From: Wargo, Dave
Sent: 4/16/2007 7:25:43 PM
To: Marty Flessner
CC:
Subject: FW: DISCA: Rediscovering Growth; Initiate with BUY rating & $25.50 Price Target -for John -FYI-Dave W

Sender: "Wargo, Dave"
Message-ID: <279C068C0F6D54498CDBDB9D48D8B976B290@HQ-WARGO1.wargoandco.local>
Recipients:
"Marty Flessner"

Attachment: FW_ DISCA_ Rediscovering Growth; Initiate with BUY rating & $25.50 Price Target -for John -FYI-Dave W

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From: Greenfield, Rich (NYC) [mailto:RGreenfield@palicapital.com]
Sent: Monday, April 16, 2007 7:51 AM
Subject: DISCA: Rediscovering Growth; Initiate with BUY rating & $25.50 Price Target

Pali Research

April 12, 2007

Discovery Holdings Co — DISCA

Rediscovering Growth; Initiate with BUY rating & $25.50 Price Target

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IMPORTANT DISCLOSURES AND ANALYST'S CERTIFICATION APPEAR IN APPENDIX

In July 2005, Liberty Media spun-off its 50% ownership in Discovery Communications Inc. (DCI) into Discovery Holding Co.; whose only consolidated asset was Ascent Media (only included in the spin for tax purposes and whose fair market value represents less than 5% of DISCA's total equity value). We were very negative on DISCA in 2005 due to the lack of asset consolidation (and no visibility as to when/if that would change), shareholder rotation issues (relative to large cap Liberty Media), weak ratings for the primary Discovery networks (particularly TLC and the Discovery channel), growing debt balances (with over $300 mm of contingent liabilities to purchase stakes in international networks) and a valuation that appeared high relative to its growth prospects and its peers.

In 2006 (as we joined Pali), we chose not even to cover DISCA because of the lack of visibility surrounding a consolidation of DCI and an increasingly troubling focus by DCI senior management on its education business, rather than its core cable networks (despite both TLC and the Discovery channel beginning ratings comebacks). In fact, we heard from several people within DCI that the "savior" of DCI would be its launch of a consumer education business (launched in 2006 as Cosmeo).

Since late 2006, DISCA has undergone dramatic changes at both the parent DISCA and subsidiary DCI levels, engineered by a new senior management team at DCI led by David Zaslav (Zaslav was appointed DCI CEO on November 16, 2006).

DCI now appears committed to developing unique, "on-brand" proprietary content across all its cable networks that it can exploit thru an increasing number of distribution platforms and is a company that no longer feels compelled to be in every country around the global and business (retail/education), unless the returns in that market/business warrant investment.

These changes at DCI, combined with the first steps toward DCI consolidation, lead us to believe that DISCA can reach $25.50 within 12 months (based on 12.4x '08E EBITDA and 21x '08E FCF), resulting in our BUY rating on DISCA shares.

Why is DISCA Near a 52-week High and Why is it Going Significantly Higher?

DCI has undergone dramatic changes over the past several months that leave the company in a far more exciting position than it has been in several years. We expect organic DCI EBITDA growth of over 20% (excluding the impact of the Travel Channel sale) in both 2007 and 2008, with the potential for significantly faster growth if the advertising environment remains healthy solid and DCI's ratings continue to rebound (our estimates assume only 8% total company revenue growth ex-Travel in 2008, which appears conservative).

- First Step Toward DCI Consolidation into DISCA. On March 29, 2007, DCI announced the acquisition of Cox

Communications' 25% stake in DCI for $1.3 bn in cash plus the Travel Channel (acquisition expected to close in May 2007). Transaction will increase DISCA's ownership of DCI to 66 2/3% from 50% with Advance/Newhouse Communications owning the remaining 33 1/3% of DCI.

It remains unclear whether Advance/Newhouse will sell their ownership in DCI to DISCA or DCI and/or whether they are interested in consolidating their stake in DCI into DISCA. With Cox's stake being transferred, the acquisition or consolidation of Advance/Newhouse's stake is the final impediment to the transformation of DISCA from a holding company to an operating company.

§ In August 2006, Bob Miron, CEO of Advance Newhouse stated (in Multichannel News) responding to a question on whether one of the shareholders would sell out: "No, we're not headed there. I don't see that... We've very happy with the investment in Discovery."

§ Following the creation of DISCA in 2005, it has always been unclear how long DISCA had to wait to discuss a consolidation to protect the tax-free nature of the original spin-off (was at least one year, but more likely two years – implying July 2007).

In October 2005, DCI made an important change to its long-term incentive compensation plan (LTIP) for senior executives provides a clue to the long-term intention of Advance/Newhouse. The LTIP, historically based on a private market valuation of DCI (performed by an investment bank annually), was changed to a plan based around the performance of DISCA shares. Based on conversations with DISCA management, we believe this was a change (given its importance) that required the consent of all three DCI owners (including Advance/Newhouse).

§ While it is probably unlikely that Advance/Newhouse wants to sell their stake in DCI (based on the aforementioned comments from Miron), we suspect they will consolidate their holdings up to the DISCA level when it becomes possible tax-wise. We simply cannot believe that Advance/Newhouse management would have allowed the LTIP to be based on DISCA, without planning to enable DISCA stock to flourish, which we believe will require the consolidation of their ownership later this year.

· Ratings Rebound Continuing: TLC and Discovery network ratings have surged in early 2007 (see Exhibit A), rebounding above 2004 peak levels. Both networks fell dramatically in 2005, with TLC primetime household ratings declining 30% between 2004-2005 and Discovery ratings down over 15% during the same period, with both networks beginning their rebound in mid-2006. Ratings have surged in early 2007, with Discovery ratings up 23% year-over-year during the first quarter and TLC up even more.

The new Planet Earth series on Discovery only started on March 25, in turn, the impact of the series' strong ratings will have a more significant positive impact on second quarter 2007 (Planet Earth debuted to a 3.6 HH rating, the strongest primetime rating from any show on the network since 2005).

American Choppers, one of the strongest Discovery channel shows was shifted to TLC beginning in January 2007, with the launch of the series' fourth season. New, even stronger programming on Discovery (Planet Earth) eliminates the negative impact from the shift of American Choppers off Discovery, while the positive impact on TLC should be felt throughout full-year 2007.

· Ending Consumer Education Initiative and Exploring Sale of Retail Stores. DCI's Commerce, Education and Other segment generated over $200 million in revenues in 2006, but generated over $121 million of EBITDA losses. What is truly amazing is that Discovery's school-based learning company (United Streaming) was profitable in 2006, implying that DCI's two other businesses within the reporting segment (Cosmeo and the Discovery retail stores) lost more than $121 million. DCI is moving rapidly to eliminate these money losing businesses, in turn, we expect the Commerce, Education and Other segment to generate positive EBITDA in 2008 – in turn, becoming a key driver of DCI EBITDA growth.

Cosmeo Gutted. We never understood how Discovery was going to build a successful consumer subscription education business on the web, given the trouble most companies are having in building on-line subscription businesses. Convincing parents to spend $9.95 per month for online homework help for their children sounded like an uphill battle to us from the beginning. Despite our skepticism, DCI devoted significant marketing and promotional resources to Cosmeo (reaching only 50,000 subscribers in early 2007) in 2006. Since taking over as CEO of Discovery in late 2006, Zaslav has quickly gutted the consumer education business, with DCI employees dedicated to Cosmeo dropping from 120 to under five following recent cost-cutting initiatives.

Discovery Stores Likely to be Sold. Discovery has lost money in its retail store division for years, but was maintained by prior management for unknown reasons. We believe there is little synergy from the Discovery stores and modest brand building value. In Discovery's 2006 10-K filed on February 28, 2007, DCI indicated that is was exploring strategic alternatives for its retail store division. We expect DCI to sell the stores to a third-party, who then licenses the Discovery brand from DCI, similar to the relationship Disney struck with Children's Place.

· International Margin Expansion Beginning in 2008. While DCI's domestic EBITDA margins have hovered in the high 30's, international network margins have actually declined over the past several years from the mid-teens to the low-teens. We expect margin pressure to continue in early-mid 2007, due to the launch of a free-to-air broadcast network in Germany DMAX (shifting Discovery's subscription based model in the rest of the world to a free, advertising supported broadcast model in Germany only, to more deeply penetrate a difficult subscription TV market). However, beginning in late 2007 and more significantly in 2008, we expect international margins to notably accelerate (reaching the high teens by 2010) due to:

Easing comparisons (such as DMAX and European lifestyle channel launches) should facilitate margin expansion.

Cost-Cutting. Discovery no longer feels compelled to be in every market across the globe, rather it is committed to focusing its resources on markets where it can generate solid returns and where significant growth exists. While the specifics of this strategy are somewhat unclear, we believe Discovery is looking to cut headcount in underperforming markets (reallocating to growth markets, albeit net headcount appears to be coming down) and may be seeking to license its brand and/or programming in markets where profitability is unclear.

Lessening Negative Impact from Developing Network Consolidation. Over the last few years, DCI has been burdened by put agreements that forced it to acquire and consolidate developing networks it had launched with joint-venture partners. With the exercise of one put in early 2007, DCI has only $50 million of remaining exposure to these agreements, which were over $300 million when DISCA was first created in mid-2005.

- Strong Growth in Subscription Revenues Due to Digital Cable Growth Globally. Cable system operators (and in certain markets satellite operators) are increasingly benefiting from the rollout of triple-play (digital video, data, and voice) bundles resulting in improving basic subscriber trends (moving sub losses or lack of growth, to meaningful basic sub growth) and more importantly, a significant re-acceleration in digital video growth (which had begun to slow). While the impact for fully penetrated cable networks, such as Discovery, is relatively modest, the impact on digital only cable networks, such as the Science or Military Channel, is far more significant. We estimate this should result in high single digit US subscriber revenue growth for DCI over the next few years (excluding the loss of the Travel channel) and mid-high teens growth in international subscription revenues.

- Investing in Original Programming Across its Networks. It has become increasingly clear over the past several months (culminating in DCI's recent upfront presentation in NYC in early April) that DCI understands the importance of original programming for each of its stable of cable networks. The only way DCI can continue to grow and differentiate itself in a multi-platform world is to create unique consumer-desirable original programming.

In January 2007, Discovery announced the creation of significant new original programming for the Military Channel, Science Channel and Discovery Times.

In April 2007, Discovery announced at its upfront presentation that it would leverage its Steve Irwin programming franchise into new original programming for the Discovery Kids network.

In April 2007, Discovery announced the transformation of the Discovery Home channel into Planet Green. The goal being to leverage successful programming on one network into a new channel (in this case, replacing an underperforming network that did not have a meaningful brand identity with consumers or advertisers).

Valuation Attractive Despite Recent Surge in Share Price, with Upcoming Catalysts. DISCA is up 30% since the end of 2006, due to investor excitement over the COX transaction and the early impact of sweeping senior management changes at DCI.

Despite the surge in DISCA, we believe there is still more than 20% upside over the next 12-months, based on our $25.50 target price. Our target price (see Exhibit B) is based on a 5x '08E EBITDA multiple for Ascent Media and a 13x multiple on DICSA's two-thirds ownership of DCI (note: fixing Ascent at 5x EBITDA, implies that DISCA is already trading at 13.7x its share of DCI '07E EBITDA). Our target price equates to a 21x multiple of proportionate '08E free cash flow.

- Our DCF (fixing Ascent's value at 5x EBITDA) equates to $26.50, based on a WACC of 9%, a 3.5% perpetual growth rate and a terminal multiple of 18x.

Upcoming Catalysts:

- Q1 '07 earnings results (to be announced when DISCA files its 10-Q in mid-May 2007) should begin to illustrate (excluding one-time restructuring charges) the margin impact of recent cost-cutting initiatives, particularly at Discovery's consumer education division.

- Q2 '07 cost-cutting to continue. We expect overall layoffs at DCI to at least double by summer 2007 (recently laid off 3% of its work force), with the Discovery retail stores likely being sold or significantly reduced/restructured over the next few months.

- Q2 Ratings. We expect significant ratings growth at the core Discovery network and Discovery HD Theater benefiting from the premiere of the Planet Earth series at the end of Q1 '07, as well as continued strong year-over-year improvements at TLC.

- July 2007: End of Two Year Post Liberty Spin Period. While we have no specific knowledge of what will happen after the two-year tax period has lapsed, we believe there is a reasonable likelihood that Advance/Newhouse will agree to upstream its DCI ownership into DISCA (we suspect maintaining management rights are the most important gating factor on a transaction).

If DCI is actually consolidated, it will create yet another catalyst for DISCA as DCI management will finally be free to communicate with the investment community (something that has not been possible since the creation of DISCA). We believe greater transparency beyond quarterly filings will result in a substantial increase in investor attention paid to DISCA.

- Throughout 2007 into 2008: Increased investor focus on companies that create their own content. We believe the value attributed to cable network companies that own the vast majority of their content will increase substantially as Internet video, HDTV and mobile video distribution platforms become more tangible to investors over the next 12-24 months. DCI is very well positioned to leverage expanding distribution platforms on a global basis, particularly with new management's increased focused on original programming across its cable networks. This theme is a key driver of our BUY rating on DISCA.

Key Risks to Our Valuation and Price Target

- Inability to Consolidate Advance/Newhouse's stake in DCI. While we do not believe this will impact shares in the next several months, we believe consolidation of the DCI stake is necessary over the next 12 months to achieve our price target.

- Dilutive Transaction with Advance/Newhouse. Even if DISCA or DCI is able to convince Advance/Newhouse to sell or upstream their stake, a key risk is at what price (relative to the current DISCA market value) will they agree to a transaction, given their control/management rights.

- Significant decline in the ratings at any of the core DCI cable networks. Given the recent rebound in ratings and success of new programming, we are not particularly concerned with this issue.

- Weakness in the overall advertising market. While DCI should benefit from its improved ratings and outperform the overall advertising market, to the extent that the overall cable television advertising market weakened dramatically, it would be difficult for DCI to grow its advertising revenues.

·

Discovery Holding Management Team

- John Malone—Chairman and CEO. Malone has been Chief Executive Officer and Chairman of the Board of Discovery Holdings since March 2005, and a director of since May 2005. He has served as Chairman of the Board and a director of Liberty since 1990. Malone served as Chairman of the Board of Tele-Communications, Inc. ("TCI") from November 1996 to March 1999; and Chief Executive Officer of TCI from January 1994 to March 1999.

- Robert Bennett—President. Bennett has been President of Discovery Holdings since March 2005, and a director since May 2005. Bennett served as President of Liberty from April 1997 to February 2006 and as Chief Executive Officer of Liberty from April 1997 to August 2005.

- David Flowers—Senior Vice President and Treasurer. Senior Vice President and Treasurer of our company since March 2005. Mr. Flowers has served as Senior Vice President of Liberty since October 2000 and Treasurer of Liberty since April 1997. Mr. Flowers served as a Vice President of Liberty from June 1995 to October 2000.

Discovery Communications Management Team

- John Hendricks—Founder and Chairman. Hendricks created the Discovery Channel in 1982 as the first cable network in the United States designed to provide high quality documentary programming enabling people to explore their world and satisfy their natural curiosity.

- David Zaslav—Chief Executive Officer. Before joining Discovery in January 2007, David Zaslav was president of NBC Universal Cable and Domestic TV and New Media Distribution. In this role, David oversaw domestic distribution of NBC Universal content to all forms of television throughout the United States and Canada. In October 1999, David was named President, NBC Cable. He joined NBC in 1989 and was instrumental in developing and launching CNBC that same year.

- Roger Millay—Chief Financial Officer. Roger Millay is responsible for the global financial functions and future financial strategies of the company and directs all accounting, treasury, budgeting, audit and tax activities. Millay previously served as senior vice president and Chief Financial Officer of Airgas, Inc. and the leasing and equipment management division of General Electric Capital Corporation.

- Mark Hollinger—Corporate Operations and General Counsel. Hollinger is responsible for management of the legal team which oversees DCI's legal affairs across all of the company's business units. Hollinger joined DCI in November 1991 as vice president and deputy general counsel.

APPENDIX

IMPORTANT DISCLOSURES AND ANALYSTS' CERTIFICATIONS

Analyst Certification

I, Richard S. Greenfield, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject companies and their securities. I also certify that I have not been, and will not be, receiving direct or indirect compensation in exchange for expressing the specific recommendations in this report.

I, Mark D. Smaldon, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject companies and their securities. I also certify that I have not been, and will not be, receiving direct or indirect compensation in exchange for expressing the specific recommendations in this report.

Analyst Stock Ratings

Pali Research's ratings are defined as follows:

BUY – A stock that is expected at initiation to produce a positive total return of 15% or greater over the 12 months following the initial recommendation. The BUY rating may be maintained following initiation as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

SELL – A stock that is expected at initiation to produce a negative total return of 15% or greater over the next 12 months following the initial recommendation. The SELL rating may be maintained following initiation as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

NEUTRAL – A stock that is not expected to appreciate or depreciate meaningfully over the next 12 months.

Disclosure of Distribution of Ratings

Pali Research, the research arm of Pali Capital, Inc. must disclose in each research report the percentage of all securities rated by the member to which the member would assign a "buy", "neutral" or "sell" rating. Below is the distribution of Pali Capital's research recommendations as of the end of the first quarter of 2007:

As of the end of the most recent calendar quarter (March 31, 2007), Pali Capital, Inc. had investment ratings on 39 equity securities.

All required disclosures, including price charts, designating ratings and price targets on all Pali Research-rated stocks are available upon request by contacting msmaldon@palicapital.com.

Subject companies in each rating category for which Pali Capital has provided investment banking services within the last 12 months is 0%.

Unless otherwise noted, all prices are as of the close on April 13, 2007.

Valuation Methodology

Our target price of $25.50 is based on a 5x '08E EBITDA multiple for Ascent Media and a 13x multiple on DICSA's two-thirds ownership of DCI (note: fixing Ascent at 5x EBITDA, implies that DISCA is trading at 13.7x its share of DCI '07E EBITDA). Our target price equates to a 21x multiple of proportionate '08E free cash flow.

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General Risks of Equity Investing

Investors need to be aware that investments in equity securities may pose significant risks due to the inherent uncertainty associated with relying on forecasts of various factors that can affect the earnings, cash flow and overall valuation of a company. Any investment in equity securities should be facilitated only within the context of diversification by asset class, industry, company, as well as investment objectives and time horizon.

For additional information, please contact your Pali sales and trading representative at (212) 259-2000.

Pali Capital, Inc. ("Pali") does not accept orders via email, please contact your Registered Representative for execution assistance.

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Please see our website, www.palicapital.com for further information on disclosures and terms of use.

Attachment: DISCA+4-16-07 CC.pdf

PALI RESEARCH

April 16, 2007

Discovery Holding Co.

Rediscovering Growth; Initiate with BUY Rating & $25.50 Price Target

Richard Greenfield
(212) 259-5176
rgreenfield@palicapital.com

Mark D. Smaldon
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DISCA: BUY
Price: $20.89
Target Price: $25.50

52 Week Range: DISCA	$12.81 - $21.07
Market Cap. (mm):	$5,848
Avg. Daily Volume (3 months):	1,777,960
4-Yr. Est. DISCA EBITDA CAGR:	2.8%
4-Yr Est. DCI EBITDA CAGR	13.1%
4-Yr. Est. DISCA EPS CAGR	28.4%

Fiscal Dec	2006A	2007E	2008E
Q1	$0.04	$0.05E	N/A
Q2	$0.05	$0.06E	N/A
Q3	($0.25)	$0.08E	N/A
Q4	$0.03	$0.09E	N/A
FY	($0.10)	$0.28E	$0.39E
P/E	NM	74.6X	53.6x
DCI Revs ($mm)	$3,013	$3,239	$3,413
DCI EBITDA	$722	$850	$1,013
DCI EV/EBITDA	NM	12.3x	10.6x
DCI FCF ($mm)	$390	$344	$504
DCI FCF/Share	$1.39	$1.23	$1.80

Note: EPS are for Ascent Media, with only an Equity pickup of 50% of Discovery thru May 2007 & 2/3 of Discovery thereafter

DCI figures represent 100% of Discovery Communications Inc. financials

DCI valuation metrics are based on fixing Ascent's valuation at 5x EBITDA

Source: Pali Research Estimates and Company Documents

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PALI CAPITAL, INC.

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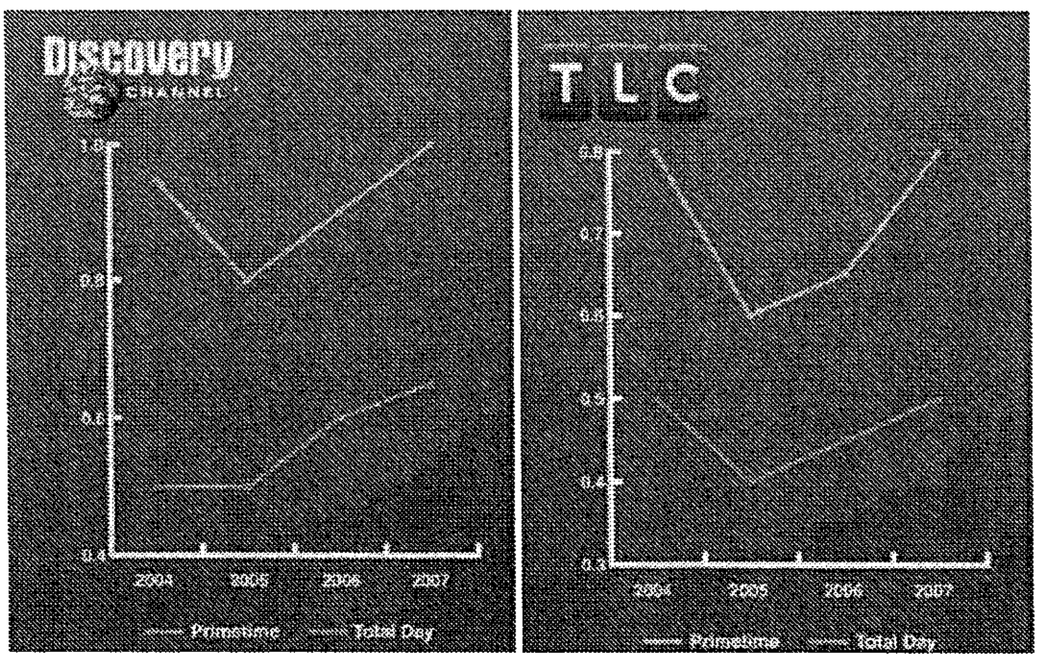
Exhibit A: Household Ratings Turnaround at Discovery and TLC (Primetime and Total Day)



Source: Nielsen Media Research

DHC.I.D.0000244

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  - *Cosmeo Gutted.* We never understood how Discovery was going to build a successful consumer subscription education business on the web, given the trouble most companies are having in building on-line subscription businesses. Convincing parents to spend $9.95 per month for online homework help for their children sounded like an uphill battle to us from the beginning. Despite our skepticism, DCI devoted significant marketing and promotional resources to Cosmeo (reaching only 50,000 subscribers in early 2007) in 2006. Since taking over as CEO of Discovery in late 2006, Zaslav has quickly gutted the consumer education business, with DCI employees dedicated to Cosmeo dropping from 120 to under five following recent cost-cutting initiatives.

  - *Discovery Stores Likely to be Sold.* Discovery has lost money in its retail store division for years, but was maintained by prior management for unknown reasons. We believe there is little synergy from the Discovery stores and modest brand building value. In Discovery's 2006 10-K filed on February 28, 2007, DCI indicated that is was exploring strategic alternatives for its retail store division. We expect DCI to sell the stores to a third-party, who then licenses the Discovery brand from DCI, similar to the relationship Disney struck with Children's Place.

- International Margin Expansion Beginning in 2008. While DCI's domestic EBITDA margins have hovered in the high 30's, international network margins have actually declined over the past several years from the mid-teens to the low-teens. We expect margin pressure to continue in early-mid 2007, due to the launch of a free-to-air broadcast network in Germany DMAX (shifting Discovery's subscription based model in the rest of the world to a free, advertising supported broadcast model in Germany only, to more deeply penetrate a difficult subscription TV market). However, beginning in late 2007 and more significantly in 2008, we expect international margins to notably accelerate (reaching the high teens by 2010) due to:

  - Easing comparisons (such as DMAX and European lifestyle channel launches) should facilitate margin expansion.

  - Cost-Cutting. Discovery no longer feels compelled to be in every market across the globe, rather it is committed to focusing its resources on markets where it can generate solid returns and where significant growth exists. While the specifics of this strategy are somewhat unclear, we believe Discovery is looking to cut headcount in underperforming markets (reallocating to growth markets, albeit net headcount appears to be coming down) and may be seeking to license its brand and/or programming in markets where profitability is unclear.

- Lessening Negative Impact from Developing Network Consolidation. Over the last few years, DCI has been burdened by put agreements that forced it to acquire and consolidate developing networks it had launched with joint-venture partners. With the exercise of one put in early 2007, DCI has only $50 million of remaining exposure to these agreements, which were over $300 million when DISCA was first created in mid-2005.

- Strong Growth in Subscription Revenues Due to Digital Cable Growth Globally. Cable system operators (and in certain markets satellite operators) are increasingly benefiting from the rollout of triple-play (digital video, data, and voice) bundles resulting in improving basic subscriber trends (moving sub losses or lack of growth, to meaningful basic sub growth) and more importantly, a significant re-acceleration in digital video growth (which had begun to slow). While the impact for fully penetrated cable networks, such as Discovery, is relatively modest, the impact on digital only cable networks, such as the Science or Military Channel, is far more significant. We estimate this should result in high single digit US subscriber revenue growth for DCI over the next few years (excluding the loss of the Travel channel) and mid-high teens growth in international subscription revenues.

- Investing in Original Programming Across its Networks. It has become increasingly clear over the past several months (culminating in DCI's recent upfront presentation in NYC in early April) that DCI understands the importance of original programming for each of its stable of cable networks. The only way DCI can continue to grow and differentiate itself in a multi-platform world is to create unique consumer-desirable original programming.

  - In January 2007, Discovery announced the creation of significant new original programming for the Military Channel, Science Channel and Discovery Times.

  - In April 2007, Discovery announced at its upfront presentation that it would leverage its Steve Irwin programming franchise into new original programming for the Discovery Kids network.

  - In April 2007, Discovery announced the transformation of the Discovery Home channel into Planet Green. The goal being to leverage successful programming on one network into a new channel (in this case, replacing an underperforming network that did not have a meaningful brand identity with consumers or advertisers).

Valuation Attractive Despite Recent Surge in Share Price, with Upcoming Catalysts. DISCA is up 30% since the end of 2006, due to investor excitement over the COX transaction and the early impact of sweeping senior management changes at DCI.

Despite the surge in DISCA, we believe there is still more than 20% upside over the next 12-months, based on our $25.50 target price. Our target price (see Exhibit B) is based on a 5x '08E EBITDA multiple for Ascent Media and a 13x multiple on DICSA's two-thirds ownership of DCI (note: fixing Ascent at 5x EBITDA, implies that DISCA is already trading at 13.7x its share of DCI '07E EBITDA). Our target price equates to a 21x multiple of proportionate '08E free cash flow.

- Our DCF (fixing Ascent's value at 5x EBITDA) equates to $26.50, based on a WACC of 9%, a 3.5% perpetual growth rate and a terminal multiple of 18x.

Exhibit B: DISCA Sum of the Parts Valuation (in millions, except per share figures)

Assets	DISCA Stake	2008E Estimate	EBITDA Multiple	Value to DISCA
Ascent Media EBITDA	100%	57	5.0x	285
DISCA Net Cash	100%	173		173
Discovery Total EBITDA (consolidated International and Education/Commerce)	67%	1,013	13.0x	8,781
Discovery's Net (Debt)	67%	(3,111)		(2,074)
Total NAV				7,166
Shares Outstanding				280
Implied DISCA Stock Price				$25.60
Implied '08E EBITDA Multiple				12.4x
Implied '08E FCF Multiple				20.8x
Current Price	DISCA			$20.89
Current '08E EBITDA Multiple				10.6x
Current '08E FCF Multiple				17.0x
Discovery Communications Current 2008 EBITDA Multiple, if Ascent's Value is Fixed at	$285			11.0x
Discovery Communications Current 2008 FCF Multiple, if Ascent's Value is Fixed at	$285			17.4x
Implied increase in DISCA's stock price				23%

Source: Company Documents and Pali Research Estimates

Upcoming Catalysts:

- Q1 '07 earnings results (to be announced when DISCA files its 10-Q in mid-May 2007) should begin to illustrate (excluding one-time restructuring charges) the margin impact of recent cost-cutting initiatives, particularly at Discovery's consumer education division.
- Q2 '07 cost-cutting to continue. We expect overall layoffs at DCI to at least double by summer 2007 (recently laid off 3% of its work force), with the Discovery retail stores likely being sold or significantly reduced/restructured over the next few months.
- Q2 Ratings. We expect significant ratings growth at the core Discovery network and Discovery HD Theater benefiting from the premiere of the *Planet Earth* series at the end of Q1 '07, as well as continued strong year-over-year improvements at TLC.
- July 2007: End of Two Year Post Liberty Spin Period. While we have no specific knowledge of what will happen after the two-year tax period has lapsed, we believe there is a reasonable likelihood that Advance/Newhouse will agree to upstream its DCI ownership into DISCA (we suspect maintaining management rights are the most important gating factor on a transaction).

- If DCI is actually consolidated, it will create yet another catalyst for DISCA as DCI management will finally be free to communicate with the investment community (something that has not been possible since the creation of DISCA). We believe greater transparency beyond quarterly filings will result in a substantial increase in investor attention paid to DISCA.

- Throughout 2007 into 2008: Increased investor focus on companies that create their own content. We believe the value attributed to cable network companies that own the vast majority of their content will increase substantially as Internet video, HDTV and mobile video distribution platforms become more tangible to investors over the next 12-24 months. DCI is very well positioned to leverage expanding distribution platforms on a global basis, particularly with new management's increased focused on original programming across its cable networks. This theme is a key driver of our BUY rating on DISCA.

Key Risks to Our Valuation and Price Target

- Inability to Consolidate Advance/Newhouse's stake in DCI. While we do not believe this will impact shares in the next several months, we believe consolidation of the DCI stake is necessary over the next 12 months to achieve our price target.

- Dilutive Transaction with Advance/Newhouse. Even if DISCA or DCI is able to convince Advance/Newhouse to sell or upstream their stake, a key risk is at what price (relative to the current DISCA market value) will they agree to a transaction, given their control/management rights.

- Significant decline in the ratings at any of the core DCI cable networks. Given the recent rebound in ratings and success of new programming, we are not particularly concerned with this issue.

- Weakness in the overall advertising market. While DCI should benefit from its improved ratings and outperform the overall advertising market, to the extent that the overall cable television advertising market weakened dramatically, it would be difficult for DCI to grow its advertising revenues.

Discovery Holding Management Team

- John Malone—Chairman and CEO. Malone has been Chief Executive Officer and Chairman of the Board of Discovery Holdings since March 2005, and a director of since May 2005. He has served as Chairman of the Board and a director of Liberty since 1990. Malone served as Chairman of the Board of Tele-Communications, Inc. ("TCI") from November 1996 to March 1999; and Chief Executive Officer of TCI from January 1994 to March 1999.

- Robert Bennett—President. Bennett has been President of Discovery Holdings since March 2005, and a director since May 2005. Bennett served as President of Liberty from April 1997 to February 2006 and as Chief Executive Officer of Liberty from April 1997 to August 2005.

- David Flowers—Senior Vice President and Treasurer. Senior Vice President and Treasurer of our company since March 2005. Mr. Flowers has served as Senior Vice President of Liberty since October 2000 and Treasurer of Liberty since April 1997. Mr. Flowers served as a Vice President of Liberty from June 1995 to October 2000.

Discovery Communications Management Team

- John Hendricks—Founder and Chairman. Hendricks created the Discovery Channel in 1982 as the first cable network in the United States designed to provide high quality documentary programming enabling people to explore their world and satisfy their natural curiosity.

- David Zaslav—Chief Executive Officer. Before joining Discovery in January 2007, David Zaslav was president of NBC Universal Cable and Domestic TV and New Media Distribution. In this role, David oversaw domestic distribution of NBC Universal content to all forms of television throughout the United States and Canada. In October 1999, David was named President, NBC Cable. He joined NBC in 1989 and was instrumental in developing and launching CNBC that same year.

- Roger Millay—Chief Financial Officer. Roger Millay is responsible for the global financial functions and future financial strategies of the company and directs all accounting, treasury, budgeting, audit and tax activities. Millay previously served as senior vice president and Chief Financial Officer of Airgas, Inc. and the leasing and equipment management division of General Electric Capital Corporation.

- Mark Hollinger—Corporate Operations and General Counsel. Hollinger is responsible for management of the legal team which oversees DCI's legal affairs across all of the company's business units. Hollinger joined DCI in November 1991 as vice president and deputy general counsel.

Exhibit C: DCI Annual Model (in $mms, except per share data)

	2006A	2007E	2008E	2009E	2010E	2011E	CAGR '07-'10E	CAGR '07-'11E
Revenue								
Total Domestic Subscribers	755.7	711.4	746.9	776.8	800.1	816.1	4.0%	3.5%
% change	*10.0% ^*	*-5.9%*	*5.0%*	*4.0%*	*3.0%*	*2.0%*		
US Channels								
Net Subscription Revs	877.9	930.3	992.4	1,071.5	1,145.3	1,213.1	7.2%	6.9%
% change	*18.3%*	*6.0%*	*6.7%*	*8.0%*	*6.9%*	*5.9%*		
Advertising Revs	965.0	990.3	1,043.4	1,121.7	1,202.4	1,285.4	6.7%	6.7%
% change	*2.2% ^*	*2.6%*	*5.4%*	*7.5%*	*7.2%*	*6.9%*		
Other Revs	83.3	104.2	119.8	131.8	142.3	149.4	11.0%	9.4%
% change	*47.5%*	*25.0%*	*15.0%*	*10.0%*	*8.0%*	*5.0%*		
Total Domestic Discovery Channels	1,926.2 ^	2,024.7	2,155.6	2,324.9	2,490.0	2,647.9	7.1%	6.9%
% change	*110.5%*	*105.1%*	*106.5%*	*107.9%*	*107.1%*	*106.3%*		
Total Revenues Ex-Travel	1754.8	1947.2	2155.6					
% change		11.0%	10.7%					
International Channels								
Net Subscription Revs	557.0	622.3	734.0	857.1	982.0	1,104.0	16.4%	15.4%
% change		*11.7%*	*18.0%*	*16.8%*	*14.6%*	*12.4%*		
Advertising Revs	278.5 ^	317.5	358.8	401.8	446.0	490.6	12.0%	11.5%
% change	*14.4%*	*14.0%*	*13.0%*	*12.0%*	*11.0%*	*10.0%*		
Other Revs	43.5	45.7	48.0	50.4	52.9	55.6	5.0%	5.0%
% change	*13.1%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*		
Total International Channels	879.074 ^	985.5	1,140.8	1,309.3	1,480.9	1,650.2	14.5%	13.8%
% change	*19.1%*	*12.1%*	*15.8%*	*14.8%*	*13.1%*	*11.4%*		
Commerce, education & other	207.7 ^	228.5	116.5	122.4	128.5	133.6	-17.5%	-12.6%
% change	*9.2%*	*10.0%*	*-49.0%*	*5.0%*	*5.0%*	*4.0%*		
Total Revenues	3,013.0 ^	3,238.7	3,413.0	3,756.6	4,099.4	4,431.8	8.2%	8.2%
% change	*12.8%*	*7.5%*	*5.4%*	*10.1%*	*9.1%*	*8.1%*		
Total Revenues Ex-Travel	2,841.6	3,161.2	3,413.0					
% change		11.2%	8.0%					

Source: Company reports and Pali Research estimates.

Exhibit C (cont'd): DCI Annual Model (in $mms, except per share data)

	2006A	2007E	2008E	2009E	2010E	2011E	CAGR '07-'10E	CAGR '07-'11E
OCF								
Total Domestic Discovery Channels	727.5 ^	769.4	819.1	902.1	978.6	1045.9	8.3%	8.0%
% margin	*37.8%*	*38.0%*	*38.0%*	*38.8%*	*39.3%*	*39.5%*		
% change	*13.1%*	*5.8%*	*6.5%*	*10.1%*	*8.5%*	*6.9%*		
Total Domestic Ex- Travel	666.6	741.1	819.1					
% margin	*38.0%*	*38.1%*	*38.0%*					
% change		*11.2%*	*10.5%*					
Total International Channels	116.4 ^	126.1	182.5	235.7	281.4	330.0	30.7%	27.2%
% margin	*13.2%*	*12.8%*	*16.0%*	*18.0%*	*19.0%*	*20.0%*		
% change	*8.7%*	*8.3%*	*44.7%*	*29.1%*	*19.4%*	*17.3%*		
Commerce, education & other	(121.5) ^	(45.7)	11.7	12.6	13.6	14.6	NM	NM
% margin	*-58.5%*	*-20.0%*	*10.0%*	*10.3%*	*10.6%*	*10.9%*		
% change	*90.4%*	*-62.4%*	*-125.5%*	*8.1%*	*8.1%*	*6.9%*		
Total OCF	722.4 ^	849.8	1,013.3	1,150.4	1,273.6	1,390.5	14.4%	13.1%
% margin	*24.0%*	*26.2%*	*29.7%*	*30.6%*	*31.1%*	*31.4%*		
% change	*5.2%*	*17.6%*	*19.2%*	*13.5%*	*10.7%*	*9.2%*		
Total OCF ex-Travel	661.6	821.5	1013.3					
% Change		24.2%	23.3%					
Expenses arising from long-term incer	(39.2) ^	(58.8)	(77.6)	(91.4)	(106.7)	(122.7)	22.0%	20.2%
% change	*-20.7%*	*49.9%*	*32.0%*	*17.7%*	*16.8%*	*15.0%*		
Depreciation & amortization	(133.6) ^	(137.4)	(140.8)	(144.1)	(147.2)	(150.5)	2.3%	2.3%
% change	*8.5%*	*2.8%*	*2.5%*	*2.3%*	*2.2%*	*2.2%*		
Gain on sale of patents	0.0	0.0	0.0	0.0	0.0	0.0	NM	NM
% change	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*		
Total Operating Income	549.6 ^	653.6	794.9	914.9	1,019.6	1,117.3	16.0%	14.3%
% change	*6.9%*	*18.9%*	*21.6%*	*15.1%*	*11.4%*	*9.6%*		
Other Income (Expense):								
Interest expense, net	(194.2) ^	(230.5)	(251.5)	(220.6)	(182.0)	(135.8)	-7.6%	-12.4%
% change	*5.2%*	*18.7%*	*9.1%*	*-12.3%*	*-17.5%*	*-25.4%*		
Unrealized gains (losses) from derivat	22.6 ^	20.0	0.0	0.0	0.0	0.0		
% change	*0.3%*	*-11.3%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*		
Minority interests in consolidated subs	(2.5) ^	(2.3)	(2.1)	(2.0)	(1.8)	(1.7)	-7.0%	-7.0%
% change	*-94.4%*	*-7.0%*	*-7.0%*	*-7.0%*	*-7.0%*	*-7.0%*		
Other	8.5 ^	9.0	9.4	9.9	10.4	10.9	5.0%	5.0%
% change	*-38.1%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*		
Income before income taxes	384.0 ^	449.8	550.6	702.2	846.1	990.7	23.4%	21.8%
% change	*19.3%*	*17.2%*	*22.4%*	*27.5%*	*20.5%*	*17.1%*		
Income Taxes	(176.8) ^	(202.4)	(242.3)	(301.9)	(355.4)	(406.2)	20.6%	19.0%
% Tax Rate	*46%*	*45%*	*44%*	*43%*	*42%*	*41%*		
Net Income	207.2 ^	247.4	308.4	400.2	490.8	584.5	25.6%	24.0%
% change	*29.8%*	*19.4%*	*24.6%*	*29.8%*	*22.6%*	*19.1%*		

Source: Company reports and Pali Research estimates.

Exhibit D: DCI Quarterly Model (in $mms, except per share data)

	2006					2007E				
	Q1	Q2	Q3	Q4	Year	Q1E	Q2E	Q3E	Q4E	Year
Revenue:										
Domestic Networks	443	498	469	517	1,926	483	533	478	531	2,025
Y/Y Growth	6.5%	9.5%	9.6%	16.2%	10.5%	9.0%	7.0%	2.0%	2.8%	5.1%
International Networks	193	207	223	256	879	215	232	249	290	986
Y/Y Growth	21.7%	15.8%	22.2%	17.4%	19.1%	11.0%	12.0%	12.0%	13.1%	12.1%
Commerce, education & other	23	28	30	126	208	25	31	34	139	229
Y/Y Growth	*-13%*	*9%*	*6%*	*15%*	*9%*	8.0%	9.0%	10.0%	*11%*	*10%*
Total Revenue	659	733	722	898	3,013	722	795	761	960	3,239
Y/Y Growth	10%	11%	13%	16%	13%	10%	8%	5%	7%	7%
Domestic Launch Amort.	(18.7)	(19.1)	(14.5)	(20.2)	(72.6)	(16.9)	(17.2)	(13.1)	(21.8)	(69.0)
Y/Y Growth	-9%	18%	-3%	25%	7%	-10%	-10%	-10%	8%	-5%
International Launch Amort.						(8.8)	(8.8)	(8.8)	(8.8)	(35.0)
Y/Y Growth					NM	NM	NM	NM	NM	NM
Total Launch Amortization	(18.7)	(19.1)	(14.5)	(20.2)	(72.6)	(25.6)	(25.9)	(21.8)	(30.6)	(104.0)
Organic Domestic Revenues	462	517	484	537	1999	500	564	534	596	2193
Y/Y Growth	6%	10%	9%	17%	10%	8%	9%	10%	11%	10%
Organic Int'l Revenues	193	207	223	256	879	223	241	258	298	1021
Y/Y Growth	22%	16%	22%	17%	19%	16%	16%	16%	17%	16%
Organic Total Revenues	678	752	736	919	3,086	748	821	783	990	3,343
Y/Y Growth	9%	11%	13%	17%	13%	10%	9%	6%	8%	8%
OCF										
Domestic Networks	152	206	188	182	727	167	221	194	187	769
margin	34.3%	41.3%	40.0%	35.3%	37.8%	34.6%	41.5%	40.6%	35.2%	38.0%
Y/Y Growth	3.1%	12.1%	13.8%	23.5%	13.1%	10.0%	7.5%	3.5%	2.6%	5.8%
International Networks	31	25	36	24	116	26	23	36	41	126
margin	16.0%	12.3%	16.3%	9.3%	13.2%	12.3%	9.9%	14.5%	14.0%	12.8%
Y/Y Growth	26.3%	18.7%	20.7%	-23.5%	8.7%	-15.0%	-10.0%	0.0%	71.1%	8.3%
Commerce, education & other	(38)	(41)	(31)	(11)	(121)	(30)	(25)	(15)	24	(46)
margin	-165.2%	-145.0%	-101.8%	-9.1%	-58.5%	-120.0%	-80.0%	-45.0%	17.1%	-20.0%
Total OCF	145	190	193	194	722	164	219	215	251	850
margin	22.0%	25.9%	26.7%	21.6%	24.0%	22.7%	27.6%	28.3%	26.2%	26.2%
Y/Y Growth	-2%	3%	12%	7%	5%	13%	15%	12%	29%	18%

Source: Company reports and Pali Research estimates.

Exhibit E: DCI Cash flow Model (in $mms, except per share data)

	2006A	2007E	2008E	2009E	2010E	2011E	CAGR '07-'10E	CAGR '07-'11E
Cash Flow Model								
Net Income	207.2 ^	247.4	308.4	400.2	490.8	584.5	25.6%	24.0%
D&A	133.6 ^	137.4	140.8	144.1	147.2	150.5	2.3%	2.3%
Amortization of deferred launch incent	77.8 ^	73.9	70.2	66.7	63.4	60.2	-5.0%	-5.0%
Provision for losses on accounts recei	3.7 ^	3.7	3.7	3.7	3.7	3.7	0.0%	0.0%
Expenses arising from long-term incer	39.2 ^	58.8	77.6	91.4	106.7	122.7	22.0%	20.2%
Equity in (earnings) losses of unconso	(7.1) ^	(7.1)	(7.1)	(7.1)	(7.1)	(7.1)	0.0%	0.0%
Deferred income taxes	108.9 ^	98.0	88.2	79.4	71.5	64.3	-10.0%	-10.0%
Unrealized (gains) losses on derivative	(22.6) ^	(20.0)	0.0	0.0	0.0	0.0	-100.0%	-100.0%
Non cash minority interest charges	2.5 ^	2.3	2.1	2.0	1.8	1.7	-7.0%	-7.0%
Other non-cash charges	1.0 ^	5.0	5.0	5.0	5.0	5.0	0.0%	0.0%
LT incentive plan	(0.8) ^	(55.9)	0.0	(90.8)	0.0	(125.5)	-100.0%	22.4%
Working Capital	(63.5) ^	(100.0)	(85.0)	(75.0)	(65.0)	(50.0)	-13.4%	-15.9%
OPERATING CASH FLOW	479.9 ^	443.5	604.0	619.5	818.0	810.0	22.6%	16.3%
% change	*596.7%*	*-7.6%*	*36.2%*	*2.6%*	*32.0%*	*-1.0%*		
INVESTING ACTIVITIES								
Acquisition of property and equipment	(90.1) ^	(100.0)	(100.0)	(95.0)	(90.0)	(90.0)	-3.5%	-2.6%
Business combinations, net of cash ac	(194.9) ^	(1,275.0)	0.0	0.0	0.0	0.0	-100.0%	-100.0%
Investments in and advances to uncor	0.0 ^	0.0	0.0	0.0	0.0	0.0	NM	NM
Contributions from minority shareholde	0.0 ^	0.0	0.0	0.0	0.0	0.0	NM	NM
Issuance (redemption) of interests in s	(180.0) ^	(44.5)	(50.3)	0.0	0.0	0.0	-100.0%	-100.0%
Purchase of Intangibles	0.0 ^	0.0	0.0	0.0	0.0	0.0	NM	NM
Proceeds from sale of patents, net	1.5 ^	0.0	0.0	0.0	0.0	0.0	NM	NM
INVESTING CASH FLOW	(463.6) ^	(1,419.5)	(150.3)	(95.0)	(90.0)	(90.0)	-60.1%	-49.8%
FINANCING ACTIVITIES								
Debt, net	9.8 ^	1,000.0	(400.0)	(400.0)	(650.0)	(600.0)	NM	NM
Repurchasing common	0.0 ^	0.0	0.0	0.0	0.0	0.0	NM	NM
Other	(11.1) ^	0.0	0.0	0.0	0.0	0.0	NM	NM
FINANCING CASH FLOW	(1.3) ^	1,000.0	(400.0)	(400.0)	(650.0)	(600.0)	NM	NM
For/ex	2.8 ^							
Change in net cash	17.8 ^	24.0	53.7	124.5	78.0	120.0	48.1%	49.5%
Beginning Cash	34.4 ^	52.2	76.2	37.9	37.9	37.9	-10.2%	-7.7%
Ending Cash	52.2 ^	76.2	129.9	162.4	115.9	157.9	15.0%	20.0%
Free Cash Flow	389.8	343.5	504.0	524.5	728.0	720.0	28.4%	20.3%
% Change	-1366%	-12%	47%	4%	39%	-1%		
FCF ex LT incentive plan	390.6	399.4	504.0	615.4	728.0	845.5	22.2%	20.6%
% Change	32%	2%	26%	22%	18%	16%		

Source: Company reports and Pali Research estimates.

Exhibit F: DCI Balance Sheet (in $mms, except per share data)

	2006A	2007E	2008E
Cash and cash equivalents	52.3	76.2	129.9
Accounts receivables, net	657.6	750.7	822.4
Inventories	35.7	40.0	43.8
Deferred income taxes	76.2	68.5	61.7
Content rights, net	64.4	70.8	77.9
Other current assets	84.6	87.1	89.7
Current Assets	970.6	1,093.4	1,225.3
PPE, net	424.0	386.7	345.8
Content rights, net, less current portion	1,253.6	1,316.2	1,382.0
Deferred launch incentives	207.0	207.0	207.0
Goodwill	365.3	365.3	365.3
Intangibles, net	107.7	107.7	107.7
Investments in unconsolidated affiliates	15.6	15.6	15.6
Other assets	32.8	33.8	34.8
Total assets	3,376.6	3,525.6	3,683.5
Accounts payable and accrued liabilities	316.8	318.5	315.5
Accrued payroll and employee benefits	122.4	122.5	120.0
Launch incentives payable	18.0	18.4	18.5
Content rights payable	57.7	51.9	46.7
Current portion of LT incentive plan	43.3	45.4	47.7
Current portion of LT debt	7.6	7.6	7.6
Income taxes payable	55.3	56.9	58.6
Unearned revenue	68.3	73.5	77.4
Other current liabilities	45.2	46.5	47.9
Current Liabilities	734.5	741.3	740.0
Long-term debt	2,633.2	3,633.2	3,233.2
Derivative financial instruments	8.3	8.3	8.3
Launch incentives payable	10.8	11.1	11.4
LT incentive plan	41.2	42.4	43.7
Content rights payable	3.8	4.0	4.1
Deferred income taxes	46.3	47.7	49.1
Other liabilities	64.9	66.8	68.8
Total Liabilities	3,543.0	4,554.7	4,158.6
Mandatory redeemable interests in subsidia	94.8	50.3	0.0
Shareholders' equity	(261.3)	(1,079.5)	(475.1)
Total Liabilities & SE	3,376.6	3,525.6	3,683.5

Source: Company reports and Pali Research estimates.

Exhibit G: DISCA Annual Model (in $mms, except per share data)

	2006A	2007E	2008E	2009E	2010E	2011E	CAGR '07-'10E	CAGR '07-'11E
Revenues								
Creative services group	417.9 ^	422.1	426.3	430.5	434.8	439.2	1.0%	1.0%
% Change	-0.9%	1.0%	1.0%	1.0%	1.0%	1.0%		
% of Total Revenues	60.7%	60.5%	60.3%	60.0%	59.8%	59.5%		
Network services group	270.2 ^	275.6	281.1	286.8	292.5	298.3	2.0%	2.0%
% Change	-0.9%	2.0%	2.0%	2.0%	2.0%	2.0%		
% of Total Revenues	39.3%	39.5%	39.7%	40.0%	40.2%	40.5%		
Net Revenues (Ascent Media)	688.1 ^	697.7	707.4	717.3	727.3	737.5	1.4%	1.4%
% Change	-0.9%	1.4%	1.4%	1.4%	1.4%	1.4%		
EBITDA								
Creative services group	52.6 ^	53.5	54.5	55.4	56.4	57.4	1.8%	1.8%
% Change	-25.7%	1.8%	1.8%	1.8%	1.8%	1.8%		
Margin	12.6%	12.7%	12.8%	12.9%	13.0%	13.1%		
Network services group	49.5 ^	50.8	52.1	53.4	54.8	56.2	2.6%	2.5%
% Change	-11.4%	2.6%	2.6%	2.6%	2.5%	2.5%		
Margin	18.3%	18.4%	18.5%	18.6%	18.7%	18.8%		
Corporate and other	(43.3) ^	(48.8)	(49.5)	(50.2)	(50.9)	(51.6)	1.4%	1.4%
% Change	-9.5%	12.7%	1.4%	1.4%	1.4%	1.4%		
Margin	-6.3%	-7.0%	-7.0%	-7.0%	-7.0%	-7.0%		
EBITDA	58.7 ^	55.5	57.0	58.6	60.3	62.0	2.8%	2.8%
% Change	-25.3%	-5.6%	2.8%	2.8%	2.8%	2.8%		
Margin	8.5%	7.9%	8.1%	8.2%	8.3%	8.4%		
D&A	67.9 ^	69.3	70.7	72.1	73.5	75.0	2.0%	2.0%
% Change	-11.1%	2.0%	2.0%	2.0%	2.0%	2.0%		
Stock compensation	1.8 ^	1.8	1.8	1.8	1.8	1.8	0.0%	0.0%
% Change	-58.5%	0.0%	0.0%	0.0%	0.0%	0.0%		
Impairment of goodwill	93.4 ^	0.0	0.0	0.0	0.0	0.0	NM	NM
% Change	n/a	-100.0%	n/a	n/a	n/a	n/a		
Restructuring and other charges	10.7 ^	0.0	0.0	0.0	0.0	0.0	NM	NM
% Change	-1561.8%	-100.0%	n/a	n/a	n/a	n/a		
Operating Income	(115.1) ^	(15.7)	(15.5)	(15.3)	(15.1)	(14.8)	-1.3%	-1.3%
% Change	8112.1%	-86.4%	-1.2%	-1.3%	-1.3%	-1.4%		
Share of earnings (losses) of DCI	103.6 ^	147.7	205.5	266.8	327.1	389.6	30.3%	27.4%
% Change	29.8%	42.6%	39.1%	29.8%	22.6%	19.1%		
Other, net	9.5 ^	9.5	9.5	9.5	9.5	9.5	0.0%	0.0%
% Change	156.0%	0.0%	0.0%	0.0%	0.0%	0.0%		
Pre-Tax Earnings	(2.1) ^	141.6	199.6	261.0	321.6	384.3	31.4%	28.4%
% Change	-102.5%	-6956.0%	41.0%	30.8%	23.2%	19.5%		
Income Tax Benefit (Expense)	(43.9) ^	(63.7)	(89.8)	(117.5)	(144.7)	(172.9)	31.4%	28.4%
Tax Rate	-2128%	45%	45%	45%	45%	45%		
% Change	-10.0%	45.0%	41.0%	30.8%	23.2%	19.5%		
Minority interests in losses of subs	0.0 ^	0.0	0.0	0.0	0.0	0.0	NM	NM
% Change	n/a	n/a	n/a	n/a	n/a	n/a		
Net Earnings (Before Extraordinary)	(46.0) ^	77.9	109.8	143.6	176.9	211.4	31.4%	28.4%
% Change	-238.3%	-269.2%	41.0%	30.8%	23.2%	19.5%		
Other comprehensive earnings	17.8 ^	0.0	0.0	0.0	0.0	0.0	NM	NM
% Change	N/A	N/A	N/A	N/A	N/A	N/A		
Net Income	(28.2) ^	77.9	109.8	143.6	176.9	211.4	31.4%	28.4%
% Change	-247.8%	-375.8%	41.0%	30.8%	23.2%	19.5%		
Basic EPS (Before Extraordinary)	($0.16) ^	$0.28	$0.39	$0.51	$0.63	$0.75	31.4%	28.4%
% Change	-238.3%	-269.2%	41.0%	30.8%	23.2%	19.5%		
Basic EPS (After Extraordinary)	($0.10) ^	$0.28	$0.39	$0.51	$0.63	$0.75	31.4%	28.4%
% Change	-247.8%	-375.8%	41.0%	30.8%	23.2%	19.5%		
Shares outstanding	280.0	280.0	280.0	280.0	280.0	280.0	0.0%	0.0%
% Change	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%		

Source: Company reports and Pali Research estimates.

APPENDIX

IMPORTANT DISCLOSURES AND ANALYSTS' CERTIFICATIONS

Analyst Certification

I, Richard S. Greenfield, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject companies and their securities. I also certify that I have not been, and will not be, receiving direct or indirect compensation in exchange for expressing the specific recommendations in this report.

I, Mark D. Smaldon, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject companies and their securities. I also certify that I have not been, and will not be, receiving direct or indirect compensation in exchange for expressing the specific recommendations in this report.

Analyst Stock Ratings

Pali Research's ratings are defined as follows:

BUY – A stock that is expected at initiation to produce a positive total return of 15% or greater over the 12 months following the initial recommendation. The BUY rating may be maintained following initiation as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

SELL – A stock that is expected at initiation to produce a negative total return of 15% or greater over the next 12 months following the initial recommendation. The SELL rating may be maintained following initiation as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

NEUTRAL – A stock that is not expected to appreciate or depreciate meaningfully over the next 12 months.

Disclosure of Distribution of Ratings

Pali Research, the research arm of Pali Capital, Inc. must disclose in each research report the percentage of all securities rated by the member to which the member would assign a "buy", "neutral" or "sell" rating. Below is the distribution of Pali Capital's research recommendations as of the end of the first quarter of 2007:

	Rating Distribution		
	Buy	Neutral	Sell
Pali Research	59%	33%	8%

As of the end of the most recent calendar quarter (March 31, 2007), Pali Capital, Inc. had investment ratings on 39 equity securities.

All required disclosures, including price charts, designating ratings and price targets on all Pali Research-rated stocks are available upon request by contacting msmaldon@palicapital.com.

Subject companies in each rating category for which Pali Capital has provided investment banking services within the last 12 months is 0%.

Unless otherwise noted, all prices are as of the close on April 13, 2007.

Valuation Methodology

Our target price of $25.50 is based on a 5x '08E EBITDA multiple for Ascent Media and a 13x multiple on DICSA's two-thirds ownership of DCI (note: fixing Ascent at 5x EBITDA, implies that DISCA is trading at 13.7x its share of DCI '07E EBITDA). Our target price equates to a 21x multiple of proportionate '08E free cash flow.

- Our DCF (fixing Ascent's value at 5x EBITDA) equates to $26.50, based on a WACC of 9%, a 3.5% perpetual growth rate and a terminal multiple of 18x.

Risk to Our Valuation and Price Target

- Inability to Consolidate Advance/Newhouse's stake in DCI. While we do not believe this will impact shares in the next several months, we believe consolidation of the DCI stake is necessary over the next 12 months to achieve our price target.

- Dilutive Transaction with Advance/Newhouse. Even if DISCA or DCI is able to convince Advance/Newhouse to sell or upstream their stake, a key risk is at what price (relative to the current DISCA market value) will they agree to a transaction, given their control/management rights.

- Significant decline in the ratings at any of the core DCI cable networks. Given the recent rebound in ratings and success of new programming, we are not particularly concerned with this issue.

- Weakness in the overall advertising market. While DCI should benefit from its improved ratings and outperform the overall advertising market, to the extent that the overall cable television advertising market weakened dramatically, it would be difficult for DCI to grow its advertising revenues.

General Risks of Equity Investing

Investors need to be aware that investments in equity securities may pose significant risks due to the inherent uncertainty associated with relying on forecasts of various factors that can affect the earnings, cash flow and overall valuation of a company. Any investment in equity securities should be facilitated only within the context of diversification by asset class, industry, company, as well as investment objectives and time horizon.

For additional information, please contact your Pali sales and trading representative at (212) 259-2000.

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2005

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 000-51205

DISCOVERY HOLDING COMPANY

(Exact name of Registrant as specified in its charter)

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

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☒

Indicate by check mark whether the Registrant is an accelerated filer as defined in Rule 12b-2 of the Exchange Act. Yes ☐ No ☒

The number of outstanding shares of Discovery Holding Company's common stock as of July 29, 2005 was:

Series A common stock 268,134,162 shares; and
Series B common stock 12,106,233 shares.