

Time Warner Inc. Strategy Report



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Executive Summary

Time Warner Inc. “uses its industry-leading operating scale and brands to create, package, and deliver high-quality content worldwide through multiple distribution outlets.” Time Warner continues to be at the top of the rankings in terms of quality, popularity, and financial results. Their operating divisions, Home Box Office, Warner Bros., Time Inc., and Turner Broadcasting System maintain unparalleled reputations among their consumers, as they try their best “to keep people informed, entertained, and connected.” Currently, Time Warner’s main focuses are to provide content on all platforms in all places, by offering their services on all types of digital media/entertainment domestically and globally. Time Warner instills a set of core values in to all of their employees: creativity, customer focus, agility, teamwork, integrity, diversity, and responsibility. By following these values, Time Warner believes that they will be able to maintain their status as one of the most successful media and entertainment conglomerates for many years to come.ⁱ

Time Warner revenue originates from three separate sectors: The networks sector recorded \$14.204 billion (49% of Time Warner’s total revenues) and \$4.719 billion in operating income. The Film and TV entertainment unit earned \$12.018 billion (39% of total revenues) in revenues and \$1.228 billion in operating income. The publishing sector, which will be spun off at the end of this calendar year, experienced revenues of \$3.436 billion (12% of total revenues) and \$420 million in operating income.ⁱⁱ

The networks sector generates revenue by providing programming to affiliates (i.e. cable providers, online streaming services, etc.) that have contracted to receive and distribute this programming to subscribers and from advertising sales. The Film and TV entertainment segment earns theatrical revenue primarily through rental fees from theatrical showings of feature films and subsequently through licensing fees obtained from the films’ distribution on TV networks and pay-TV programming services. Additionally, they earn television revenue from the licensing of programs to networks and pay-TV services. The Film and TV Entertainment unit earns money through DVD



and Blue-ray sales of their product and in various digital formats. Lastly, revenue is gained through the development and distribution of video games. The publishing unit generates revenue from the sale of advertising, magazine subscriptions, and newsstand sales.ⁱⁱⁱ

The world of media and entertainment is becoming digitally-driven. Time Warner is at the forefront of this transformation. They operate on the business model of TV Everywhere: offering original content to their subscribers, on demand, on all digital platforms, all over the world. This allows them to retain subscribers and attract new ones more efficiently than other top media and entertainment corporations.^{iv}



Company Background

Time Warner Inc. is one of the largest media and entertainment conglomerates in the world, competing with stalwarts like Disney and News Corporation. Over the course of its history, Time Warner's brand has encompassed magazines, books, recorded music, motion pictures, online services, and broadcast cable television programming and distribution. They previously owned AOL, Time Warner Cable, and Warner Music Group, but all have been spun off into independent companies. Furthermore, in March, Time Warner announced that Time Inc. would be split off at the end of the calendar year, completing their transformation into a streamlined entertainment company.^v

The company's origins can be dated back to 1972 when Kinney National Company, a parking and cleaning company, established Warner Communications. It did so by acquiring National Periodical Publications (now DC Comics), Panavision (motion picture equipment company), and then buying out the film company Warner Bros.-Seven Arts in 1969 ("Seven Arts" was deleted from the name soon after.) Due to a financial scandal over parking operations, Kinney National spun off its non-entertainment assets in 1971 and changed its name to Warner Communications Inc. Warner Communications owned Warner Bros. Pictures, DC Comics, Mad, and Atari from 1976 to 1984. The company experienced great success (and later losses) with Atari, a major arcade and video games force at the time. At its peak, Atari accounted for 1/3 of Warner's annual income and was the fastest-growing company in the history of the US at the time. In 1975, under CEO Steve Ross, Warner expanded and formed a joint venture with American Express (Warner-Amex Satellite Entertainment), which held cable channels including MTV, Nickelodeon, and The Movie Channel. They eventually bought out American Express's half in 1984 and sold the venture a year later to Viacom, which renamed the group of channels, MTV Networks.^{vi}

The birthplace of Time Inc. can be traced back to 1923, when *Time* magazine first appeared on newsstands, selling 9,000 copies. Over the next five decades, the magazine industry experienced substantial growth and by the 1970s, Time Inc. owned *Life*, *Fortune*, *Sports Illustrated*, and *People* magazine. At this time, Time Inc. started their



own book division, naming it *Time-Life Books*. They first moved into the broadcast and entertainment industry in the 1950s, but announced in 1970 that they were selling their broadcast holdings to focus entirely on cable television. Their most crucial play came in 1972 when they founded Home Box Office (HBO), which became a global leader among premium cable stations.^{vii}

In 1990, Time Inc. and Warner Communications merged to form Time Warner and the company went on to purchase Turner Broadcasting System in 1996. This move brought Time Warner back into the basic cable television industry. Additionally, they regained the rights to their pre-1950 film library. In 2000, AOL purchased Time Warner for \$164 billion. This merger was supposed to be a good omen for everyone involved. By tapping into AOL, Time Warner would reach deep into the homes of tens of millions of new customers. AOL would use Time Warner's high speed cable lines to deliver to its subscribers Time Warner's branded magazines, books, music, and movies. This would have created 130 million subscription relationships. Unfortunately, due to the burst of the dot-com bubble and economic recession after September 2001, the value of the AOL division dropped significantly. In 2002, AOL Time Warner reported a loss of \$99 billion (largest loss ever reported by a company at the time).^{viii} In 2009, Time Warner announced it would spin off AOL as a separate independent company. In the same year, Time Warner Cable was divested from the company in a spin-out. In 2013, Time Warner continued its attempts to become even more streamlined, announcing their plans to spin off Time Inc. at the end of the year. They believe that by separating their publishing unit, Time Warner can focus solely on their high-growth products in film and network entertainment.^{ix}



Financial Analysis

Time Warner Inc. (TWX) is a media and entertainment company that operates in three reporting segments: Networks, Filmed Entertainment and TV, and Publishing.

Networks consist of television networks, premium pay and basic tier television services, which provide programming. Filmed Entertainment consists of feature film, television, home video and videogame production and distribution. Publishing consists of magazine publishing.

In 2011 and 2012, Time Warner's adjusted operating income grew by 8.6% to \$5.9 billion, and 4.5% to \$6.1 billion respectively. In 2012, free cash flow grew 8.6% to \$2.9 billion after remaining flat at \$2.7 billion in 2011. In February 2013, Time Warner raised its quarterly dividend by 11%, to \$0.29 per share, and currently is ranked 4th for annual dividend yield within the entertainment industry. Management expects low double-digit percentage growth in adjusted EPS, up from \$3.28 in 2012.^x

In March 2009, Time Warner received \$9.25 billion in special dividends due to the spin-off of its Time Warner Cable segment. Time Warner has a net debt of about \$17 billion, factoring cash and equivalents of \$2.8 billion as of January 1, 2013. This net debt is within the company's target net debt/EBITDA ratio of 2.4X.^{xi}

Industry Specifics & Comparisons

Entertainment companies have sizable capital requirements, meaning it is important to examine current debt and cash and ask the question, is the company in a good position to borrow more funds in the future? On June 8th of 2012, Standard & Poor's Ratings Services assigned its 'BBB' rating to Time Warner Inc.'s proposed issuance of up to \$1 billion of debt securities. "The company plans to split the offering between senior notes due 2022 and senior debentures due 2042. The company plans to use the net proceeds of the debt issuance for general corporate purposes." The 'BBB' long-term and 'A-2' short-term ratings on Time Warner remain unchanged and are predicated on management pursuing its strategic objectives. In addition, it is advisable to assess



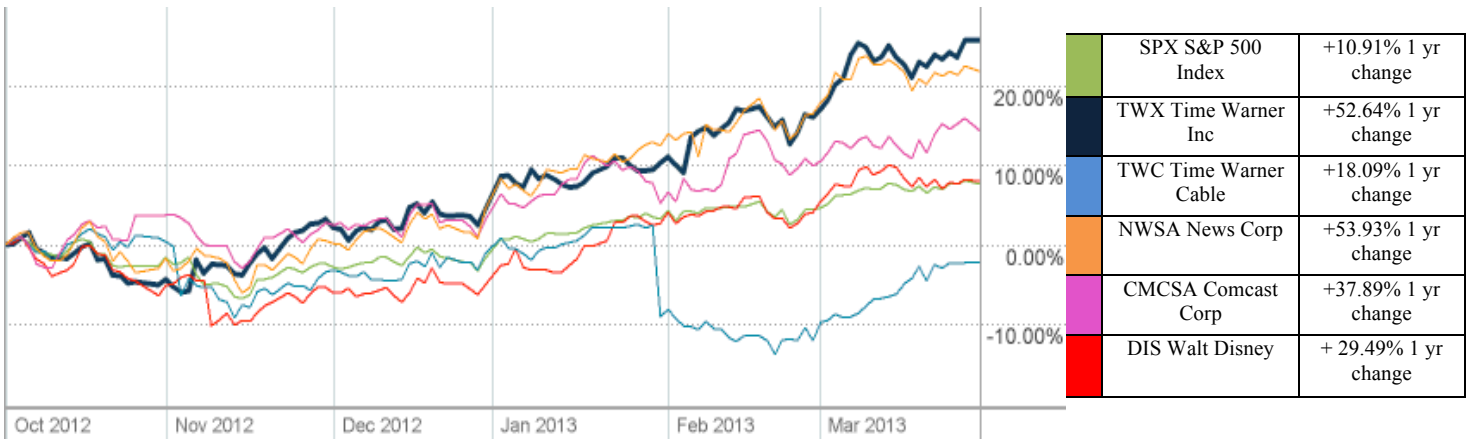
whether Time Warner has made capital or borrowing commitments that may be difficult to meet if the business environment changes. Selling equity is another way in which the company can raise capital.^{xii}

Entertainment companies also generally have cash expenditures that are not included on the income statement (an example are production costs for movies that have yet to be released, debt repayment, and dividends to share holders). Movies and TV shows may have a period of several years between the start of production and the generation of a positive cash flow. Lastly, when looking at Time Warner's balance sheet, it is also important to assess whether the reported values are accurate measures of the assets' worth, or if intangible assets such as brand names or management ability may not be reflected.

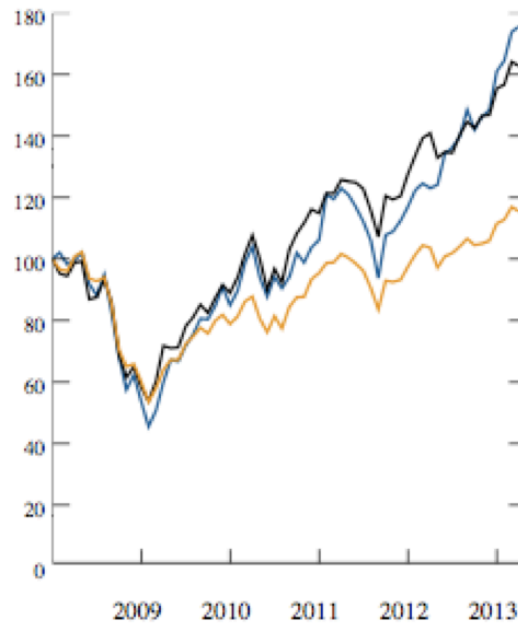
The following is a quick summary of key financial figures for Time Warner as compared to two of their competitors, Disney and News Corp, and the Diversified Entertainment Industry as a whole, as well as a comparison of stock price over the past 6 months:

	TWX	NWS	DIS	Industry	TWX Rank in Industry
Market Cap:	53.86B	71.15B	102.35B	324.15M	6/151
Employees:	34,000	48,000	166,000	526.00	
Qtrly Rev Growth (yoy):	-0.04	0.05	0.05	0.00	62/151
Revenue (ttm):	28.73B	34.33B	42.84B	283.56M	
Gross Margin (ttm):	0.45	0.38	0.21	0.6	
EBITDA (ttm):	7.28B	6.86B	10.90B	74.90M	
Operating Margin (ttm):	0.22	0.17	0.21	0.20	
Net Income (ttm):	3.00B	4.00B	5.60B	N/A	
EPS (ttm):	3.09	1.67	3.10	0.61	
P/E (ttm):	18.65	18.35	18.29	24.3	32/151
PEG (5 yr expected):	1.30	N/A	1.32	1.06	7/151
P/S (ttm):	1.87	2.08	2.39	2.35	

Source: Yahoo Finance



Based on S&P 1500 Indexes
 Month-end Price Performance as of 3/29/13



Sub-Industry Sector S&P 1500

NOTE: All Sector & Sub-Industry information is based on the Global Industry Classification Standard (GICS)

Source: S&P 500 Report

While Time Warner has a significantly smaller Market Cap than its competitors and the size of its revenue declined after spinning off its cable and AOL segments in 2009, Time Warner has a higher gross margin than both Disney and News Corp. This means that Time Warner retains more on each dollar of sales to service its other costs and obligations, though its gross margin is still below the industry average. Time



Warner has an operating margin slightly above those of Disney and the Industry average and is higher than News Corp, meaning that Time Warner has more revenue left over after paying for variable costs of production. It is important that Time Warner retains a healthy operating margin to be able to pay for fixed costs later, such as interest on debt. When comparing Time Warner and News Corp's specifically, we can see that Time Warner's higher EBITDA despite its smaller revenue means Time Warner has fewer pre tax, interest, depreciation, and amortization expenses than its rival. All three companies have similar price-to-earnings ratios, while Time Warner and Disney have almost double News Corp's earnings per share.

Profitability

Time Warner achieved an increase in profitability in 2012 despite a decrease in revenue, primarily through an increase in demand and cost control. Current net profit margin within the Diversified Entertainment Industry is 7.90%, which Time Warner is outperforming.

Time Warner Inc., Profitability ratios (USD \$ in millions)

	Dec 31, 2012	Dec 31, 2011	Dec 31, 2010	Dec 31, 2009	Dec 31, 2008
Gross profit	12,795	12,663	11,865	11,347	19,695
Revenues	28,729	28,974	26,888	25,785	46,984
Gross profits margin	44.54%	43.70%	44.13%	44.01%	41.92%
Operating profit margin	20.60%	20.04%	20.19%	17.63%	-33.96%
Net profit margin	10.51%	9.96%	9.59%	9.57%	-28.52%

Source: Yahoo Finance

While overall revenue fell drastically in 2009 after the spinoff of the AOL and Time Warner Cable business segments, the revenue generated by the Networks, Film and TV Entertainment, and Publishing Segments increased from 2008 to 2011, while revenue took a slight dip in 2012. We see that revenue growth in the company's Network segment has been positive from 2008 to 2012, while Publishing revenue has been



consistently declining (though in March of this year the company announced they will be spinning off their publishing segment by year's end). Revenue in the Film and TV Entertainment segment has experienced ups and downs, and closed 2012 down from 2011.

Time Warner Inc., Income Statement, Revenues (USD \$ in millions)

12 months ended	Dec 31, 2012	Dec 31, 2011	Dec 31, 2010	Dec 31, 2009	Dec 31, 2008
AOL	–	–	–	–	4,155
Cable	–	–	–	–	17,188
Networks	14,108	13,562	12,391	11,609	10,208
Film and TV Entertainment	11,206	11,784	10,844	10,453	10,854
Publishing	3,415	3,628	3,653	3,723	4,579
Revenues	28,729	28,974	26,888	25,785	46,984

Source: Stock Analysis on Net

When examining the company's quarterly revenue, it is clear that Time Warner has been performing strongest in the 4th quarter. The company had a strong start in the first quarter of 2012 when compared to 2011, but failed to match the previous year's performance in the following three quarters.

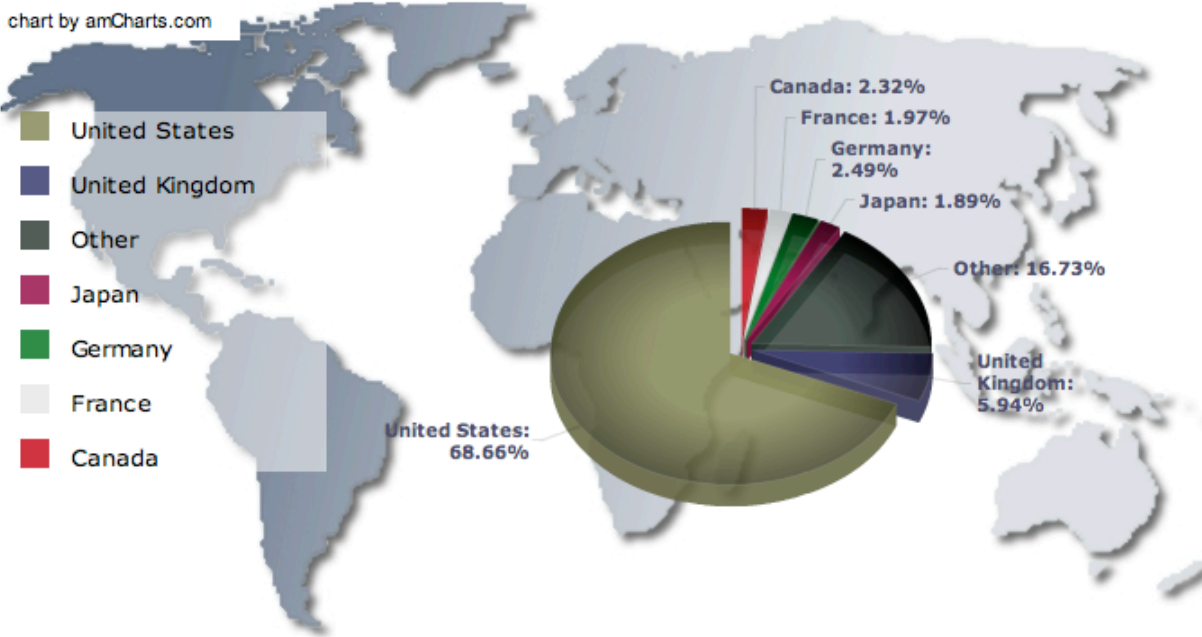
Periods	2011	2012
March	6,683	6,979
June	7030	6744
September	7068	6842
December	8193	8164

Source: Stock Analysis on Net



The geographic breakdown of sales is shown below, and have been increasing in all areas except for Canada.

TIME WARNER SALES BY GEOGRAPHY



Source: CSIMarket



Liquidity

Time Warner Inc., liquidity ratios (USD \$ in millions)

	Dec 31, 2012	Dec 31, 2011	Dec 31, 2010	Dec 31, 2009	Dec 31, 2008
Current ratio	1.35	1.51	1.52	1.48	1.19
Quick ratio	1.14	1.17	1.17	1.13	0.92
Cash ratio	0.29	0.39	0.42	0.55	0.48

	TWX	Industry	Sector
Current Ratio (MRQ)	1.35	0.74	1.56
Quick Ratio (MRQ)	1.14	0.58	1.19
LT Debt to Equity (MRQ)	64.00	53.60	31.81
Total Debt to Equity (MRQ)	66.51	55.98	53.69

Source: Yahoo Finance

We analyze Time Warner's liquidity ratios to determine solvency risk. The current ratio is derived by dividing a company's current assets by the current liabilities, and therefore should signal whether their short-term assets are readily available to pay off its short-term liabilities. This means that generally, a higher current ratio is better. The quick ratio is a similar measurement, but is more conservative. This liquidity indicator refines the current ratio by measuring the amount of the most liquid current assets there are to cover current liabilities, and excludes inventory and other current assets that are more difficult to turn into cash. Time Warner's current and quick ratios, while less than they were at the end of 2011, indicate good financial health when compared to the Consumer Services sector ratio.

Management Effectiveness

ROA tells us what earnings were generated from invested capital (assets), while ROI evaluates the efficiency of an investment by dividing the return on an investment by the



cost of the investment. Similarly, ROE is the amount of net income returned as a percentage of shareholders equity. These ratios can vary widely across industries so it is best to compare a company to a competitor or the industry as a whole.

Time Warner Inc., management effectiveness

	Company	Industry
Return on Assets (TTM)	4.43	2.17
Return on Assets - 5 Yr. Avg.	1.31	4.62
Return on Investment (TTM)	5.14	2.74
Return on Investment - 5 Yr. Avg.	1.53	2.46
Return on Equity (TTM)	10.05	5.79
Return on Equity - 5 Yr. Avg.	2.98	6.88

Source: Stock Analysis on Net

Time Warner's ROE is ranked 29th in the industry, and we can break down ROE further using DuPont Analysis into a product of other financials, and use this to assess what areas are most influencing the increasing trend in ROE (with the exception of the 2008 outlier).

Time Warner Inc., decomposition of ROE

(Industry ROE = 9.50)	ROE	=	Net Profit Margin	×	Asset Turnover	×	Leverage
Dec 31, 2012	10.10%		10.51%		0.42		2.29
Dec 31, 2011	9.63%		9.96%		0.43		2.26
Dec 31, 2010	7.83%		9.59%		0.40		2.02
Dec 31, 2009	7.39%		9.57%		0.39		1.97
Dec 31, 2008	-31.69%		-28.52%		0.41		2.69

Source: Stock Analysis on Net



Projections

According to Standard & Poor's, 2013 consolidated revenues are predicted to grow 2.8%, with 2014 revenues growing at 7.1% to reach \$31.61 billion. The basis for these projections is predicted higher Turner networks advertising, HBO subscriptions, and a strong TV syndication pipeline aided by international expansion. Also taken into account is a backlog of licensing deals for the core film/TV entertainment segments in addition to video games revenues. Standard & Poor's also projects total adjusted EBIT growth of 7.6% and 8.3% in 2013 and 2014, respectively, and a 12-month target price of \$63. Risks to these projections include possible decreases in consumer discretionary spending and potential ratings issues for Turner networks.

(29 analysts were used each month)	Current Month	Last Month	Two Months Ago	Three Months Ago
Strong Buy	7	6	5	6
Buy	14	14	14	14
Hold	8	9	10	9
Underperform	0	0	0	0
Sell	0	0	0	0

Source: Yahoo Finance



Competitive Analysis

Through a Five Forces Analysis of Time Warner Inc., one discovers that the media and entertainment industry exhibits high internal rivalry, relatively high barriers to entry, low buyer power, high supplier power, and a good deal of substitutes with few complements. Given the announced spin-off of Time Inc. at the end of 2013, the publishing sector is left out of this breakdown.

Internal Rivalry (high)

Time Warner's three major competitors in the media and entertainment industry are The Walt Disney Company (DIS), News Corporation (NWS), and NBCUniversal Media, LLC, which is owned by the Comcast Corporation. In the movie industry, the "big six" in major Hollywood film studios are Warner Bros., Walt Disney's Buena Vista, News Corp.'s Twentieth Century Fox, Viacom's Paramount, Sony/Columbia, and NBC Universal Inc.'s Universal. These studios usually account for approximately 80% of the market share in terms of annual box office revenues (netadvantage.standardpoor.com). Rivalry in the filmed entertainment industry is clearly concentrated within a few major corporations. In 2012, Warner Bros. possessed a market share of 15.4%.^{xiii} Each production studio is constantly on the lookout for that next director, cast, and crew needed to create the perfect film that will yield optimal revenue from rental and licensing fees.

Time Warner also owns many entertainment and news networks: Turner's networks include TBS, TNT, Cartoon Network, TCM, and CNN. Additionally, HBO is engaged in providing programs to cable providers who have contracted to receive and distribute such programming to those customers who choose to subscribe to their network services (HBO, Cinemax). Home Box Office also partakes in several other forms of program distribution, including through DVDs, Blu-ray Discs, and electronic sell-through (EST). The rivals to these networks include the abundance of network channels that are provided on TV. Each major corporation that owns these networks is competing to attract and retain as many subscribers as possible. As of Dec. 31, 2012,



Home Box Office had 114 million subscribers worldwide. By year's end, HBO was the #1 domestic premium pay television service in primetime and total day ratings in 2011 (timewarner.com). HBO's ability to offer award-winning shows like *True Blood*, *Boardwalk Empire*, *Game of Thrones*, and *Girls*, provides Time Warner with an advantage in the battle for customers.^{xiv} The greater the volume of subscribers TWX can obtain, the more revenue they can generate from advertisers.

Barriers to Entry (moderate-high)

Barriers to entry in the filmed entertainment business are relatively high. Economies of scale are a major factor. A large firm, such as Warner Bros., can diversify its risks by developing a plethora of projects (films). The sheer volume of its products gives it greater influence with owners of theaters and TV networks. The Big Six utilize their brand name, management experience, personalized relationships with creative talent, and specialized product distribution capabilities to gain an advantage over potential entrants. That being said, entry barriers in filmmaking and distribution are not as extreme as in more capital-intensive sectors. Consequently, independent films have achieved considerable success in the industry in recent years. While a number of new players have entered the scene, the long-standing reputations of the Big Six make competition from smaller firms relatively insignificant.^{xv}

Buyer Power (low)

Given the popularity of filmed and TV entertainment, buyer power can be characterized as relatively low. In 2012, Warner Bros. Pictures Group grossed \$4.3 billion at box offices worldwide, surpassing the \$1 billion mark for the 12th straight year. This feat has not been reached by any other studio. Warner Home Video also received a 21% market share in total DVD and Blu-ray sales, an accomplishment reached by no one else.^{xvi} This overwhelming success leaves distributors and theaters with little buying power when negotiating contracts. Failure to come to terms on deals to broadcast their films will result in substantial revenue losses for these distribution companies. The annual ability



to dish out high-end films leaves Warner Bros. with all the leverage in contract negotiations.

The same logic holds true for entertainment in the TV sector. For example, as mentioned earlier, Time Warner has experienced great success with their network subsidiary, Home Box Office Inc.'s top-tier original programming results in the record number of subscribers. The more viewers, the more cable providers and advertising companies are incentivized to establish relationships with proven network stalwarts, like HBO. This results in low buyer power for those involved.

Supplier Power (high)

In the entertainment industry, there can be a considerable amount of vertical integration. Studios and other developing units are often associated with the distribution network. Within the film industry, a company that is in charge of the theatrical release of a film typically owns the rights to distribute this film in the home video market. According to *The Economist*, "The bulk of stuff that fills prime-time television screens in America is filmed between two valleys in Los Angeles, and is in the grip of a handful of production companies belonging to large media conglomerates."^{xvii} While content development is sometimes contracted out, the majority of it comes from within the firm. Guilds, such as the Screen Actors Guild (SAG), operate similar to labor unions. Members are guaranteed a certain wage, but in exchange, must promise to deny work from companies not affiliated with these guilds. This gives the suppliers (i.e. actors, directors, writers, screenwriters) a sizable degree of power when it comes to negotiating contracts with film studios. A similar line of reasoning applies to the television sector of Time Warner.

Substitutes & Compliments (High & Low, respectively)

The network subsidiaries of Time Warner have experienced increased competition from various online streaming services, including Hulu and Netflix. These businesses offer a large library of content for a cheaper subscription fee than cable providers will offer for



their services. Although Time Warner is known for its distinguished original content, the ability to use a digital service where you can access shows on demand for less makes companies like Netflix significant competition for networks looking to maximize revenue across the viewing populace. Although these online streaming sites can be regarded as substitutes to pay-TV programming, Time Warner has still signed several streaming deals with Netflix and Amazon, allowing them to stream their branded content on the websites. Thus, Time Warner is able to generate licensing revenue from its competitors.

Pirated content is now more prevalent in the realm of internet streaming than it was in the past. It has become far easier to distribute television, film, video games, and music online illegally. Although the quality of these distribution outlets is usually lower, the actual content is the same and the cost to each viewer is practically zero. Theoretically, an increase in piracy could result in a loss of revenue for Time Warner's media and entertainment divisions. However, this substitute was not substantial enough to affect the film industry. Warner Bros. had the 2nd largest market share in terms of box office revenue in 2012.^{xviii}

Lastly, given the present state of our economy, consumers generally have less disposable income. They are no longer able to indulge in some of the luxuries they once took for granted. This could be detrimental to the film industry, as customers might be more inclined to engage in activities that don't require a paid ticket stub for every visit. Other healthier substitutes to the two-hour movie sit-down viewing include walking, running, and playing sports. These activities not only provide an alternative form of entertainment, but can also come at a significantly cheaper cost.

One of Time Warner's continual goals is to provide all of their branded content on as many digital platforms as possible. As technology continues to improve, these platforms (i.e. televisions, computers, smart phones) will be offered at lower prices. Consumers will find it more economically feasible to purchase these platforms at discounted prices. As customers continue to purchase the plethora of ever-improving digital platforms, Time Warner will reap the benefits of these "complements". For example, the quality of



televisions has risen immensely over the past decade or so. Having high-definition TVs used to be an expensive luxury. Now, however, flat-screen HDTVs are becoming much more cost-effective and commonplace. Customers buy televisions for one major reason: to watch shows and movies in the convenience of their own homes. Therefore, they will buy subscriptions to a variety of cable networks that they find appealing, which is to the direct benefit of Time Warner Inc.



SWOT Analysis

Strengths	Weaknesses
<ul style="list-style-type: none">❖ Reputation/Brand Recognition❖ Customer Base❖ Diversified Operations❖ Financial Performance	<ul style="list-style-type: none">❖ Publishing Unit❖ Declining DVD/Blu-ray sales❖ Dying Video Game Industry❖ Revenue Concentration in US
Opportunities	Threats
<ul style="list-style-type: none">❖ Global Expansion<ul style="list-style-type: none">○ TV○ Film❖ Social Media Relationships	<ul style="list-style-type: none">❖ Online streaming services❖ Piracy❖ Password Sharing

Strengths

Time Warner Inc. utilizes its top-of-the-line brands and franchises, along with its industry-leading scale, to attract the best talent that media and entertainment have to offer. They work together with Time Warner employees to create the highest-quality content in a multitude of entertainment sectors, from film, to television, to magazines. Whether measured by popularity, quality, or financial results, Time Warner is ahead of the competition. The operating divisions (Home Box Office, Time Inc., Turner Broadcasting System, and Warner Bros. Entertainment) have developed an unrivaled reputation over the years for their creativity and excellence in providing the best possible content to the viewing populace. This has led to a great deal of customer loyalty, meaning that Time Warner should continue to expect a steady stream of subscribers for years to come.

Home Box Office is a major contributor to Time Warner's strong reputation. It is the world's most successful pay-tv service, with over 114 million subscribers to their networks (HBO and Cinemax) across the globe. HBO's brand continues to be recognized for their highly innovative and critically acclaimed television programming. In 2012, the network won 23 Primetime Emmy Awards, which was the most of any



network for the 11th consecutive year. HBO has been rewarded for their ability to provide exceptional content across the entire spectrum of entertainment themes, from the sports world to news and documentaries. In the last calendar year, the network earned three Sports Emmys, two News & Documentary Emmy Awards, and a Best Documentary Short Oscar.^{xix} HBO's versatility allows them to appeal to an incredibly wide range of consumer tastes. This is why they are able to maintain such a large customer base every single year.

HBO is just one of the thriving brands of Time Warner. The many award-winning TV series under the Warner Bros. Television Group and Turner Broadcasting Systems, as well as the high-grossing feature films of the Warner Bros. Pictures Group, speak to the success of Time Warner across the entire field of entertainment. For instance, "The Hobbit: An Unexpected Journey", a Warner Bros. production, surpassed the \$1 billion milestone at the worldwide box office in March, joining a select group of films that achieved unparalleled global fame.^{xx} It is clear that the company's diversified operations are a major ingredient for their financial success, as they are capable of reaching so many different types of consumers.

The accomplishments of Time Warner's subsidiaries have resulted in continued financial success. They have remained one of the top-three leading entertainment/media conglomerates in the world. Time Warner achieved an increase in profitability in 2012. Overall company sales have increased in all areas except for Canada. They have a current ratio of 1.35, compared to the industry average of 0.74, indicating they are in good financial health. The company can afford to make the investments needed to grow and expand in the future. Their ROA, ROI, and ROE percentages are all roughly double the industry averages, showing management's efficiency in earning returns on assets, investments, and shareholders' equity (see "Financial Analysis" section for more details).



Weaknesses

Time Warner has been able to adjust successfully to our changing society by becoming more streamlined. They have accomplished this through several successful spin-offs (AOL & Time Warner Cable) and sales (Warner Music Group, 50% stake in Comedy Central, etc.). These modifications have contributed to their stability and improved growth profile.^{xxi} Still, Time Warner has room for improvement.

Their publishing business unit, Time Inc., is experiencing declines in their print advertising and newsstand sales as a result of market conditions in the magazine publishing industry and the current global economic environment.^{xxii} Fortunately, the company recently announced their plans to spin-off Time Inc. at the end of the calendar year, in an effort to enhance their growth prospects. Magazine publishing is a dying industry and this should prove to be a good move for the company.

Traditional formats of entertainment distribution, such as CDs, DVDs, and Blu-ray discs, are reaching saturation. Changing consumer tastes have led to an increasing popularity in online streaming and viewing on mobile platforms. Declines in sales revenue over the last couple of years have forced Time Warner to seek alternative ways of monetizing their content.^{xxiii}

Another industry which has the potential to adversely affect Time Warner is video games. 2012 marked the end of the gaming industry as primarily a business of physical goods. Discs are making way to digital distribution. According to the NPD group, the digital industry is growing at a steady rate, but nowhere near fast enough to replace the revenues lost from physical sales. In 2012, the industry experienced a 9% drop in total video game revenue. Physical sales are declining faster than digital sales are increasing. Even though several leading digital distribution platforms do not publicly disclose their sales data, the NPD Group financial data is reliable enough to recognize a trend that is altering the gaming industry significantly.^{xxiv} If Time Warner wants to capitalize on their video game content, they must find a way to adapt to the changing gaming world.



Opportunities

Time Warner has excelled in providing premium content to millions of customers across the nation. However, the United States is just one country. There are substantial opportunities overseas that Time Warner has yet to capitalize on; non-U.S. markets account for only 30% of Time Warner sales revenue (see “Financials Analysis” section). This number should increase if the company wants to take full advantage of the untapped profits abroad. With the domestic box office approaching saturation, US film studios like Warner Bros. have opportunities for growth in the international markets of Asia Pacific, Latin America, and Eastern Europe. Despite sizable competition from local production outlets, American movies and television shows hold a substantial market share in a number of international territories.^{xxv} The acceptance of English as an international language gives US film studios a much larger potential revenue base than foreign counterparts. Warner Bros. should seize this opportunity to offer their movies on a more global scale, especially in areas where American films garner widespread appeal.

The same opportunities for global expansion apply within the realm of television. The US accounts for less than 15% of the world’s more than 800 million TV households. Time Warner can take advantage of the increased demand for US television shows. Recently, there has also been a growth in the number of broadcast, cable, and satellite outlets in foreign countries.^{xxvi} Time Warner should use this improved technology overseas to their benefit by offering their network subsidiaries in more places.

It might be in their best interest to begin by increasing the scope of cable networks in countries in which it is already has a presence. Time Warner has long-established subsidiaries throughout Europe; there are thirteen country-specific Warner Bros. Entertainment companies in Europe alone (at the end of 2010).^{xxvii} It is far easier to offer more of their networks in a country that they have already done business with. This would be more cost-effective and thus, profitable.



Lastly, there has been a noticeable rise in social media popularity. People of all ages now flock to networks like Facebook, Twitter, and YouTube to get the latest updates on their friends and to watch the most recent video phenomena. Entertainment content providers are beginning to recognize this trend and starting to develop partnerships with the major social networking sites to offer their content online. For example, in March 2011, Warner Bros. studio launched a pilot test to make certain titles (i.e. The Dark Knight) available for rental on Facebook for up to two days. This is only a start, however. Time Warner still has plenty of opportunities to take advantage of this new online networking craze.

Threats

A business that operates on such a large, diversified scale can be subject to many threats. Currently, Time Warner's major competitive threats lie in the online streaming industry. Companies like Netflix, Hulu, Vudu, and Amazon.com offer streaming services at a relatively smaller monthly subscription fee than those offered by cable providers like DirecTV and Charter Communications. If these companies are able to provide high-quality content (not Time Warner-produced content), then they pose a significant threat to Time Warner. Time Warner's revenue could take a major hit. Fortunately, if Time Warner continues to develop business relationships with these streaming companies by licensing out their branded content, then Time Warner will profit from their success.

Piracy is another potential threat to Time Warner profits. With the trend toward online digital distribution, hackers can play a prominent role. Although the quality of pirated content is very poor, it costs virtually nothing. When performing a quick "cost-benefit analysis", more and more consumers will choose to go the free, pirated route. Up to now, Time Warner has not had a problem with this issue, but who knows what will happen in the future with our continually-changing consumer habits and tastes?

Password sharing on HBO Go is another issue that Time Warner might have to deal with soon. Instead of paying for a cable subscription and full access to HBO and its



content, people will use their friends' accounts and access the shows and movies for free. When asked about these phenomena in sharing and privacy, HBO officials did not seem too concerned. They believe that this will only lead to more exposure for the company's brand, which will benefit the company in the long run.



Strategic Recommendations

Continue Global Expansion in TV & Film

One of Time Warner's chief goals in the 2012 Annual Report is to continue expanding their brand internationally. They have done an especially good job with their major network revenue producer, HBO. The network's 114 million subscribers worldwide give it a larger customer base than any competitor. Home Box Office Inc. TV services are distributed in more than 60 countries across Latin America, Asia, and Europe.

As a long-term recommendation, Time Warner should begin acquiring or partnering with cable networks in emerging markets such as Latin America, where they have only one subsidiary to cover the entire continent. As globalization quickly elevates the incomes of citizens in emerging markets, their demand for entertainment will quickly follow; it could be incredibly lucrative for Time Warner to have established networks in place when that happens. Time Warner seems to be taking steps in the right direction internationally. Currently, Time Warner is said to be the front-runner in a bid to buy Turkey's ATV television network for approximately \$1 billion.^{xxviii} Networks overseas like this one are becoming premier attractions for U.S. media companies. They are continually looking to foreign investments to spark sales growth as it becomes more difficult to add new subscribers in a domestic market that is approaching maturation.

However, as mentioned earlier, it would be in Time Warner's best interest to increase their network scope and visibility in emerging markets (i.e. Latin America). Over time, as developing countries in these areas grow economically, the world of entertainment will become more relevant. If Time Warner wants to capitalize on this eventual reality, they need to have established networks in these areas when the time comes.

Until recently, China, one of the fastest-growing markets, posed a myriad of restrictions for US filmed entertainment companies trying to enter the country. These restrictions were apparent in the areas of content censorship, protectionism, cultural



differences, among others. However, according to an S&P Report, it appears that the Chinese film market is becoming more welcoming toward foreign studios. Time Warner should take advantage of China's newfound openness and find a way to get their products into theaters in China. Entering partnership agreements with Chinese studios would be a good way to do this. While box office revenue growth in the US has been experiencing a downward trend, China's revenues from the box office have been growing at a fast pace. Box office revenues in the country are expected to top \$5 billion by 2015, an almost \$3 billion increase over the recorded revenue in 2011 of \$2.1 billion.^{xxix} Warner Bros. Entertainment should form a partnership with a major Chinese studio to capitalize on the recent growth trends in the Chinese film market.

Selling or Shutting Down Video Game Sector of Warner Bros. Interactive Entertainment

The video gaming landscape is changing as digital distribution sales are up while physical sales are down. Warner Bros. Interactive Entertainment is in charge of publishing, developing, licensing, and distributing video games for both internal and third party titles. Given the shifting nature of video game distribution, the entertainment group will need to find a way to alter its business model to continue generating profits in the gaming industry. Bridges does not believe that the potential benefits are worth the time and effort that the sector needs to put in to succeed. For this reason, our firm suggests that Time Warner follow in the footsteps of one of their major competitors, The Walt Disney Co., by shutting down their video game production unit at Warner Bros. Interactive Entertainment.^{xxx} Instead, they should focus on the less risky, cost-effective path of licensing its characters and storylines to other gaming developers. Making games for consoles (i.e. Xbox 360, Playstation 3, Wii U) is quite expensive. Rather than continue with that arduous production process, Time Warner should shift to a licensing business model. Licensing their entertainment content out to prominent app and videogame developers is in the best interest of their company. They will still generate considerable revenue from licensing out their popular content (i.e. Harry Potter, Batman, Superman, etc.) without having to use their valuable resources in the production process.



Continue Building on the Concept of “TV Everywhere”

Time Warner introduced the TV Everywhere initiative in 2009 and it has been a rousing success ever since. The idea is simple: Provide customers “new ways to access TV networks, on demand on new platforms, on all devices, when and where they want.” The main issue is that customers only have access to content IF they currently have a cable subscription through some cable, satellite, or phone company. Critics believed initially that this would not be a viable business model option. However, with advancements in technology and the abundance of mobile devices entering the market daily, TV Everywhere is more enticing. The more convenient it is to access your favorite shows, the more likely it is that customers will continue to subscribe to their existing TV services. Time Warner has thrived with this universal option. Services like HBO Go and NCAA’s March Madness app on smart devices, appeal to a wide variety of customers. These have been big hits in the app world. My recommendation is that Time Warner continues to build off of the advancements in TV Everywhere that they have already made. This could include offering mobile apps for specific networks. For example, they could offer an interactive app for fans of the Turner Classic Movie network. Any way that Time Warner can appeal to the greatest volume of customers will benefit them.

Sign Deals with Social Networking Sites to Stream Content

Time Warner would benefit from signing content deals with popular social networks like Facebook, Google+, and Twitter. HBO stresses the importance of exclusivity with their “TV Everywhere” marketing campaign. Because of this, Time Warner should refrain from offering any HBO-related content on these sites. However, I do believe that Time Warner would benefit greatly by partnering with these social networks to offer Warner Bros. films to those that frequent these sites for a small rental fee per film. Not only would this generate substantial revenue through licensing, but it would also provide the public with increased exposure to Time Warner’s plethora of high-quality products.



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