, engineering, adventure, lifestyles, forensics, civilization, and current events. A significant portion of our programming tends to be culturally neutral and maintains its relevance for an extended period of time. As a result, a significant amount of our content translates well across international borders and is made even more accessible through extensive use of dubbing and subtitles in local languages. We also create local programming tailored to individual market preferences.

We have an extensive library of programming and footage and ongoing content production that provide a source of content for creating new services and launching into new markets and onto new platforms. We own all or most rights to the majority of our programming and footage, which enables us to exploit our library to launch new brands and services into new markets quickly. Our programming can be re-edited and updated in a cost-effective manner to provide topical versions of subject matter that can be utilized around the world.

Our media content is designed to target key audience demographics and the popularity of our programming creates a reason for advertisers to purchase commercial time on our channels. Audience ratings are a key driver in generating advertising revenue and creating demand on the part of cable television operators, direct-to-home (DTH) satellite operators, and other content distributors to deliver our programming to their customers.

We classify our operations in three segments: U.S. Networks, consisting principally of domestic cable and satellite television networks, websites, and other digital media services; International Networks, consisting primarily of international cable and satellite television networks and websites; and Education and Other, consisting principally of curriculum-based product and service offerings and postproduction audio services.

U.S. Networks

U.S. Networks generated net revenues of $695 million and $1.9 billion during the three and nine months ended September 30, 2011, respectively, which represented 63% and 62% of our total consolidated net revenues for the three and nine months ended September 30, 2011, respectively. This segment wholly owns and operates nine national television networks, principally throughout the U.S., including prominent television brands such as Discovery Channel, TLC, and Animal Planet. In addition, this segment holds our interests in OWN: Oprah Winfrey Network (OWN), The Hub, and 3net, which are joint venture operated networks. We account for our interests in the underlying joint ventures using the equity method and services provided to them as other revenue.

On January 1, 2011, we contributed the domestic Discovery Health network to OWN. The contribution included affiliate relationships with cable operators and DTH satellite service providers, content licenses, and website user information. The contribution did not impact our ownership interest, voting control, or governance rights related to OWN. We recorded the contribution at fair value, which resulted in a pretax gain of $129 million. The gain resulted in $27 million of tax expense. Following the contribution, we no longer consolidate the domestic Discovery Health network. Additionally, net losses generated by OWN are allocated to both joint venture partners based on their proportionate ownership interests, which are 50-50. Previously, we recognized 100% of OWN s net losses. Future net income generated by OWN will initially be allocated 100% to us up to $104 million, the amount of net losses previously recognized by us prior to the contribution. After we have recouped our losses, any excess net income will be allocated to both joint venture partners based on their proportionate ownership interests.

U.S. Networks generates revenues from fees charged to distributors of our network content, which include cable and DTH satellite service providers and digital distributors, from advertising sold on our television networks and other arrangements. Distribution fees are largely based on the number of subscribers receiving our programming. Distribution revenues are recognized net of incentives we provide to operators in exchange for carrying our networks. Incentives may include cash payments to operators (launch incentives), providing the channel to the distributor for free for a predetermined length of time, or both. Launch incentives are capitalized as assets upon launch of our network by the operator and are amortized on a straight-line basis as a reduction of revenue over the term of the contract, including free periods. Advertising revenues are dependent upon a number of factors including the number of subscribers to our channels, viewership demographics, the popularity of our programming, and our ability to sell commercial time over a group of channels. Our U.S. Networks segment also generates revenues from affiliate and advertising sales representation services for third-party and joint venture networks and the licensing of our brands for consumer products. During the three months ended September 30, 2011, distribution, advertising, and other revenues were 50%, 46%, and 4%, respectively, of total net revenues for this segment. During the nine months ended September 30, 2011, distribution, advertising, and other revenues were 46%, 50%, and 4%, respectively, of total net revenues for this segment. The Discovery Channel, TLC, and Animal Planet collectively generated 66% and 72% of U.S. Networks total net revenues for the three and nine months ended September 30, 2011, respectively.

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U.S. Networks largest single cost is content expense, including content amortization, content impairments and production costs. U.S. Networks amortizes the cost of capitalized content rights based on the proportion that current estimated revenues bear to the estimated remaining total lifetime revenues, which normally results in an accelerated method over the estimated useful lives. Less mature networks utilize a straight-line method of amortization over the estimated useful lives.

International Networks

International Networks generated net revenues of $363 million and $1.1 billion during the three and nine months ended September 30, 2011, respectively, which represented 33% and 34% of our total consolidated net revenues for the three and nine months ended September 30, 2011, respectively. International Networks consists of national and pan-regional television networks and a portfolio of websites. The Discovery Channel, Animal Planet and TLC lead the International Network s portfolio of television networks, which are distributed in virtually every pay-television market in the world through an infrastructure that includes operational centers in London, Singapore, and Miami. International Networks has one of the largest international distribution platforms of cable networks from the U.S. with one to twelve networks in more than 200 countries and territories around the world. At September 30, 2011, International Networks operated over 140 unique distribution feeds in over 40 languages with channel feeds customized according to language needs and advertising sales opportunities.

The International Networks segment continues to pursue international expansion in select areas. For example, in 2010, we began the international rollout of TLC as a female-targeted global flagship and have launched TLC in nearly 170 countries and territories. In addition, on November 12, 2010, we acquired the remaining 50% interest in substantially all of the international Animal Planet and Liv (formerly People + Arts) networks from our joint venture partner, the BBC, giving us 100% ownership of these networks. Previously, these networks were operated as 50-50 joint ventures between us and the BBC. We determined that we were the primary beneficiary of the joint ventures with the BBC, and therefore, consolidated these joint ventures prior to the acquisition. With this acquisition, we wholly own and operate most of our international television networks, except for channels in Japan and Canada, which are operated by joint ventures with strategically important local partners. We anticipate that international expansion will continue to be an area of focus.

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

On September 1, 2010, we sold Antenna Audio Limited, which was a component of our International Networks segment, which is reported as discontinued operations for all periods presented.

Effective January 1, 2011, we realigned our International Networks reporting structure into the following four regions: Western Europe, which includes the U.K. and western European countries; Central and Eastern Europe, Middle East, and Africa (CEEMEA); Latin America; and Asia-Pacific. Previously, International Networks regional operations reported into the following four regions: the U.K.; Europe (excluding the U.K.), Middle East, and Africa (EMEA); Asia-Pacific; and Latin America. This realignment did not impact our consolidated financial statements other than to change the regions in which we describe our operating results for the International Networks segment.

Similar to our U.S. Networks segment, the primary sources of revenues for International Networks are fees charged to operators who distribute our networks, which primarily include cable and DTH satellite service providers, and from advertising sold on our television networks. Distribution fees are based on the number of subscribers receiving our programming and are recognized net of launch incentives. International Networks executes a localization strategy by offering shared programming with U.S. Networks, customized content, and localized schedules via our distribution feeds. International television markets vary in their stages of development. Some, notably the U.K., are more advanced digital multi-channel television markets, while others remain in the analog environment with varying degrees of investment from operators in expanding channel capacity or converting to digital. Advertising revenues are dependent upon a number of factors including the stage of development of pay television markets, number of subscribers to our channels, viewership demographics, the popularity of our programming, and our ability to sell commercial time over a group of channels. In developing pay television markets, we expect advertising revenue growth will result from subscriber growth, our localization strategy, and the shift of advertising spending from broadcast to pay television. In relatively mature markets, such as Western Europe, the growth dynamic is changing. Increased market penetration and distribution are unlikely to drive rapid growth in those markets. Instead, growth in advertising sales will come from increasing viewership and advertising pricing on our existing pay television networks and launching new services, either in pay television or free television environments. During the three months ended September 30, 2011, distribution, advertising, and other revenues were 63%, 33%, and 4%, respectively, of total net revenues for this segment. During the nine months ended September 30, 2011, distribution, advertising, and other revenues were 63%, 34%, and 3%, respectively, of total net revenues for this segment.

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International Networks largest cost is content expense, which is acquired from our U.S. Networks segment or through production, coproduction, or license arrangements with third parties. While our International Networks segment maximizes the use of shared programming from our U.S. Networks segment, we also develop local programming that is tailored to individual market preferences. International Networks amortizes the cost of capitalized content rights based on the proportion that current estimated revenues bear to the estimated remaining total lifetime revenues, which results in either an accelerated method or a straight-line method over the estimated useful lives.

Education and Other

Education and Other generated net revenues of $37 million and $117 million during the three and nine months ended September 30, 2011, respectively, which represented 3% and 4% of our total consolidated net revenues during the three and nine months ended September 30, 2011, respectively. Our Education and Other segment is primarily comprised of curriculum-based product and service offerings and postproduction audio services. Our education business generates revenues primarily from subscriptions charged to K-12 schools for access to an online suite of curriculum-based VOD tools, professional development services, and to a lesser extent student assessment and publication of hardcopy curriculum-based content. Our education business also participates in corporate partnerships, global brand and content licensing business with leading non-profits, foundations and trade associations. Other businesses primarily include postproduction audio services that are provided to major motion picture studios, independent producers, broadcast networks, cable channels, advertising agencies, and interactive producers.

RESULTS OF OPERATIONS

Items Impacting Comparability

Following the contribution of the domestic Discovery Health network to OWN on January 1, 2011, we no longer consolidate the network. The comparability of our results of operations between 2011 and 2010 has been impacted by the deconsolidation. Accordingly, to assist the reader in better understanding the changes in our results of operations, the following table presents the results of operations of the Discovery Health network for the three and nine months ended September 30, 2010 (in millions).

	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
Revenues:		
Distribution	$ 4	$ 11
Advertising	15	46
Other		1
Total revenues	19	58
Costs of revenues	8	22
Selling, general and administrative	2	10
Total operating expenses	10	32
Operating income	$ 9	$ 26

Reclassifications

We expanded the types of revenue included in distribution revenue in our consolidated statements of operations for the three and nine months ended September 30, 2011 and reclassified prior year amounts. Distribution revenues include fees charged for the right to view Discovery network branded content made available to customers through a variety of distribution platforms and viewing devices. The largest component of distribution revenue continues to be fees charged to cable, DTH satellite and telecommunications service providers for distribution rights to Discovery s television networks. Beginning July 1, 2011, distribution revenues also include fees charged for certain licensing arrangements, including those for digital streaming of library content, which totaled $83 million and $93 million for the three and nine months ended September 30, 2011, respectively. These fees, which totaled $4 million and $17 million for the three and nine months ended September 30, 2010, respectively, and $10 million for the six months ended June 30, 2011, were previously classified as other revenue and have been reclassified to distribution revenue to conform to the current presentation.

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Consolidated Results of Operations

Our consolidated results of operations were as follows (in millions).

	Three Months Ended September 30, 2011	2010	% Change Favorable/ (Unfavorable)	Nine Months Ended September 30, 2011	2010	% Change Favorable/ (Unfavorable)
Revenues:						
Distribution	$ 580	$ 456	27%	$ 1,563	$ 1,363	15%
Advertising	442	402	10%	1,328	1,185	12%
Other	73	68	7%	222	210	6%
Total revenues	1,095	926	18%	3,113	2,758	13%
Costs of revenues, excluding depreciation and amortization	342	261	(31)%	903	782	(15)%
Selling, general and administrative	295	306	4%	864	894	3%
Depreciation and amortization	30	32	6%	90	98	8%
Restructuring and impairment charges	2	15	87%	7	18	61%
Gain on disposition				(129)		
Total costs and expenses	669	614	(9)%	1,735	1,792	3%
Operating income	426	312	37%	1,378	966	43%
Interest expense, net	(56)	(49)	(14)%	(154)	(155)	1%
Loss on extinguishment of debt					(136)	NM
Other expense, net	(5)	(16)	69%	(10)	(57)	82%
Income before income taxes	365	247	48%	1,214	618	96%
Provision for income taxes	(127)	(83)	(53)%	(417)	(171)	NM
Income from continuing operations, net of taxes	238	164	45%	797	447	78%
(Loss) income from discontinued operations, net of taxes	(1)	25	NM	(1)	25	NM
Net income	237	189	25%	796	472	69%
Net income attributable to noncontrolling interests		(3)	NM		(10)	NM
Net income attributable to Discovery Communications, Inc.	237	186	27%	796	462	72%
Stock dividends to preferred interests			NM		(1)	NM
Net income available to Discovery Communications, Inc. stockholders	$ 237	$ 186	27%	$ 796	$ 461	73%

NM not meaningful.

Revenues

Distribution revenues for the three and nine months ended September 30, 2011, increased $124 million and $200 million, respectively. Excluding the impact of foreign currency fluctuations and the effect of no longer consolidating the Discovery Health network, distribution revenues increased 25% and 13% for the three and nine months ended September 30, 2011, respectively. During the three months ended September 30, 2011, we extended and expanded an agreement to license selected library titles. As a result of titles delivered under this agreement, license revenue from this and similar agreements increased from $4 million to $83 million for the three months ended September 30, 2010 and 2011, respectively. License revenue from this and similar agreements increased from $17 million to $93 million for the nine months ended September 30, 2010 and 2011, respectively. The timing and amount of revenue recognized under license agreements are largely driven by the titles delivered. The remaining distribution revenue increase was attributable to rate increases and subscriber growth.

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Advertising revenues for the three and nine months ended September 30, 2011, increased $40 million and $143 million, respectively. Excluding the impact of foreign currency fluctuations and the effect of no longer consolidating the Discovery Health network, advertising revenues increased 13% and 15% for the three and nine months ended September 30, 2011. Increases were attributable to worldwide increases in pricing, higher sellouts at US Networks, and international expansion of network feeds for the three and nine months ended September 30, 2011. Advertising revenues also benefited from an $8 million non-recurring revenue item for the nine months ended September 30, 2011.

Other revenues for the three and nine months ended September 30, 2011, increased $5 million and $12 million, respectively, due to growth in revenues from services provided to our unconsolidated joint ventures and growth in corporate partnerships at our education business, partially offset by no longer providing services to The Travel Channel.

Costs of Revenues

Costs of revenues, which consist primarily of content expense, distribution costs, and sales commissions, increased $81 million and $121 million for the three and nine months ended September 30, 2011, respectively. Excluding the impact of foreign currency fluctuations and the effect of no longer consolidating the Discovery Health network, costs of revenues increased 34% and 17% for the three and nine months ended September 30, 2011, respectively. The increase in costs of revenues was principally related to higher content expense. Content expense increased $74 million and $112 million for the three and nine months ended September 30, 2011, respectively, primarily due to continued investment in content and the international expansion of networks, such as TLC. For the three months ended September 30, 2011, content expense also included an increase of $22 million in content impairments compared to the three months ended September 30, 2010 due to refinement of programming strategy and content performance. Cost of revenues also increased due to charges of $11 million associated with the licensing of select library titles.

Selling, General and Administrative

Selling, general and administrative expenses, which principally comprise employee costs, marketing costs, research costs, occupancy, and back office support fees, decreased $11 million and $30 million for the three and nine months ended September 30, 2011, respectively. Excluding the impact of foreign currency fluctuations and the effect of no longer consolidating the Discovery Health network, selling, general and administrative expenses decreased 7% for the three and nine months ended September 30, 2011. The decrease in selling, general and administrative expenses was driven by decreases of $38 million and $83 million for stock-based compensation for the three and nine months ended September 30, 2011, respectively. Stock-based compensation expense decreased $40 million and $95 million due to a decline in outstanding unit awards and SARs, which are cash-settled awards, for the three and nine months ended September 30, 2011, respectively; partially offset by an increase in expense of $2 million and $12 million for stock options, PRSUs and RSUs. Selling, general and administrative expenses further increased due to higher employee costs due to merit based increases in compensation, increased costs related to the international expansion of networks, such as TLC, and greater presence in new territories, such as Eastern Europe, and increased research costs related to obtaining ratings services for additional networks.

Depreciation and Amortization

Depreciation and amortization expense decreased $2 million and $8 million for the three and nine months ended September 30, 2011, respectively due to lower asset balances as a result of certain assets becoming fully depreciated in prior periods.

Restructuring and Impairment Charges

We incurred restructuring charges of $2 million and $7 million for the three and nine months ended September 30, 2011, respectively, primarily related to various employee terminations and organizational changes.

During the three and nine months ended September 30, 2010, we recorded $4 million and $7 million, respectively, of exit and restructuring charges as part of a reorganization of portions of our business. The charges, which primarily consisted of severance and contract termination costs, were primarily incurred by our International Networks segment and Corporate operations.

During the three and nine months ended September 30, 2010, we recorded an $11 million charge related to the impairment of goodwill at our Creative Sound Services reporting unit, which is a component of our Education and Other segment. The impairment was the result of lower than expected operating performance.

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Gains on Dispositions

In connection with the contribution of the Discovery Health network to OWN on January 1, 2011, we recorded a pretax gain of $129 million, which represents the fair value of the investment retained less the book basis of contributed assets.

Interest Expense, Net

Interest expense, net, increased $7 million for the three months ended September 30, 2011, when compared to the same period in 2010, due to an increase in the amount of outstanding debt. Interest expense, net, was relatively flat for the nine months ended September 30, 2011, when compared to the same period in 2010. For the nine months ended September 30, 2010, we incurred $22 million in interest expense related to interest rate swaps. During 2010, most of our interest rate swaps either matured or were settled prior to maturity as a result of refinancing most of our debt in June 2010. Decreases in interest expense attributable to interest rate swaps were partially offset by increases in interest expense on outstanding debt.

Other Expense, Net

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Unrealized (losses) gains on derivative instruments, net	$ (1)	$ 3	$ 1	$ 8
Realized losses on derivative instruments, net		(4)	(2)	(37)
Losses from equity investees, net	(4)	(12)	(12)	(29)
Other, net		(3)	3	1
Total other expense, net	$ (5)	$ (16)	$ (10)	$ (57)

The decrease in losses from equity method investments was primarily attributable to changes associated with our investment in OWN. While we recognized 100% of OWN s losses prior to OWN s launch on January 1, 2011, we have recognized 50% of OWN s losses subsequent to the launch. Additionally, the funding to OWN has increased, we have recorded an increase in interest earned of $8 million for the nine months ended September 30, 2011. The decrease in derivative losses is a result of reducing the derivatives held by us as part of the issuance of Senior Notes on June 30, 2010.

Provision for Income Taxes

Our provisions for income taxes were $127 million and $83 million, and the effective tax rates were 35% and 34% for the three months ended September 30, 2011 and 2010, respectively. The effective tax rate for the three months ended September 30, 2011 was consistent with the U.S. federal statutory income tax rate of 35% as production activity deductions were offset by state taxes. The effective tax rate for the three months ended September 30, 2010 differed from the U.S. federal statutory income tax rate of 35% due primarily to production activity deductions which were partially offset by state taxes.

Our provisions for income taxes were $417 million and $171 million, and the effective tax rates were 34% and 28% for the nine months ended September 30, 2011 and 2010, respectively. The effective tax rate for the nine months ended September 30, 2011 differed from the U.S. federal statutory income tax rate of 35% principally because we were not required to record a deferred tax liability of $21 million with respect to the portion of the outside basis in the OWN joint venture attributable to the nondeductible goodwill contributed to OWN and production activity deductions. These items were partially offset by state taxes. The effective tax rate for the nine months ended September 30, 2010, differed from the U.S. federal statutory income tax rate of 35% primarily due to the reversal of a $28 million previously established foreign tax reserve recorded in connection with the completion of a tax audit, production activity deductions and a $16 million tax expense reduction for a change in the our election to claim foreign tax credits that were previously taken as deductions, which were partially offset by state taxes.

Prior to December 31, 2011, we plan to undertake an international reorganization of our legal entities in order to consolidate and better align certain content and affiliate functions. We are evaluating the effect of the reorganization on expected tax expense for the three months ended December 31, 2011. It is possible that the reorganization results in material changes in non cash income tax expense compared to our current estimates for the three months ended December 31, 2011. As part of the reorganization, we also expect to record a benefit for filing amended tax returns to claim foreign tax credits that were previously taken as deductions.

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Net Income Attributable to Noncontrolling Interests

The $3 million and $10 million decreases in net income attributable to noncontrolling interests for the three and nine months ended September 30, 2011, respectively, were due to the acquisition of the BBC s interests in the international Animal Planet and Liv networks on November 12, 2010. Following the acquisition, we no longer allocates net operating results to noncontrolling interests.

Segment Results of Operations

We evaluate the operating performance of our segments based on financial measures such as revenues and adjusted operating income before depreciation and amortization (Adjusted OIBDA). Adjusted OIBDA is defined as revenues less costs of revenues and selling, general and administrative expenses excluding: (i) mark-to-market stock-based compensation, (ii) depreciation and amortization, (iii) amortization of deferred launch incentives, (iv) exit and restructuring charges, (v) certain impairment charges, and (vi) gains (losses) on business and asset dispositions. We use this measure to assess the operating results and performance of our segments, perform analytical comparisons, identify strategies to improve performance, and allocate resources to each segment. We believe Adjusted OIBDA is relevant to investors because it allows them to analyze the operating performance of each segment using the same metric management uses and also provides investors a measure to analyze the operating performance of each segment against historical data. We exclude mark-to-market stock-based compensation, exit and restructuring charges, certain impairment charges, and gains (losses) on business and asset dispositions from the calculation of Adjusted OIBDA due to their volatility. We also exclude the depreciation of fixed assets and amortization of intangible assets and deferred launch incentives as these amounts do not represent cash payments in the current reporting period. Adjusted OIBDA should be considered in addition to, but not a substitute for, operating income, net income and other measures of financial performance reported in accordance with U.S. generally accepted accounting principles (GAAP).

Additionally, certain corporate expenses are excluded from segment results to enable executive management to evaluate segment performance based upon decisions made directly by segment executives. Additional financial information for our reportable segments is set forth in Note 14 to the consolidated financial statements included in Item 1, Financial Statements, in this Quarterly Report on Form 10-Q.

Total consolidated Adjusted OIBDA was calculated as follows (in millions).

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	% Change Favorable/ (Unfavorable)	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010	% Change Favorable/ (Unfavorable)
Revenues:						
U.S. Networks	$ 695	$ 585	19%	$ 1,942	$ 1,751	11%
International Networks	363	304	19%	1,054	893	18%
Education and Other	37	38	(3)%	117	108	8%
Corporate and inter-segment eliminations		(1)	NM		6	NM
Total revenues	1,095	926	18%	3,113	2,758	13%
Costs of revenues, excluding depreciation and amortization(1)	(342)	(261)	(31)%	(903)	(782)	(15)%
Selling, general and administrative(1)	(287)	(258)	(11)%	(833)	(770)	(8)%
Add: Amortization of deferred launch incentives(2)	13	11	18%	39	32	22%
Adjusted OIBDA	$ 479	$ 418	15%	$ 1,416	$ 1,238	14%

NM not meaningful.

(1) Costs of revenues and selling, general and administrative expenses exclude mark-to-market stock-based compensation, restructuring charges, gains (losses) on dispositions, and depreciation and amortization.

(2)

Amortization of deferred launch incentives are included as a reduction of distribution revenues for reporting in accordance with GAAP but are excluded from Adjusted OIBDA.

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The following table presents our Adjusted OIBDA, by segment, with a reconciliation of total consolidated Adjusted OIBDA to consolidated operating income (in millions).

	Three Months Ended September 30, 2011	2010	% Change Favorable/ (Unfavorable)	Nine Months Ended September 30, 2011	2010	% Change Favorable/ (Unfavorable)
Adjusted OIBDA:						
U.S. Networks	$ 378	$ 346	9%	$ 1,107	$ 1,018	9%
International Networks	156	130	20%	473	384	23%
Education and Other	3	1	NM	16	7	NM
Corporate and inter-segment eliminations	(58)	(59)	2%	(180)	(171)	(5)%
Total Adjusted OIBDA	479	418	15%	1,416	1,238	14%
Amortization of deferred launch incentives	(13)	(11)	(18)%	(39)	(32)	(22)%
Mark-to-market stock-based compensation	(8)	(48)	83%	(31)	(124)	75%
Depreciation and amortization	(30)	(32)	6%	(90)	(98)	8%
Restructuring and impairment charges	(2)	(15)	87%	(7)	(18)	61%
Gains on dispositions				129		
Operating income	$ 426	$ 312	37%	$ 1,378	$ 966	43%

NM not meaningful.

U.S. Networks

The following table presents, for our U.S. Networks segment, revenues by type, certain operating expenses, contra revenue amounts, Adjusted OIBDA, and a reconciliation of Adjusted OIBDA to operating income (in millions). While the table below discloses reported amounts, the discussion of segment results that follows compares the current year operating results to the prior year s excluding the impact of the Discovery Health network for all periods discussed.

	Three Months Ended September 30, 2011	2010	% Change Favorable/ (Unfavorable)	Nine Months Ended September 30, 2011	2010	% Change Favorable/ (Unfavorable)
Revenues:						
Distribution	$ 350	$ 264	33%	$ 898	$ 790	14%
Advertising	322	304	6%	973	899	8%
Other	23	17	35%	71	62	15%
Total revenues	695	585	19%	1,942	1,751	11%
Costs of revenues, excluding depreciation and amortization	(207)	(139)	(49)%	(508)	(415)	(22)%
Selling, general and administrative	(113)	(102)	(11)%	(334)	(324)	(3)%
Add: Amortization of deferred launch incentives	3	2	50%	7	6	17%
Adjusted OIBDA	378	346	9%	1,107	1,018	9%
Amortization of deferred launch incentives	(3)	(2)	(50)%	(7)	(6)	(17)%

Depreciation and amortization	(4)	(5)	20%	(12)	(16)	25%
Restructuring and impairment charges				(3)		
Gains on dispositions				129		
Operating income	$ 371	$ 339	9%	$ 1,214	$ 996	22%

Revenues

Distribution revenues for the three and nine months ended September 30, 2011 increased $90 million and $119 million, respectively, excluding the impact of the Discovery Health network. During the three months ended September 30, 2011, we extended and expanded an agreement to license selected library titles. As a result of the titles delivered under this and similar agreements, license revenue increased $77 million and $74 million for the three and nine months ended September 30, 2011, respectively. The timing and amount of license agreements are largely driven by titles delivered. The remaining distribution revenue increase was attributable to annual contractual rate increases and an increase in paying subscribers, principally for networks carried on the digital tier.

Advertising revenues for the three and nine months ended September 30, 2011 increased $33 million and $120 million, respectively, excluding the impact of the Discovery Health network, driven by increased pricing in the upfront and scatter markets and higher sellouts. Additionally, the increase for the nine months ended September 30, 2011, includes the benefit of $8 million for nonrecurring revenue items in the second quarter of 2011.

Other revenues for the three and nine months ended September 30, 2011 increased $6 million and $10 million, respectively, excluding the impact of the Discovery Health network, due to growth in revenues from services provided to our unconsolidated joint ventures, partially offset by no longer providing services to The Travel Channel.

Costs of Revenues

Costs of revenues, which consist primarily of content expense, sales commissions, distribution costs, and production costs, increased $76 million and $115 million during the three and nine months ended September 30, 2011, respectively, excluding the impact of the Discovery Health network. The increases in costs of revenues were due primarily to an increase in content expense, which reflects our continued investment in content. Content impairments increased $24 million and $6 million for the three and nine months ended September 30, 2011, respectively, due to refinement of programming strategy and content performance. There was also $11 million in expenses associated with the licensing of select library titles during the three and nine months ended September 30, 2011.

Selling, General and Administrative

Selling, general and administrative expenses, which principally comprise employee costs, marketing costs, research costs and occupancy and back office support fees, increased $13 million and $20 million for the three and nine months ended September 30, 2011, respectively, excluding the impact of the Discovery Health network. The increases in selling, general and administrative expenses were driven by research, personnel and other general and administrative costs for the nine months ended September 30, 2011 and higher marketing costs for the three months ended September 30, 2011.

Adjusted OIBDA

For the three and nine months ended September 30, 2011, Adjusted OIBDA increased $41 million and $115 million, respectively, excluding the impact of the Discovery Health network, primarily due to increased distribution revenues largely generated from a licensing arrangement and increased advertising sales, partially offset by higher content expense and selling, general and administrative expenses.

International Networks

The following table presents, for our International Networks segment, revenues by type, certain operating expenses, contra revenue amounts, Adjusted OIBDA, and a reconciliation of Adjusted OIBDA to operating income (in millions).

	Three Months Ended September 30,		% Change Favorable/ (Unfavorable)	Nine Months Ended September 30,		% Change Favorable/ (Unfavorable)
	2011	2010		2011	2010	
Revenues:						
Distribution	$ 230	$ 192	20%	$ 665	$ 573	16%
Advertising	120	98	22%	354	286	24%

Other	13	14	(7)%	35	34	3%
Total revenues	363	304	19%	1,054	893	18%
Costs of revenues, excluding depreciation and amortization	(112)	(98)	(14)%	(330)	(294)	(12)%

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	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	% Change Favorable/ (Unfavorable)	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010	% Change Favorable/ (Unfavorable)
Selling, general and administrative	(105)	(85)	(24)%	(283)	(241)	(17)%
Add: Amortization of deferred launch incentives	10	9	11%	32	26	23%
Adjusted OIBDA	156	130	20%	473	384	23%
Amortization of deferred launch incentives	(10)	(9)	(11)%	(32)	(26)	(23)%
Depreciation and amortization	(11)	(10)	(10)%	(33)	(29)	(14)%
Restructuring and impairment charges		(3)	NM	(2)	(6)	67%
Operating income	$ 135	$ 108	25%	$ 406	$ 323	26%

NM not meaningful.

Revenues

Distribution revenues for the three and nine months ended September 30, 2011, increased $38 million and $92 million, respectively. Excluding the impact of foreign currency fluctuations, distribution revenues increased 13% and 11% for the three and nine months ended September 30, 2011, respectively. The increase in distribution revenue was attributable to continued expansion of pay television services across all regions and subscriber growth across all regions.

Advertising revenues for the three and nine months ended September 30, 2011, increased $22 million and $68 million, respectively. Excluding the impact of foreign currency fluctuations, advertising revenues increased by 16% and 17% for the three and nine months ended September 30, 2011, respectively. Increases were primarily attributable to improved pricing across all regions as well as expansion of network feeds primarily in Western Europe and CEEMEA.

Costs of Revenues

Costs of revenues, which consist primarily of content expense, distribution costs and sales commissions, increased $14 million and $36 million during the three and nine months ended September 30, 2011, respectively. Excluding the impact of foreign currency fluctuations, costs of revenues increased 10% and 9% for the three and nine months ended September 30, 2011, respectively. Cost of revenues increased due to increases in content expense of $6 million and $18 million for the three and nine months ended September 30, 2011, respectively, as a result of the international rollout of new networks, such as TLC, and higher sales commissions across most regions.

Selling, General and Administrative

Selling, general and administrative expenses, which principally comprise employee costs, marketing costs, research costs, occupancy, and back office support fees, increased $20 million and $42 million during the three and nine months ended September 30, 2011, respectively. Excluding the impact of foreign currency fluctuations, selling, general and administrative costs increased 3% and 8% for the three and nine months ended September 30, 2011, respectively. Increased selling, general and administrative expenses were attributable to a greater presence in certain regions such as CEEMEA and expansion of female lifestyle networks.

Adjusted OIBDA

Adjusted OIBDA for the three and nine months ended September 30, 2011, increased $26 million and $89 million, respectively. Excluding the impact of foreign currency fluctuations, Adjusted OIBDA increased 20% and 19% for the three and nine months ended September 30, 2011, respectively. The increases were attributable to growth in revenues, partially offset by higher content expense and other expenses associated with greater presence in certain regions such as CEEMEA, and expansion of female lifestyle networks.

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Education and Other

The following table presents, for our Education and Other segment, revenues by type, certain operating expenses, Adjusted OIBDA, and a reconciliation of Adjusted OIBDA to operating income (in millions).

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	% Change Favorable/ (Unfavorable)	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010	% Change Favorable/ (Unfavorable)
Revenues:						
Other	$ 37	$ 38	(3)%	$ 117	$ 108	8%
Costs of revenues, excluding depreciation and amortization	(22)	(25)	12%	(63)	(67)	6%
Selling, general and administrative	(12)	(12)		(38)	(34)	(12)%
Adjusted OIBDA	3	1	NM	16	7	NM
Depreciation and amortization	(1)	(2)	50%	(4)	(5)	20%
Restructuring and impairment charges		(11)	NM		(11)	NM
Operating income (loss)	$ 2	$ (12)	NM	$ 12	$ (9)	NM

NM not meaningful.

Revenues

Other revenues for the three months ended September 30, 2011 decreased $1 million due to lower revenues from post production audio services offset by growth in corporate partnerships at our Education business. Other revenues for the nine months ended September 30, 2011 increased $9 million due to continued growth in subscriptions for access to our online streaming service and growth in corporate partnerships and assessment services for our educational business.

Costs of Revenues

Costs of revenues, which consist principally of content expense, royalty payments, distribution and sales commissions, decreased for the three and nine months ended September 30, 2011 due to decreases in content expense and sales commissions.

Selling, General and Administrative

Selling, general and administrative expenses, which are principally comprised of employee costs, occupancy expenses, back office support fees and marketing costs were relatively flat for the three months ended September 30, 2011 when compared to the same period in the prior year. Selling, general and administrative expenses increased during the nine months ended September 30, 2011 due to higher employee expenses.

Adjusted OIBDA

Adjusted OIBDA for the three and nine months ended September 30, 2011 increased $2 million and $9 million, respectively. Adjusted OIBDA for the three months ended September 30, 2011 was relatively flat when compared with the same period for 2010. The increase in Adjusted OIBDA for the nine months ended September 30, 2011 compared to the same period for 2010 was due to continued growth in online streaming services, improved performance for our postproduction audio services, as well as lower costs of revenues, which were partially offset by increased employee expenses.

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Corporate and Inter-segment Eliminations

The following table presents, for our unallocated corporate amounts, revenues, certain operating expenses, Adjusted OIBDA, and a reconciliation of Adjusted OIBDA to operating loss (in millions).

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	% Change Favorable/ (Unfavorable)	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010	% Change Favorable/ (Unfavorable)
Revenues:						
Other	$	$ (1)	NM	$	$ 6	NM
Total revenues		(1)	NM		6	NM
Costs of revenues, excluding depreciation and amortization	(1)	1	NM	(2)	(6)	67%
Selling, general and administrative	(57)	(59)	3%	(178)	(171)	(4)%
Adjusted OIBDA	(58)	(59)	2%	(180)	(171)	(5)%
Mark-to-market stock-based compensation	(8)	(48)	83%	(31)	(124)	75%
Depreciation and amortization	(14)	(15)	7%	(41)	(48)	15%
Restructuring and impairment charges	(2)	(1)	(100)%	(2)	(1)	(100)%
Operating loss	$ (82)	$ (123)	33%	$ (254)	$ (344)	26%

NM not meaningful.

Corporate operations primarily consist of executive management, administrative support services, a consolidated joint venture, and substantially all of our stock-based compensation. Consistent with our segment reporting, corporate expenses are excluded from segment results to enable executive management to evaluate business segment performance based upon decisions made directly by business segment executives.

Selling, general and administrative expenses for the three months ended September 30, 2011 were relatively flat when compared to the same period in 2010. Selling, general and administrative expenses for the nine months ended September 30, 2011, increased $7 million due to higher stock-based compensation expense for equity-settled awards such as stock options, PRSUs, and RSUs that received fixed accounting, as well as increased personnel costs, offset by a reduction in other general and administrative costs.

FINANCIAL CONDITION

Sources and Uses of Cash

Our principal sources of cash are cash and cash equivalents on hand, cash flows from operating activities, available borrowing capacity under our revolving credit facility, and access to capital markets. As of September 30, 2011, we had $2.0 billion of total capital resources available, comprised of $1.0 billion of cash and cash equivalents on hand, excluding amounts held by consolidated joint ventures, and approximately $1.0 billion available to borrow under our revolving credit facility. As a public company, we may have access to other sources of capital such as the public bond and equity markets. On June 17, 2009, we filed a Registration Statement on Form S-3 (Shelf Registration) with the SEC in which we registered securities, including debt securities, common stock, and preferred stock. On June 20, 2011, DCL, one of our subsidiaries, issued $650 million aggregate principal amount of 4.375% Senior Notes due on June 15, 2021. DCL received net proceeds of $641 million from the offering after deducting underwriting discounts and issuance costs. In total we have issued approximately $4.2 billion of senior notes under the Shelf Registration. Access to sufficient capital from the public market is not assured.

Our primary uses of cash include the creation and acquisition of new content, operating expenditures, discretionary repurchases of stock, income taxes, interest, funding to joint ventures, capital expenditures, and business acquisitions. We believe our financial condition is sound and anticipate that our existing cash and cash equivalents on hand, cash generated by operating activities, and cash available to us, considered together, should be sufficient to meet our anticipated cash operating requirements for at least the next twelve months.

On August 3, 2010, we implemented a stock repurchase program with authorization to purchase up to $1.0 billion of our common stock. On July 27, 2011, our Board of Directors authorized us to purchase an additional $1.0 billion of our common stock under our stock repurchase program. In total, we have been authorized to purchase $2.0 billion of our common stock under our repurchase program. We have been funding and expect to continue to fund repurchases through a combination of cash on hand, cash generated by operations, borrowings under our revolving credit facility, and future financing transactions. Under the program, management is authorized to purchase shares from time to time through open market purchases or privately negotiated transactions at prevailing prices as permitted by securities laws and other legal requirements, and subject to stock price, business conditions, market conditions, and other factors. The repurchase program has no expiration date.

We have interests in various joint ventures and provide funding to those joint ventures from time-to-time. As of September 30, 2011, we have provided $270 million in funding, including interest accrued on outstanding borrowings, to our joint ventures. We expect to provide significant additional funding to our joint ventures and expect to recoup amounts funded.

Cash Flows

Changes in cash and cash equivalents were as follows (in millions).

	Nine Months Ended September 30,	
	2011	**2010**
Cash and cash equivalents, beginning of period	$ 466	$ 623
Cash provided by operating activities	760	445
Cash used in investing activities	(135)	(114)
Cash (used in) provided by financing activities	(55)	56
Effect of exchange rate changes on cash and cash equivalents	(4)	6
Net change in cash and cash equivalents	566	393
Cash and cash equivalents, end of period	$ 1,032	$ 1,016

Changes in cash and cash equivalents for the nine months ended September 30, 2010 include insignificant amounts related to Antenna Audio, which was sold on September 1, 2010.

Operating Activities

Cash provided by operating activities increased $315 million for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. The increase in cash provided by operating activities was driven by increased advertising sales and distribution fees, a decrease in taxes paid, and decreases in stock compensation payments for cash settled equity awards. During 2010, there was a $112 million overpayment of tax (2010 overpayment) resulting primarily from an extension of the tax law in the fourth quarter of 2010 that allowed for the immediate deduction of certain domestic programming costs. During the nine months ended September 30, 2011, we received a $39 million tax refund related to the 2010 overpayment and there was a decrease in tax payments of $73 million as a result of the use of the remaining overpayment carry forward from the 2010 overpayment. The $21 million decrease in payments for cash-settled equity awards was attributable to the decrease in number of outstanding unit awards and SARs. These improvements were partially offset by a $95 million increase attributable to investments in programming.

Investing Activities

Cash flows used in investing activities increased $21 million for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010, which was attributable to a $22 million increase in funding to unconsolidated network joint ventures and a $13 million increase in payments for purchases of property, plant, and equipment. The increase in funding to unconsolidated network joint ventures was primarily due to continued investments in OWN, which was launched on January 1, 2011. Cash flows used in investing activities for the nine months ended September 30, 2010 included $35 million for the acquisition of an uplink facility and net cash proceeds of $24 million related to the sale of our Antenna Audio business. There are no comparable investing activities for the nine months ended September 30, 2011.

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Financing Activities

Cash flows from financing activities decreased $111 million for the nine months ended September 30, 2011 as compared to the same period in 2010. The decrease in cash flows from financing activities was principally attributable to repurchases of 20 million shares of Series C common stock for $732 million made pursuant to our stock repurchase program implemented on August 3, 2010, and repayments of our capital lease obligations, partially offset by our issuance of $650 million of senior notes in June 2011 for which we received $641 million of net proceeds. We paid an additional $2 million in financing fees associated with our modified credit agreement.

Cash provided by financing activities for the nine months ended September 30, 2010 principally reflects the issuance of $3.0 billion of senior notes, for which we received $2.97 billion of net proceeds after deducting underwriting discounts and issuance costs and $27 million of proceeds from stock option exercises. We used the debt offering proceeds and cash on hand to repay $2.88 billion of principal outstanding under our term loans and previously outstanding senior notes. Additionally during the nine months ended September 30, 2010, we repurchased 1.12 million shares of our Series C common stock for $38 million.

Capital Resources

As of September 30, 2011, we had approximately $2.0 billion of total capital resources available, which was comprised of the following (in millions).

	September 30, 2011			
	Total Capacity	Outstanding Letters of Credit	Outstanding Indebtedness	Unused Capacity
Cash and cash equivalents	$ 1,030	$	$	$ 1,030
Revolving credit facility	1,000	1		999
Fixed rate public debt:				
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	
6.35% Senior Notes, semi-annual interest, due June 2040	850		850	
Total fixed rate public debt	4,150		4,150	
Total	$ 6,180	$ 1	$ 4,150	$ 2,029

Cash and cash equivalents exclude $2 million of cash held by consolidated joint ventures as of September 30, 2011.

COMMITMENTS AND OFF-BALANCE SHEET ARRANGEMENTS

In the normal course of business, we enter into various commitments for the purchase of goods or services or that would require us to make payments or provide funding in the event certain circumstances occur. Information regarding our commitments and off-balance sheet arrangements is set forth in Note 13 to the consolidated financial statements included in Item 1, Financial Statements, in this Quarterly Report on Form 10-Q.

RELATED PARTY TRANSACTIONS

In the normal course of business, we enter into transactions with related parties. Related parties include our investments accounted for using the equity method, such as OWN, The Hub, 3Net, Discovery Japan and Animal Planet Japan. Other related parties include Liberty Global, Inc., Liberty Interactive Corporation, Liberty Media Corporation, Ascent Capital Group, Inc., and their respective subsidiaries and affiliates. Information regarding transactions and amounts with related parties is set forth in Note 12 to the consolidated financial statements included in Item 1, Financial Statements, in this Quarterly Report on Form 10-Q.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our critical accounting policies and estimates have not changed since December 31, 2010. Disclosure about our critical accounting policies and estimates is set forth in Item 7, Management s Discussion and Analysis of Results of Operations and Financial Condition, in our Annual Report on Form 10-K for the year ended December 31, 2010.

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NEW ACCOUNTING AND REPORTING PRONOUNCEMENTS

We adopted certain accounting and reporting standards during the nine months ended September 30, 2011. Information regarding our adoption of new accounting and reporting standards is set forth in Note 1 to the consolidated financial statements included in Item 1, Financial Statements, in this Quarterly Report on Form 10-Q.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Our exposures to market risk have not changed materially since December 31, 2010. Quantitative and qualitative disclosures about our existing market risk are set forth in Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in our Annual Report on Form 10-K for the year ended December 31, 2010.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2011. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act of 1934, as amended (the Exchange Act), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2011, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f), during the three months ended September 30, 2011, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

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

ITEM 1A. Risk Factors

Our risk factors have not changed materially since December 31, 2010. Disclosure about our existing risk factors is set forth in Item A, Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2010.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

There were no sales of unregistered securities during the three months ended September 30, 2011.

The following table presents information about our repurchases of common stock that were made through open market transactions during the three months ended September 30, 2011.

Period	**Total Number of Shares Purchased**	**Average Price Paid per Share (1)**	**Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)**	**Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1)(2)**
Series C common stock:				
July 1, 2011 July 30, 2011	2,923,200	$ 37.04	2,923,200	$ 1,409,657,673
August 1, 2011 August 31, 2011	4,233,800	$ 34.84	4,233,800	$ 1,262,131,502
September 1, 2011 September 30, 2011	2,632,000	$ 37.80	2,632,000	$ 1,162,633,812
Total	9,789,000	$ 36.30	9,789,000	$ 1,162,633,812

(1) The amounts do not give effect to any fees, commissions or other costs associated with repurchases of shares.

(2) On August 3, 2010, we announced a stock repurchase program, with authorization to purchase up to $1.0 billion of our common stock. On July 27, 2011, our Board of Directors authorized us to purchase an additional $1.0 billion of our common stock. In total, we have been authorized to purchase $2.0 billion of our common stock under our repurchase program. We have been funding and expect to continue to fund repurchases through a combination of cash on hand, cash generated by operations, borrowings under our revolving credit facility and future financing transactions. Under the program, management is authorized to purchase shares from time to time through open market purchases or privately negotiated transactions at prevailing prices as permitted by securities laws and other legal requirements, and subject to stock price, business conditions, market conditions, and other factors. The repurchase program has no expiration date. The above repurchases were funded using cash on hand. There were no repurchases of our Series A common stock or Series B common stock during the three months ended September 30, 2011.

ITEM 6. Exhibits.

Exhibit No.	Description
4.1	Amendment No. 1, dated as of August 8, 2011, to the Credit Agreement, dated as of October 13, 2010, among Discovery Communications, LLC, as borrower, Discovery Communications, Inc., as guarantor, the Lenders party thereto, and Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K filed on August 9, 2011, SEC File No. 1-34177).
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as Amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as Amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)
101.INS	XBRL Instance Document (furnished herewith)
101.SCH	XBRL Taxonomy Extension Schema Document (furnished herewith)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document (furnished herewith)
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document (furnished herewith)
101.LAB	XBRL Taxonomy Extension Label Linkbase Document (furnished herewith)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document (furnished herewith)

Attached as Exhibit 101 to this Quarterly Report on Form 10-Q are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets as of September 30, 2011 and December 31, 2010, (ii) Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2011 and 2010 (iii) Consolidated Statements of Cash Flows for the Nine Months ended September 30, 2011 and 2010, (iv) Consolidated Statements of Equity for the Three and Nine Month Ended September 30, 2011 and 2010, and (v) Notes to Consolidated Financial Statements.

In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act, is deemed not filed for purposes of section 18 of the Exchange Act, and otherwise is not subject to liability under these sections.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	DISCOVERY COMMUNICATIONS, INC.
	(Registrant)
Date: November 2, 2011	By: /s/ David M. Zaslav David M. Zaslav President and Chief Executive Officer
Date: November 2, 2011	By: /s/ Bradley E. Singer Bradley E. Singer Senior Executive Vice President and Chief Financial Officer

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