Discovery, Inc. (DISCA) CEO David Zaslav on Q3 2019 Results - Earnings Call Transcript

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Q3: 11-07-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $0.87 beats by $0.05 | Revenue of $2.68B (3.32% Y/Y) beats by $5.88M

Earning Call Audio

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Discovery, Inc. (NASDAQ:DISCA) Q3 2019 Earnings Conference Call November 7, 2019 8:30 AM ET

Company Participants

Andrew Slabin - Executive Vice President, Global Investor Strategy

David Zaslav - President & Chief Executive Officer

Gunnar Wiedenfels - Chief Financial Officer

JB Perrette - President & Chief Executive Officer, Discovery Networks International

Peter Faricy - Chief Executive Officer, Global Direct-to-Consumer

Conference Call Participants

Jessica Ehrlich - Bank of America

Vijay Jayant - Evercore ISI

Alexia Quadrani - JPMorgan

Drew Borst - Goldman Sachs

Steve Cahall - Wells Fargo

Doug Mitchelson - Credit Suisse

Michael Nathanson - MoffettNathanson

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Discovery Third Quarter 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today Andrew Slabin, Executive Vice President, Global Investor Strategy. Please go ahead sir.

Andrew Slabin

Good morning, everyone and thank you for joining us for Discovery's third quarter 2019 earnings call. Joining me today are David Zaslav, our President and Chief Executive Officer; Gunnar Wiedenfels, our Chief Financial Officer; JB Perrette, President and CEO, Discovery Networks International; and Peter Faricy CEO, Global Direct-to-Consumer.

You should have received our earnings release, but if not, feel free to access it on our website at www.corporate.discovery.com. On today's call we will begin with some opening comments from David and Gunnar, and then we will open the call for David, Gunnar, JB and Peter to take your questions.

Before we start, I would like to remind you that comments today regarding the company's future business plans, prospects of financial performance are forward-looking statements that we make pursuant to the Safe Harbor provisions of the Private Securities Litigation

Reform Act of 1995. These statements are made based on management's current knowledge and assumptions about future events, and may involve risks and uncertainties that could cause actual results to differ materially from our expectations.

In providing projections and other forward-looking statements, the company disclaims any intent or obligation to update them. For additional information on important factors that could affect these expectations, please see our Annual Report for the year ended December 31, 2018 and our subsequent filings made with the U.S. Securities and Exchange Commission.

And with that, let's turn the call over to David.

David Zaslav

Good morning, everyone, and thank you for joining us to discuss our Q3 results and outlook. Discovery reported an impressive quarter of operating and financial results, with performance at the top end of our competitive set. Across all businesses and regions, we met or exceeded our guidance, with a notable acceleration in our international segment high single-digit growth. Overall, a very strong set of numbers by any measure.

I believe we have the best operating team in media today. I am proud of what we have accomplished both in the quarter and since our acquisition of Scripps early last year. It is a story of promises made and promises delivered and in most cases overdelivered.

To that point, well before we closed on Scripps, we talked about our goal of being able to generate $3 billion of free cash flow. Before the acquisition, we were generating about $1.4 billion and Scripps was generating about $700 million. Today, we are at $2.9 billion for the trailing 12-month period. And having generated nearly $900 million in free cash flow this quarter, we feel good about that goal.

On net leverage, we had been relentlessly focused on reducing our financial leverage from the post-merger peak of nearly 4.8 times net debt to AOIBDA. And at the end of Q3, our net leverage of 3.1 times is close to the low end of our target range.

We've begun to return capital to our shareholders having repurchased $300 million of our equity or nearly 12 million shares in Q3, with additional purchases in Q4, while at the same time reinvesting in our future growth strategy.

From the beginning, we viewed Scripps as much more than a portfolio of cable channels, but rather a trove of global IP, with among the strongest lifestyle brands, programming and personalities in the world. We envisioned a major opportunity to not only enhance their position globally, but also to carve out a differentiated direct-to-consumer strategy.

A few weeks ago, we launched another key component of that strategy with Food Network Kitchen, a world-class customer experience in the kitchen with live and on-demand cooking classes with the most celebrated chefs from around the globe.

We work closely on all elements of the product with our partner Amazon over the last year to get it off the ground. We are very pleased with the product and very excited about the opportunity of value creation it presents.

And to support our broad strategic initiatives, we've taken a major step forward in the seamless rollout of our singularly owned and operated tech stack, on to which all of our direct-to-consumer platforms will sit from Dplay across Europe and Motor Trend OnDemand to the Eurosport Player, our Global Cycling Network, GOLFTV, Magnolia and our factual content service.

Everything we said we were going to do, we've done. And looking forward, we are equally focused on delivering against an aggressive set of objectives within an industry undergoing real disruption. Yet Discovery has always punched above its weight, by being nimble opportunistic and flexible in leveraging every opportunity to put our content and beloved brands everywhere consumers are across an unrivaled global footprint.

It is core to how we operate. It's our North Star and the engine behind what drives our broader strategy and investments in our future. Today there are more ways than ever to get content to consumers. And we are as well positioned as anyone to leverage every path and platform to monetize our content investment, across both linear and direct-to-consumer.

It starts with strategic decisions we made many years ago to control our destiny and build long-term value, by owning and controlling our IP globally, content and brands that people love, which was further strengthened by the Scripps portfolio.

We generate roughly 8,000 hours of original content annually, alongside a library of titles in every language that aggregates several hundred thousand. It's a huge competitive advantage, especially as we watch our industry peers on the premium scripted side pay whatever it takes to amass enough content for a slice of the fragmenting entertainment space within the direct-to-consumer market. We are not in that series scripted and movie side of the entertainment business. It's crowded. It's aggressive. It's expensive and it's risky.

As women over the past year around America have put their TV sets on, they can choose to watch movies, scripted series. They could watch anything they want. But more have chosen to watch our programming than any other media company, which makes us the number one media company for women in the United States.

In addition, our strategy of pivoting into sports has made us the largest producer of live sports outside the U.S., another aggregation of IP that we think is high on the value chain. Our investment in world-class IP defines our beloved brands in areas people love and drives powerful engagement across our portfolio.

Our international footprint across 200-plus markets is unrivaled, with an average of 10 to 12 free-to-air or cable channels in every key television market. Owning great content that people love, strong brands and operating at scale is important, but no longer enough. We are also focused on building industry-leading capabilities and proprietary tech IP so we can create truly compelling customer experiences and ecosystems.

As I noted we launched Food Network Kitchen two weeks ago, a first of its kind experience offering the most complete food and cooking digital ecosystem, with content and interactive features, as well as the largest roster of iconic cooking talent.

We are the peloton of food but we are priced for the masses. We'd like to be in everybody's kitchen. It is powered by a unique partnership with Amazon, as well as the biggest promotional push ever across our network portfolio, with food and cooking being big funnels to drive and create value.

Food Network Kitchen is also the first new product to launch on our owned and operated tech stack. And it is becoming increasingly apparent that owning and operating our own tech architecture is a distinct competitive advantage and one that should allow us to further scale opportunities across multiple verticals, meaningfully driving global functionality, efficiencies and speed to market. Peter Faricy who oversaw a marketplace for Amazon has been a big help to us and he's here with us today and will be able to answer some questions during Q&A.

Switching gears to our core traditional business. Our performance has been solid. Though domestic ratings are a work in progress across certain properties networks like TLC have been nothing short of a phenomenon in our industry. The team at TLC has done an extraordinary job turning around and building that network. Just two years ago it was the ninth or 10th network in America for women. Today it continues to be the number one ad-supported cable network in prime time for women 25 to 54 and women 18 to 49.

Together with TLC and our other networks it allows us to reach almost 35% of women on Sunday nights in America. It's a great, great story. It's what we do. And we're attacking every one of our channels for growth. And at HGTV, A Very Brady Renovation delivered its biggest hit of all time, a prime example of us leaning into our scale with an ambitious creative swing supported across our broad network portfolio.

We recently announced that the Brady Bunch gang will return for a holiday special.

Our portfolio performance helped us secure our position as the number 1 TV destination for women 25 to 54, once again during the quarter. And in fact for the better part of the year and our best-in-class GO apps along with products like Discovery Premiere and Engage form the backbone of a uniquely secular growth narrative within an industry that has been largely static.

And as such, we are definitively taking share. On the international front our business continues to show signs of steady growth in part driven by continued programming and audience strength, traction of our direct-to-consumer products, as well as further integration of the Scripps content and brands around the world.

Once again our share of market and delivery across our top 10 markets was up with growth of 3% and 2% respectively building upon last quarter's very strong increases. Our international growth was driven by the highest Q3 ever for EMEA, led by strength in the U.K. and Italy both of which delivered record audiences in July and August, up 12% and 9% respectively.

This also has helped to insulate us from ongoing macro weakness in these key markets, especially in the U.K. where our commercial share of market has increased to roughly 8%. JB Perette is here with us and can discuss in more detail the strides we are making not just in Europe, but all around the globe.

With exciting locally differentiated streaming products gaining traction and expanding, we aim to become the Hulu equivalent in select TV markets in Europe. Our strategy in certain cases has been to partner with key local players that broaden the content offering and share of market.

In Germany our JV with ProSieben Joyn which combines 55 channels into one app has become a leading streaming platform since launching in June with more than four million monthly average users.

And we announced a few weeks back that in our largest European market, Poland we will launch a single streaming destination to access a powerhouse of Polish content in partnership with leading media and distribution company Polsat. We are very excited about this opportunity and our team is looking at other large market opportunities.

I would also add that getting deals like this done is not easy. We lean on our local teams and the credibility and relationships they have built over the years. There's a lot to appreciate in getting these structured deals, content, technology and partnership in the aggregate off the ground.

There are a number of markets where we aggregate all of our content and go-to-market alone. And the brand we use is Dplay. And Dplay has now expanded to 10 countries internationally including; Japan, the Nordics, Italy, Spain and most recently in the U.K. and Ireland.

Dplay has some great momentum particularly after having been repositioned onto our own tech platform and it's given us a lot of learning about how to position a large aggregated content service.

People are consuming more content in the aggregate than ever before, but every programmer is battling for people's free time and attention. And we are driving deeper connections with our fans in a far more cost-effective manner than many others. Behind our brands and personalities big personalities, which have delighted audiences for in some cases decades, we are taking that engagement and those personalities and putting it on steroids, whether it is unique view-and-do experiences like Food Network Kitchen, aggregated AVOD and SVOD platforms in Europe and even looking at lifting large collections of our channels and taking them on to OTT and pushing them into distribution around the globe.

We have great assets, resources, IP and an adept management team with local knowledge and infrastructure that are well equipped to succeed across the ecosystem. We are super excited about the direction and opportunities ahead. Our operating performance is strong and stable. And while the industry is undergoing secular challenges, we are facing disruption head on with a very confident operating posture and strategic position.

Our focused financial investments in our world-class IP and relentless pursuit of new revenue opportunities makes us a stronger company than we were a year ago and one that is on a path to continued sustainable success.

Many thanks and I will turn the call over now to Gunnar.

Gunnar Wiedenfels

Thank you David and thank you everyone for joining us today. I am very pleased with our third quarter operational and financial performance. We continue to build momentum as we deliver on our strategic objectives to transform and pivot Discovery.

I'd like to share some financial highlights from our third quarter. My comments will be in constant currency terms for our international business as well as for total company unless otherwise stated. And please refer to our earnings release published earlier this morning for a more comprehensive view of all the drivers of our third quarter financial results.

In the third quarter, Discovery again achieved healthy operating performance delivering 3% U.S. advertising growth, 6% U.S. affiliate growth 10% international advertising growth which included a full quarter of impact from the consolidation of the three networks acquired from UKTV which added about 300 basis points of growth and 8% international affiliate growth.

We grew total company adjusted OIBDA 9% driven by revenue growth and 7% decline in U.S. expenses which helped us to maintain an almost flat expense base. As we've previously flagged, we've anticipated that expenses in our international business will ramp up as we invest for future growth.

Turning to one of my priority topics, we reported $884 million of free cash flow in the third quarter keeping our trailing 12 months free cash flow at $2.9 billion which is inclusive of about $200 million of cash restructuring costs, as well as the funding for our growth investments. At quarter end our net leverage was 3.1 times.

Now let me share some forward-looking commentary starting with the four key revenue drivers for the fourth quarter 2019. First, for U.S. advertising growth is expected to be again in the low single-digit range driven by the typical dynamics in pricing, digital monetization, the health of the market and of course the impact from ratings which remains the greatest variable impacting U.S. ad revenue growth.

While ratings of some key networks have been challenged in the third quarter, we have doubled the amount of premiere content on the Food Network for the holiday season and we are excited about our programming slate for the remainder of the year such that our Q4 estimate of low single-digit growth could turn out to be conservative.

In addition, we expect to continue to benefit from increased viewership on our GO platform further growth from our data-driven Engage product as well as upward CPM pressure from innovations such as Discovery Premiere all of which are contributing to our top-of-peer performance and revenue growth, despite the noted ratings headwinds.

Second, U.S. affiliate is projected to increase in the 3% to 5% range for the fourth quarter and we reaffirm our full year guidance for U.S. affiliate revenue growth in the mid-single-digit range. As you know in the fourth quarter we will let our initial inclusion in certain virtual MVPDs such as Hulu and Sling TV. Accordingly, implicit in this projection is a sequential decline in our core subscriber growth.

Third, we expect international advertising growth in the mid-single-digit range, driven by share growth in our top markets and contributions from our digital investments. Contribution from the consolidated UKTV Lifestyle Business is projected to again add 2 to 3 percentage points of growth. While the balance of our international advertising business remains healthy there are some increasingly more challenging markets such as Mexico and Argentina, creating an overall more volatile picture and one that we will keep a close eye on during the remainder of the quarter.

And finally, international affiliate growth is expected to be again in the high single-digit range supported by favorable terms in certain new affiliate deals, new channel launches and traction from our suite of D2C products.

Turning to total company guidance. We continue to expect solid free cash flow growth for the remainder of the year even as we continue to invest in the build-out of our expanded digital ecosystem and our previously noted step-up in CapEx from such items as global real estate consolidation and transformation projects related to technology infrastructure and software development.

Turning now to our direct-to-consumer investments. We now expect the impact from direct-to-consumer investments on full year 2019 adjusted OIBDA to be at the lower end of the $300 million to $400 million range we have previously discussed. And though, we again enjoyed another quarter of total company margin improvement, which was 100 basis points higher this quarter, the expected ramp in our digital investment spending will flow through more meaningfully in Q4 as we have previously detailed with you.

Turning now to our capital allocation strategy, our priorities remain consistent. We continue to expect to: Number one optimize leverage. While we are nicely within our three to 3.5 times net leverage range, we expect to continue to delever further towards the very low end of this range.

Number two, concurrently we will continue to evaluate value-enhancing investments along with strategic M&A. And number three, finally, we will opportunistically return excess capital to shareholders. As noted in the third quarter, we repurchased nearly 12 million Class C common shares for a total consideration of $300 million at an average price of $25.93 per share with additional purchases thus far into Q4.

Before I close, let me quantify the expected impact that foreign exchange will have on our 2019 financial results. Given the movement of the dollar at current spot rates, FX is now expected to negatively impact revenues by roughly $245 million to $255 million and AOIBDA by $90 million to $100 million versus our 2018 reported results.

In closing, our results today highlight the consistency of our company's overall performance, particularly at a time of great change within our industry. And I couldn't be more pleased with our strategic and financial position.

Looking ahead, we remain confident in our ability to generate healthy free cash flow and execute on our long-term growth initiatives. Thank you for your time this morning. And now David, JB, Peter and I will be happy to answer any questions that you may have.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from Jessica Ehrlich with Bank of America. You may proceed with your question.

Jessica Ehrlich

Thank you so much. Can you give us some color on what's going on with Food Network Kitchen. I know it's only two weeks but how many I guess users do you have so far? Can you give us some color on ancillary revenue? The shopping app look is amazing. And then on just D2C kind of what your view is? Where will discovery be over the next five years? What are the services can you launch? You have so many brands. What do you think that this will look like to you? Thank you.

David Zaslav

Thanks, Jessica. I'm going to hand it over to Peter for the food stuff, but let me address the broader issue. We have -- as you know, we've really shied away from these seven or eight players that are [indiscernible] fighting it out in this entertainment area.

It's getting more and more expensive and we believe that three or four are going to make it. And it's going to be a lot of carnage and very, very difficult great companies and good luck to them. But when we look at the overall space, we really have two strategies.

One is the people will have three of those or maybe four of those but then they still love golf. They still love natural history and science. We together with everything we got from the BBC, now have a definitive collection of content with Planet Earth, Blue Planet, space, ocean, science that if you think about when we were younger a family would buy World Book or Encyclopedia Britannica because every family and every child should see it.

We have a collection of natural history and science content not just in scale in having the majority of it that exists in every language but a collection of content that every family and every child should watch, which is very differentiated from watching scripted and series movies.

We have Chip and Joanna Gaines and we'll be launching in 2020 with them direct-to-consumer. And we have cycling and cars. And so we're going in these niches. We're doing a very good job and Peter will speak to it. We are developing a uniform platform so it's very easy for us to just jump on. That platform has interactivity. It has the ability to do -- have commercial to buy things, to buy cycling equipment, to buy golf equipment. And so we think that that's a terrific strategy and it's starting to bear real fruit for us.

In addition, we're doing very well with our GO, our direct-to-consumer product, which is growing massively. And it gave us real confidence that people that are not subscribing to cable love our content together with Dplay, which is scaling around the world.

And so outside the U.S., you see that our strategy is becoming clearer. We've gotten together with ProSieben in Germany and we announced that we had 4 million subscribers as of last quarter. ProSieben announced this morning that there's now 5 million subscribers that are using Joyn on a regular basis.

And when you think of Germany you got Sky Deutschland that's been in business there for 10 years. They don't have 4 million subscribers. Now they have paying subscribers. But in four months or five months we have five million users that are spending significant amount of time with us with Joyn. And the reason is we've aggregated 55 channels and a massive amount of great local content.

So Netflix is doing all their thing. Disney will do their thing. But we have local, local, local. Same thing is true in Poland. We announced the deal with Polsat, which is -- we're the largest player in Poland with TVN, the second largest player is Polsat, the third largest player is the government.

Polsat and we are coming together to create our own local Netflix product. It worked. It's working very well in Germany. It's working well in Northern Europe with Dplay for us. And we think by aggregating with others we could really be differentiated with local. So that's our European strategy and it's rolling out. It's ahead of plan. We're learning a ton and our platform is working.

In the U.S., I'll just say that, we're now starting to examine a new opportunity. I mentioned it in my comments that people could watch anything but they're spending -- we're looking at the viewing patterns of our content our -- the aggregate of all of our channels makes us not just number one for women. But if you think about the basic cable ecosystem, people could watch anything they want but more of them are choosing to watch us.

And you have some of these platforms launching with eight Series 10 series or a bunch of movies and series to come. We have hundreds of thousands of hours that people grew up on. And when you aggregate all of our product in the U.S. we're looking now at whether we should just aggregate and you have eight people that are doing entertainment and scripted and we're examining the opportunity of -- in addition to what we're doing here of aggregating all of our content in the U.S. and having something that looks very different is very deep, has great personalities, great brands secured right a through very deep, has great personalities, great brands secured right a through.

And so more to come on that in the next several months. But it feels very good right now to us in terms of our niche strategy with passion and depth view and do our strategy in Europe of aligning with the other big players and accelerating into that with Dplay and Joyn and with Polsat. And finally, with all the success we're having here in the U.S. we're saying hey, maybe why not? It looks like we have the most win, we may have the most compelling content and the deepest library of anyone. So with that let me pass off to Peter on Food Network Kitchen which is off to a great, great start and we're super proud of it.

Peter Faricy

Good morning, Jessica. Yes, we're super pleased with the results so far. One of the biggest lessons of my time at Amazon is, if you really want to drive the outputs and the outputs here are things like subscribers and revenue, at the very beginning of launching a new product, you really have to focus on the inputs. So we're obsessed right now with focusing on the inputs.

And the inputs that I'll give you some feedback on are about customer ratings, the customer experience, how engaged are they and what do the early customers think of the product. So far we're very pleased. So on the -- one of the biggest benefits of having our own technology that David talked about earlier is the fact that we can build a product that we know consumers will love. And the feedback so far has been terrific. So we have a 4.1 rating across Amazon devices, 4.5 on Android and 4.8 on iOS. So, coming out of the gate, we're very pleased with that feedback.

And one of the things that we're seeing from consumers is that many of them were already interacting with us before on Food Network. But in particular, we're looking harder at the feedback from brand-new customers. So these are people -- this is the first time they have an experience with Food Network. Their ratings are even higher than those ratings I just gave you. So that's a good leading indicator that we're headed in the right direction.

Number two, as expected the star of the show, if you will, is really our live and on-demand cooking classes. We're really pleased with the engagement so far. Some of the most popular classes -- it won't surprise you. It's Bobby Flay cooking pork chops.

One of my favorites was Molly Yeh doing fried cheese pickles. But -- it's a fun product. People are engaged. They're asking questions to the chefs. It's kind of a unique product and a unique experience, and we're beginning to see some pick up across social media of how much people love it.

For those of you who have the app, which I hope has everybody on this call, we have Alex Guarnaschelli, Marc Murphy, Rachael Ray, Geoffrey Zakarian and Bobby Flay over the next five days. Bobby Flay, I think is doing three classes on Sunday. So, we have this thing loaded with the best chefs in the world.

The consumer demand on the classes has been so high so far that we're actually going to make two changes. We're going to expand the number of live classes from 25 per week to 40. We're also happy to announce the opening of a brand-new Food Network Kitchen studio in Los Angeles. So we're going to double. We have this Food Network Kitchen here in New York.

We're going to double our capacity by opening up a studio in Los Angeles. That will allow us to serve customers all across the U.S. well, but also allow us frankly to add more and more classes over time. So, the live and on-demand classes, we're very pleased with so far.

And then finally, as you probably know, I think we've talked about this before. November, December and January are the Super Bowl of the cooking and food season. And we are very excited about the marketing plans we have.

You will not be able to watch any one of our networks across the Discovery portfolio and not see a reference back to Food Network Kitchen. If you happen to be watching Food Network of the cooking channel, you'll see a lot of very direct references to you can go make this right now on Food Network Kitchen. So we're very excited about that.

Number two David mentioned the partnership with Amazon has just been terrific. Most consumers in the U.S. will be on Amazon between now and the end of the year as we have this big holiday shopping season, and I'm happy to say Food Network Kitchen will be featured prominently across the site.

And that includes all the Alexa devices and it also includes the very popular Fire TV. So Fire TV has millions of customers right now. And if you tune into Fire TV, front and center is Food Network Kitchen being featured. So we feel like we're on the right track at this point. And net-net we're very pleased with the first couple of weeks of results.

The only thing I'd add to David's comments about the bigger portfolio for direct-to-consumer is we publicly announced the couple of things for next year. David mentioned Magnolia. We've also talked about our factual product with the BBC. We also plan to rollout something with cycling and global cycling network.

And then I would just add to David's comments and say stay tuned, because we have a bunch of good ideas and we're going to be pretty aggressive I think coming out of the gate.

I'll just close with -- a lot of people wonder what was it about this opportunity that drove me from Amazon to come to Discovery. And I think it's really -- we have the most powerful brands in the world. We have these very dedicated loyal consumer bases. And now we're building products that they love. And I think that gives us a chance to really, really innovate and change this industry. So I couldn't be more excited to be here and looking forward to sharing more results as we go forward.

Jessica Ehrlich

Peter, can you just elaborate a little bit on the ancillary revenue opportunity, the shopping and selling other products, whether it's kitchenware or other things?

Peter Faricy

Yeah. I think that's something I'd love to talk about more over time. I think we continue to see people using that feature, but I'd love to give you more feedback on that. And also, we've talked about we want to launch in 2020 the ability for people to be able to buy kitchen utensils and kitchen equipment as well. So, I'd love to talk about -- more about that in a future call.

But right now, I think one of the biggest signals we're excited about is it's very hard to have live classes all over the nation every single day. The technology has worked outstandingly well. And that's one of the reasons that I think we really feel like we can scale up the number of classes.

We even did a series of classes last weekend with Molly Yeh in North Dakota, live from her actual kitchen which was just wonderful to watch. The customer feedback was incredible. So, we're excited. This has a lot of potential avenues for growth. And right now, we're all in on all those avenues.

Jessica Ehrlich

Thank you.

Operator

Thank you. Our next question comes from Vijay Jayant with Evercore ISI. You may proceed with your question.

Vijay Jayant

Great. Thanks. Since we have Peter on the phone, I just wanted to get any sense of sort of the size of your digital opportunity today. I mean you keep talking about all these ions on the file that are sort of growing. But if you had to sort of size Joyn, Dplay, PGA, Eurosport and the like, excluding your virtual MVPD how big is that? How is that sort of offsetting some of the linear pressures that we have in the business? And obviously you have a lot of growth coming. So any help on that would be really, really helpful.

And then probably for Gunnar, your margins keep going up. Obviously, we stopped talking about synergies, the $600 million number. It's probably hard to even quantify that now. But how much more room is there on just the Scripps-related synergies going forward? Thanks so much.

Gunnar Wiedenfels

Okay. Vijay let me comment on those. So I'll start with your margin point. I mean, as you know we had already guided for no margin increase for the third quarter and came in a little better. But I continue to say do not expect further margin increase. We are operating at industry-leading margins. And that being said we will absolutely continue to be laser-focused on the efficiency of this company. We have a lot more initiatives in store. We're continuing to improve our cash conversion, et cetera. But as you know, we're also looking at a number of initiatives on the digital side that Peter just referred to that, we will be funding as we look forward. So, no more margin expansion to be expected, even though we continue to be super focused.

Vijay Jayant

Before you get to the next point, in this area of digital JV, you were the driving force on the Joyn deal on this aggregation strategy in Europe with Polsat and us and going across Europe and leading out with Dplay. Could you just talk a little bit about those, because those are -- it really is a differentiator?

Peter Faricy

When we see, David and myself, Bruce Campbell runs our corporate development were all at NBC back in the days when 10-plus years ago when we created Hulu here in the U.S. and we've seen what that has done over the last 10 years. And so, we not only are believers in the aggregation strategy and the power of local in that context for the U.S. market, but we know that that can work and it can scale meaningfully.

And so in a world where a lot of English language international players are, as David said, spending a lot of money on English language scripted content. At the end of the day, for the last three decades as a company, we've learned that as you go out internationally local is incredibly important. And while some of those companies may eventually get to that and certainly are investing in certain areas, it's hard. It takes time. And we already have in many of these markets, very strong positions with the leading local players.

And so, we believe that the local strategy is critically important, can be very viable and can be a leading video aggregation streaming service, just like it's proven out here in the U.S. with Hulu. And so whether it's Joyn, whether it's our Dplay apps, we have now -- and you look across certainly the European footprint, we have the leading position in Europe of being able to connect the dots over time on a -- the leading local streaming services in each of the big markets across Europe.

And it's working. It's scaling in the markets we have it. And we think that these things are hard. They're not easy to do, but we have real track record. We have experience doing them. We have people who know how to execute these deals. And then we know how to build the right teams and hire the right people to get these up and running. And so, we think that's a very differentiated approach for us that is unique to our strategy across Europe.

Gunnar Wiedenfels

And maybe to the question of the size of the opportunity again, as we've said many times, for us it's too early to be talking about a framework of P&L metrics for you guys at this point. But let me just say, we were convinced that it can be material. We've got super passionate audiences in all of those verticals.

And as a matter of fact, if you look at our numbers that we're reporting this quarter, last quarter and what we're seeing for next quarter, we're starting to see some material contributions come through on the top-line. And I only see that expanding as we move forward.

And the other thing to keep in mind is from a P&L perspective, all of these verticals that we're talking about have the great advantage again that we're not in the business of $5 million per hour production. But we have the benefit of true utility content at very low costs. So I'm excited about the opportunity not only from a revenue growth, but also from the bottom-line perspective. Again, with that being said, obviously, we want to make the right investments. We're not netting for margins in the short-term, but we'll manage for a sustainable long-term setup of this company.

Peter Faricy

Thank you, Bob.

Operator

Operator

Thank you. Our next question comes from Alexia Quadrani with JPMorgan. You may proceed with your question.

Alexia Quadrani

Hi. Thank you. As we look into 2020, any sense how much the Summer Olympics might contribute in, sort of, revenues and costs next year? And is that -- would that be a great vehicle maybe Olympics in general to promote your DTC services?

Gunnar Wiedenfels

Alexia, 100%. It's a great year. It's an exciting event that's coming up. And certainly with the transition that JB and Peter have managed for the Eurosport Player it's now on our own tech stack, et cetera. So we're in attack mode for the player for sure. So it's an important event.

Financially as we have discussed previously, remember we're going to see about 30% of the total rights costs for the Olympics come through next year. So that is a significant chunk of events that is going to hit the third quarter. And if you keep in mind the monetization, we're exploiting these rights across all levers sublicensing advertising affiliate deals and then our own direct-to-consumer deal. So those revenue streams are all contributing to the monetization, but obviously over a longer term while the expenses are going to hit in the third quarter.

And it's also fair to say that given this is later in the year, we'll have less time in the year 2020 to recoup some of those investments because especially if you look at player revenues from additional subscribers affiliate renewals et cetera, those are longer-term impacts on the top line. I hope that's helpful.

David Zaslav

Having said that, it is a great magnet for massive audiences and attention to the quality of what we're able to do. We're the only company that can have the Olympics in 25 languages with local hosts. It's one of the reasons that the PGA TOUR came to us. It's the reason why Thomas Bach came to us to innovate. It was in terms of innovation. Last time we were on every platform and we reached more people under 25 than ever before. And we were on every platform and we reached more people under 25 than ever before. And

we were just getting started. JB talk a little bit about how we can use the Olympics not just for sustainable growth which you've done but also to promote a lot of these other products golf cycling the Eurosport Player.

JB Perrette

Yes. But, I think, if we look at the Olympics as having several different value streams aside from the direct ones that Gunnar pointed out. And so two or three that are additional to that. Number one, obviously, with the world turning for that 17-day period to the games right in advance of also the fall season launches in a lot of our bigger entertainment and free-to-air markets in Europe we use the games massively as a promotional vehicle to drive all fall seasons and our new lineups across the network.

So as a marketing push it will be hugely helpful. It was incredibly successful for us in PyeongChang. Realizing that PyeongChang obviously in the Winter Olympics were only popular in a fraction of the European continent where winter sports are more popular. This obviously being the summer is a totally Pan European and every market is interested in this. So we'll use it from a marketing vehicle for our content mainly.

The second piece is I think you've heard David previously, say in PyeongChang even though it was off-cycle in terms of games that probably had a little less visibility because it's winter a little less visibility because it was PyeongChang and not Tokyo which is getting a lot more buzz and a lot more awareness to it than 2018 did. We drove 0.5 million new subscribers to the player in that period during the winter. For now for the summer where the games are popular across the entire continent, where we have the only place you'll be able to get all the games will be on the player. We think we can use that to drive greater -- a much greater penetration for our Eurosport Player product.

And then the third is as we look at the broader line of the direct-to-consumer products that Peter and the team are building whether that be Dplay, obviously, Eurosport Player and potentially some of the other products that we are rolling out whether it be Motor Trend et cetera using the Olympics also to drive awareness to the rest of the direct-to-consumer portfolio and try and drive subs in a broader range of our portfolio. Those are really three major priorities for us as we look at leveraging this huge event and the biggest global event in the world to drive value for us across our portfolio.

Alexia Quadrani

Thank you. And again just, sort of, staying on international for a quick follow-up. Just given the initial success of the launch of your Network Kitchen and your expansion plans already in the U.S., I guess, how should we think about the time line for the rollout in other international markets?

Peter Faricy

Yes. We -- our current thinking is regrouping at the very beginning of 2020 and choosing with Amazon our partners in this a few more countries to launch across the world. And I think JB and I are very excited about the opportunity. I think, JB mentioned on the previous call we actually have some food assets outside the U.S. that are quite popular. That extends all the way through Asia as well and the Middle East. And so we're going to kind of take a look at where we think we have the best localized content to leverage already because we like to own our own P and have a head start and -- where we can get the biggest benefit from having Amazon and where we think we can serve consumers best, but we absolutely plan to roll this product out beyond the U.S. in 2020.

Alexia Quadrani

Thank you.

Operator

Thank you. Our next question comes from Drew Borst with Goldman Sachs. You may proceed with your question.

Drew Borst

Thank you for taking my questions. You guys outlined a lot of your DTC efforts that you already have in the marketplace. There's obviously a bunch on the come for next year. I was hoping that you -- just taking a step back, I want to understand the base of revenue that you guys have now like say this year? Because I feel like there's a lot of services.

They're in a lot of different segments across a lot of different revenue lines. But I don't know if you'd be willing to share just sort of what is kind of the revenue of this broader DTC business globally say, for this year.

Gunnar Wiedenfels

Drew so, we don't break that out specifically because as you say it's several contributions in multiple lines of business in the two segments. But as I said before, it's starting to meaningfully contribute to revenue growth and it has been for a couple of quarters. And I expect more of that next year. And just to give you an order of magnitude it's several hundred million dollars of total direct-to-consumer revenues that we already have to-date.

Drew Borst

Okay. Thank you. And then you mentioned that -- the OIBDA impact of these investments you expect to be at a low end of the original $300 million to $400 million range. I was wondering if you might be willing to share what you're thinking for next year in terms of kind of an OIBDA impact?

Gunnar Wiedenfels

Yes. So let me take a step back here. When we defined that original $300 million to $400 million envelope keep in mind a lot of these individual products were business plans at that point. So there's a certain amount of uncertainty and we have been prioritizing products against each other. That's why we've come in at the lower end of that spend envelope around $300 million rather than towards the top end of the $400 million.

As I said earlier you should expect that in Q4 as we fully get behind Food Network Kitchen from a marketing perspective as well and all the other products we've got internationally that you'll see some more investments come through. And it's too early to talk about specific numbers for next year. I mean, we're still in the process of budgeting. But you shouldn't be surprised to see increased investments.

Keep in mind Food Network Kitchen is going to be a full year plus some global markets. We've got a handful of new markets coming online for golf. Eurosport Player is going to be the priority with the Olympics. Dplay has seen a tremendous run extremely successful in the priority with the Olympics. Dplay has seen a tremendous run extremely successful in

terms of the subscriber uptake. So we really want to get behind that as well. And then we've got new products coming to the market with Magnolia in -- around the summer with our factual products that's in the making. So with all that you should assume a little bit of an increase in investments. Again, too early to talk about specific numbers.

And then as we've said earlier as well I want to have the full flexibility to be able to get behind products that work because with all of these products it's the drumbeat that Peter laid out initially focused on the input factors make sure that we have the right product, make sure we're seeing the engagement of first adopters. And then once we're convinced that we're onto something, we really want to be able to get behind performance, marketing, and really spending up to lifetime value to scale those products quickly. So there's very likely again going to be a bit of a range as we talk about.

David Zaslav

A good way to think about it is, we're doing a terrific job, great leadership team driving down on the existing ecosystem, everywhere in the world. We're on the leading end of performance in terms of our ability to -- we're growing ratings outside the U.S., our ability to commercially monetize that, our relationships with distributors, the ability to launch new channels everywhere in the world where no one else can. So the existing ecosystem we're very effective and we're driving hard.

But what you're seeing now is we're mounting a massive attack with all this IP as our artillery on everybody else, because everyone should have our content. So whether it's Food Network Kitchen, whether it's Golf, whether it's the Eurosport Player, whether it's Motor Trend, Magnolia those are siloed passion driven attacks. And Dplay across Europe is picking up. Everybody that doesn't subscribe to cable and those who do subscribe to cable with SVOD and AVOD products and that's what we're looking at in the U.S. is stepping up a full-on attack, mount and attack with our differentiated content against -- to serve --super serve and serve viewers and people that own phones and people that just love the characters and content that we have and delight in the fact that we're differentiated.

Everybody knows who we are. We don't promote ourselves because we have a show. We don't have to tell everybody come watch a show. They want to come hang out with the characters we have and the brands that we have. And so we're starting -- we're looking at things very differently because the passion for us as a group of IP seems to be very, very sustainable and strong.

Drew Borst

Yeah. And I assume David, what you're talking about seems to be like taking your channels and offering a suite of direct-to-consumer suite. And I just want to confirm, I assume you wouldn't say this, but there's no contractual restrictions with your current MVPD partners in terms of content or anything that would restrict your decision making or your ability to do something like that just to confirm?

David Zaslav

We have an ability to do whatever we want, but we're probably the most -- we've been the most friendly company in terms of the existing ecosystem. And we're looking to continue. We're talking to existing distributors. We're in the marketplace. We started by talking to customers about their confusion, about all these offers of what scripted series should I watch now? I got 20 of them in the hopper. And we're finding some great information about what we have and how valuable it is. And we're now trying to evaluate the best way -- we want to preserve the existing ecosystem. And we think that we have an ability to also attack everyone that doesn't subscribe to cable and have them have an opportunity to watch the great content they grew up watching.

Drew Borst

Great. Thank you. Appreciate it.

Operator

Thank you. Our next call -- question comes from Steve Cahall with Wells Fargo. You may proceed with your question.

Steve Cahall

Thanks. And I joined a little late, so apologies if I missed this. You've got now all these digital initiatives and they're sitting nicely under Peter. I was wondering if you think there's a point in the future, since it's such a broad portfolio that you might be able to give us some sort of goalposts or like a revenue range of what you think these can do on a run rate basis?

And then on the buyback side, I was just wondering how we should think about it? Do you think about this is now a structural thing where you can generate a few billion dollars a year in free cash flow. So there's always going to be a couple of billion dollars a year that you can use to buy back stock now that you're at this level of debt? Or is it more opportunistic than that? And just last one related to free cash flow. Next year, are the Olympics a drag on free cash flow? Or are they just a drag on EBITDA when they hit in the summer? Thank you.

Gunnar Wiedenfels

All right. So let me start with the digital initiatives and the goalpost. I understand the desire to get as much of a modeling framework as possible. As I have said many times before, we want to maintain the flexibility right now to try things and to fail if we have to fail or to get behind stuff that's working. And as Peter said, we're really focused on input metrics rather than trying to chase metrics further down the funnel, be it subscriber numbers or let alone revenue and profit numbers. So that's why it is very early.

The other thing is -- one thing to keep in mind -- again this business drives our two reporting segments, the U.S. Nets the D&I segment. So there's always that element that these businesses are all embedded in our regional structure.

Now that being said, I do think -- and again it's a little early for that but I would expect that as we go through next year with more product launches and more let's say track record on existing products that we will increasingly start giving more disclosure here. But again I don't think it would be helpful right now to get too granular. And it wouldn't be responsible either because again it's very early days.

Number two on the buybacks, look I mean we've been saying the same thing for the longest time now and our priorities haven't changed. We are now at 3.1 times. Very soon we'll be at the lower end of our target range. And again I do continue to want to take advantage of our balance sheet here. And we're funding all the investments as you could see in our numbers here.

We will continue to look for M&A opportunities. But you all know that that's easier said than done. We would do another Scripps acquisition any day, but they're not that available. And to be honest with you, if I look at the buybacks that we executed last quarter, those are going to be great investments. And honestly investing in our own stock sets a very, very high bar for every M&A activity. So this idea of investing in ourselves be it through buybacks or be it through funding organic investments on the D2C side is going to be a priority.

Steve Cahall

Thank you.

Operator

Thank you. Our next question comes from Doug Mitchelson with Credit Suisse. You may proceed with your question.

Doug Mitchelson

Thanks so much. A couple of questions. David, I mean you're mentioning what sounds like a pretty remarkable strategic shift with your direct-to-consumer strategy in the U.S. So I was hoping for some more clarity. Are you talking about taking your library of content and going direct-to-consumer? Are you talking about actually taking your current content on the live networks plus the library going direct-to-consumer? Are you talking about doing this in combination with other content companies or leveraging other platforms like Peacock? Or is this something that you would do yourself?

David Zaslav

Look what we're doing is we're looking at the strength of our IP in the U.S. in the aggregate. And we're looking at -- and talking to consumers, how much they love it. We see through our GO platform, how young the people that are using it and how much time they're spending with it. And we're now looking at what -- how do we take that content. We're already doing it independently.

Is there an opportunity for us to take that content on a broader basis to reach -- to mount and attack on those that are not existing cable subscribers. That's the full ecosystem. That's what everyone is looking to do and needs to do, which is take the great IP and reach everyone. We want everyone to watch our content.

And we have to do it the way we did it in Germany. But candidly, we haven't wanted a partner in the U.S. because all those entertainment platforms don't have enough. They've spoken to us. And we look at what they have is differentiated. They're part of an overall entertainment pie. And they each have a piece; none of them have it all. We have almost all of each of our platforms. And when we put it together we have something that's compelling. And so we'll be looking at that over the next few months.

Doug Mitchelson

Very interesting. And Gunnar, you were threatening to continue to delever but there's only 10 basis points left to go. And you just talked about capital deployment a little bit. If you're doing close to $3 billion of free cash flow next year and you're basically at 3.0 times as you end this year, it sounds like either that's going to M&A or capital returns. The only other thing that would be an input in the model is if you were investing so much in digital initiatives like the one David is talking about that EBITDA would be pressured. And that some of that cash flow would have to go to pay down debt. Am I, sort of, thinking about all that right? And is that last scenario in play?

Gunnar Wiedenfels

Well, I think you're thinking about it right, but let me make one thing very clear. I don't see any scenario where we'd be spending that much in Peter's investments here that there will be a really material impact on our free cash flow. We will prioritize those investments but this is not this is not…

David Zaslav

And one of the reasons is that, if you think, the jewel for HBO's Game of Thrones, our jewel on Food Network Kitchen, might be Martha Stewart cooking for Thanksgiving or just cooking -- doing a live cooking class every day.

If we find that they really love Martha or they really love Bobby then we can -- we don't have to wait 1.5 years. It doesn't cost us $8 million an episode. The next week we sit down -- everyone working with us is having a great time.

And even with our existing content, our average cost of content is -- has stayed relatively flat. In some cases, we've been able to maybe do a little bit better. But -- and our average cost of content is $0.5 million an episode.

On Sunday night, we're generating a 35 on -- with 90 Day Fiancé on TLC. And the cost of that content is -- it's the number one show on television on Sunday night. And the cost of that content is actually less than that.

JB Perrette

I think, the other thing -- Doug, its JB, I think Dplay and the traction we've had internationally has also opened our eyes a little bit, to the fact that we all focus -- and particularly obviously for the U.S. focus on what's happening to the pay-TV bundle and subscriber loss.

I think that's the defensive way of looking at it. The offensive way to look at it which is what we've seen internationally is, there's also enormous -- and in some markets obviously like the U.S. growing percentage of base that has never or doesn't have access to our content or is choosing not to have access. And yet would love it.

And so when we look at a market like Italy, which essentially has more than 70% of the population is not signing up for pay-TV. As we've launched Dplay in that market we've realized, now rather than just holding on to the 30% penetration of pay-TV, we got to get much more offensive about going after the 70% that never has had it.

And that's a whole new target base that -- as we're seeing early numbers is looking at our content and saying, we'd love to have this. And so that's an exciting way of looking at it. And I think, part of what David is referring to in terms of us looking at the U.S. market and having sort of that same question.

David Zaslav

The one point on the current ecosystem, Charlie announced this morning, that he added 150,000 subscribers, with 214,000 Sling subscribers, which is a skinny bundle. And we are -- on every skinny bundle, we happen to have very good carriage on both of the Sling platforms which I don't know that anybody else does.

So we'll be the beneficiary of that. But it's a directional point. 214,000 subscribers and they don't carry any regional sports. Charlie is not putting regional sports on Sling. You talk about this overstuffed bundle, retrans, sports networks regional sports networks. It's all weighing down this industry.

And here's Charlie. He just takes the regional sports code off. And he picks up 214,000 subscribers. And if you take one of our distributors out, that has been working on getting rid of non-performing subscribers. And you see we're slightly down. We may be flat. So I don't know, if this is going to be a pivot.

But if there's a skinny bundle that can get some acceleration and we are seeing a rotation into some of these, what I would call, MVPDs, we have very good carriage on all of them, better positioned than anybody.

And maybe this is a moment where the U.S. can -- if the existing distributors can get some courage, I think they can start to benefit the consumers which is, "Hey I don't want to pay $100 and get all these regional sports networks. I don't want to pay for all the sports. I just want some great content. That's what I spend time watching.

So I think Sling is very encouraging. And it's a good mark for the industry. Stop stuffing the damn bundle, serve the consumer.

Doug Mitchelson

All right, thank you.

Operator

Thank you. And our last question comes from Michael Nathanson with MoffettNathanson. You may proceed with your question.

Michael Nathanson

Thanks. I have just a couple for JB. I just wanted to learn more about, how you think about what markets do you partner with a local broadcaster or you go it alone. And in those markets what have you learned? Or how necessary is maybe the local content versus just taking your discovery products into a Dplay mode?

JB Perrette

Yeah. So, I think our view is generally. And as sort of David referred to in the Poland example, we think the faster and the more local aggregation can come together the better. And so in that market where essentially between us and Polsat we have about 70% of the audience share in the market.

I think that sort of answers the question of we view that -- even though, we have -- we are the largest broadcaster in Poland as an example. And we do go it alone. And we're seeing traction and growth on our own.

We think that making it easier back to what David just said about, lead with the consumer, that the simpler we can make it, in aggregating content, in a good experience, for the consumer wins. And at the end of the day, even with a 30% share of audience plus in a market, if we can partner with another big -- one or two big players that have meaningful share and make it even easier with more great content will locally differentiate it.

So that is always going to be the better approach. Whether we can get that done in every market, look, obviously is something that's a work in process. But I think, as broadcasters around the world are realizing that the model has to change.

And that their future is going to be entirely based on how quickly and how well they can pivot to the streaming world. The good news is, Discovery with our track record of putting these partnerships together, developing these products, scaling these products. We're a unique partner and the most credible partner and in a lot of these markets to pull it together.

Michael Nathanson

Thanks.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.