TIME WARNER INC.
Form 10-Q
May 01, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

for the quarterly period ended March 31, 2013 or

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

for the transition period from ____________________ to ____________________

Commission file number 001-15062

TIME WARNER INC.

(Exact name of Registrant as specified in its charter)

Delaware	**13-4099534**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

One Time Warner Center

New York, NY 10019-8016

(Address of Principal Executive Offices) (Zip Code)

(212) 484-8000

(Registrant s Telephone Number, Including Area Code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer ¨
	Smaller reporting company ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	

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

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

Description of Class	Shares Outstanding as of April 23, 2013
Common Stock $.01 par value	932,174,040

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INTRODUCTION

Management s discussion and analysis of results of operations and financial condition (MD&A) is a supplement to the accompanying consolidated financial statements and provides additional information on Time Warner Inc. s (Time Warner or the Company) businesses, current developments, financial condition, cash flows and results of operations. MD&A is organized as follows:

Overview. This section provides a general description of Time Warner s business segments, as well as recent developments the Company believes are important in understanding the results of operations and financial condition or in understanding anticipated future trends.

Results of operations. This section provides an analysis of the Company s results of operations for the three months ended March 31, 2013. This analysis is presented on both a consolidated and a business segment basis. In addition, a brief description of transactions and other items that affect the comparability of the results being analyzed is included.

Financial condition and liquidity. This section provides an analysis of the Company s financial condition as of March 31, 2013 and cash flows for the three months ended March 31, 2013.

Caution concerning forward-looking statements. This section provides a description of the use of forward-looking information appearing in this report, including in MD&A and the consolidated financial statements.

OVERVIEW

Time Warner is a leading media and entertainment company whose major businesses encompass an array of the most respected and successful media brands. Among the Company s brands are TNT, TBS, CNN, HBO, Cinemax, Warner Bros., New Line Cinema, *People*, *Sports Illustrated* and *Time*. During the three months ended March 31, 2013, the Company generated Revenues of $6.939 billion (down 1% from $6.979 billion in 2012), Operating Income of $1.410 billion (up 13% from $1.247 billion in 2012), Net Income attributable to Time Warner shareholders of $720 million (up 23% from $583 million in 2012) and Cash provided by operations of $729 million (up 75% from $416 million in 2012). On March 6, 2013, Time Warner announced that its Board of Directors has authorized management to proceed with plans for the complete legal and structural separation of the Company s Publishing segment from Time Warner (the Time Separation).

Time Warner Businesses

Time Warner classifies its operations into three reportable segments: Networks, Film and TV Entertainment and Publishing. For additional information regarding Time Warner s segments, refer to Note 12, Segment Information, to the accompanying consolidated financial statements.

Networks. Time Warner s Networks segment consists of Turner Broadcasting System, Inc. (Turner) and Home Box Office, Inc. (Home Box Office). During the three months ended March 31, 2013, the Networks segment recorded Revenues of $3.695 billion (53% of the Company s total Revenues) and $1.268 billion in Operating Income.

Turner operates domestic and international television networks, including such recognized brands as TNT, TBS, truTV, CNN and Cartoon Network, which are among the leaders in advertising-supported television networks. The Turner networks generate revenues principally from providing programming to affiliates that have contracted to receive and distribute this programming to subscribers and from the sale of advertising. In addition, Turner provides online and mobile offerings for on-demand viewing of programs on its networks and live streaming of CNN, HLN and Cartoon Network to authenticated subscribers. Turner also manages and operates various digital media properties that primarily consist of brand-aligned websites, including *CNN.com*, *NBA.com* and related properties, *NCAA.com* and *cartoonnetwork.com* that generate revenues principally from the sale of advertising and sponsorships.

Home Box Office operates the HBO and Cinemax domestic multi-channel premium pay television services, with the HBO service ranking as the most widely distributed domestic multi-channel premium pay television service. HBO- and Cinemax-branded premium pay and basic tier television services are distributed in more than 60 countries in Latin

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America, Asia and Europe. HBO and Cinemax domestic premium pay television subscribers have access to the authenticated HBO GO and MAX GO streaming services, respectively, on various online and mobile platforms, and an authenticated HBO GO streaming service is available to international premium pay television subscribers of HBO in a number of countries. Home Box Office generates revenues principally from providing programming to affiliates that have contracted to receive and distribute such programming to their customers who subscribe to the HBO or Cinemax services. Additional sources of revenues for Home Box Office are the sale of its original programming, including *Game of Thrones, Boardwalk Empire* and *True Blood,* via DVDs, Blu-ray Discs and electronic sell-through (EST) and the licensing of original programming primarily to international television networks.

The Company expects that over the next several years subscription revenues generated by basic cable networks and premium pay television services in the industry will grow as a result of domestic affiliate rate increases driven by investments in high quality programming.

Film and TV Entertainment. Time Warner s Film and TV Entertainment segment consists of businesses managed by Warner Bros. Entertainment Inc. (Warner Bros.) that principally produce and distribute feature films, television shows and videogames. During the three months ended March 31, 2013, the Film and TV Entertainment segment recorded Revenues of $2.681 billion (36% of the Company s total Revenues) and $263 million in Operating Income.

The Film and TV Entertainment segment s theatrical product revenues are generated principally through rental fees from theatrical exhibition of feature films, including the following recently released films: *Argo*, *The Dark Knight Rises* and *The Hobbit: An Unexpected Journey*, and subsequently through licensing fees received from the distribution of films on television networks and premium pay television services. Television product revenues are generated principally from the licensing of programs to television networks and premium pay television services. The segment also generates revenues for both its theatrical and television product through home video distribution on DVD and Blu-ray Discs and in various digital formats (e.g., EST and video-on-demand) as well as through licensing of feature films and television programming to broadband subscription video on demand (SVOD) services. In addition, the segment generates revenues through the development and distribution of videogames.

Warner Bros. continues to be an industry leader in the television content business. For the 2012-2013 season, Warner Bros. produced more than 50 series, with at least two series for each of the five broadcast networks (including *2 Broke Girls*, *Arrow*, *The Bachelor*, *The Big Bang Theory*, *The Following*, *The Middle*, *Mike & Molly*, *Person of Interest*, *Revolution*, *Two and a Half Men*, *Vampire Diaries* and *The Voice*), several original series for cable television networks (including *Dallas*, *Longmire, Major Crimes*, *Pretty Little Liars* and *Rizzoli & Isles*) and several series for first-run syndication (including *The Ellen DeGeneres Show*, *Extra* and *TMZ*). Internationally, Warner Bros. operates a group of local television production companies in the U.K. and the Netherlands that focus on developing non-scripted programs and formats that can be sold internationally and adapted for sale in the U.S. Warner Bros. also creates locally produced versions of programs owned by the studio as well as original local television programming.

The distribution and sale of physical discs (both standard definition DVDs and high definition Blu-ray Discs) is one of the largest contributors to the segment s revenues and profits. However, in recent years, home video revenues have declined as a result of several factors, including consumers shifting to subscription rental services and discount rental kiosks, which generate significantly less revenue per transaction for the Company than physical disc sales; the general economic downturn in the U.S. and many regions around the world; increasing competition for consumer discretionary time and spending; and piracy. The electronic delivery of film and television content is growing and becoming more important to the Film and TV Entertainment segment, which has helped to offset some, but not all, of the decline in sales of physical discs. However, in 2012 and through the first quarter of 2013, the decline in consumer spending on physical discs moderated compared to prior years, while the growth in consumer spending on electronic delivery increased.

Publishing. Time Warner s Publishing segment consists principally of Time Inc. s magazine publishing and related websites as well as book publishing and marketing businesses. During the three months ended March 31, 2013, the Publishing segment recorded Revenues of $737 million (11% of the Company s total Revenues) and $9 million in Operating Loss.

As of March 31, 2013, Time Inc. published 21 magazines in print in the U.S., including *People*, *Sports Illustrated*, *InStyle* and *Time*, and over 70 magazines outside the U.S. All of Time Inc. s U.S. magazines are available as tablet editions on multiple digital devices and platforms. The Publishing segment generates revenues primarily from the sale of advertising, magazine subscriptions and newsstand sales. The Publishing segment is experiencing declines in its print advertising and newsstand sales as a result of market conditions in the magazine publishing industry as well as the current economic environment. The Publishing segment is pursuing a

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number of initiatives to help mitigate these declines, including conducting additional brand marketing; developing innovative ways to sell branded magazine content outside of traditional channels, including websites, tablets and other mobile devices; developing integrated advertising solutions that will provide greater data insight and value to advertisers; developing a new cross-platform content management system; and improving its operating efficiency through management of its cost structure.

Recent Developments

Time Inc. Separation from Time Warner

On March 6, 2013, Time Warner announced that its Board of Directors has authorized management to proceed with plans for the Time Separation. The Time Separation is currently expected to be effected as a spin-off of Time Inc., a wholly owned subsidiary. In the Time Separation, Time Warner will distribute all of its Time Inc. common stock to Time Warner stockholders, and Time Inc. will become an independent publicly-traded company. The Time Separation is contingent on the satisfaction of a number of conditions, including the effectiveness of a registration statement on Form 10 that Time Inc. will file with the Securities and Exchange Commission. Time Warner expects to complete the Time Separation by the end of the year.

Central European Media Enterprises Ltd.

On April 29, 2013, Central European Media Enterprises Ltd. (CME) commenced a public offering of shares of its Class A common stock to raise up to approximately $200 million. In connection with this offering, Time Warner and CME entered into an arrangement in which the Company committed to exercise its preemptive rights to purchase its pro rata share of the number of shares of Class A Common Stock sold in the offering at the price paid by the public in the offering, which would maintain the Company s 49.9% economic interest. Additionally, subject to the consummation of the offering, the approval of CME s shareholders and certain other conditions, Time Warner agreed to purchase $200 million of CME s newly-issued non-voting convertible redeemable preferred stock. The Company may also purchase from CME additional preferred stock under certain circumstances in connection with the offering of the common stock. CME intends to seek shareholder approval of the issuance and sale of the preferred stock at its 2013 annual general meeting of shareholders. CME has agreed to use at least $300 million of the net proceeds from these transactions to retire outstanding indebtedness.

RESULTS OF OPERATIONS

Recent Accounting Guidance

See Note 1, Description of Business and Basis of Presentation, to the accompanying consolidated financial statements for a discussion of recent accounting guidance adopted.

Transactions and Other Items Affecting Comparability

As more fully described herein and in the related notes to the accompanying consolidated financial statements, the comparability of Time Warner s results has been affected by transactions and certain other items in each period as follows (millions):

	Three Months Ended March 31,	
	2013	2012
Asset impairments	$ (27)	$ (52)
Gain (loss) on operating assets, net	8	(42)
Other	(11)	(10)
Impact on Operating Income	(30)	(104)
Investment losses, net	(17)	(9)
Amounts related to the separation of Time Warner Cable Inc.	5	(1)
Amounts related to the disposition of Warner Music Group	(1)	-
Pretax impact	(43)	(114)
Income tax impact of above items	(22)	36
Impact of items on net income attributable to Time Warner Inc. shareholders	$ (65)	$ (78)

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In addition to the items affecting comparability described above, the Company incurred Restructuring and severance costs of $80 million and $26 million for the three months ended March 31, 2013 and 2012, respectively. For further discussion of Restructuring and severance costs, see Consolidated Results and Business Segment Results.

Asset Impairments

During the three months ended March 31, 2013, the Company recognized asset impairments of $18 million at the Networks segment consisting of $12 million related to certain Turner international intangible assets and $6 million related to programming assets resulting from Turner s decision in the first quarter of 2013 to shut down certain of its entertainment networks in Spain, $2 million at the Film and TV Entertainment segment related to miscellaneous assets and $7 million at the Corporate segment related to internally developed software.

During the three months ended March 31, 2012, the Company recognized $52 million of charges at the Networks segment primarily related to certain receivables, programming assets and long-lived assets in connection with Turner s decision in the first quarter 2012 to shut down its general entertainment network, Imagine, in India.

Gain (Loss) on Operating Assets, Net

For the three months ended March 31, 2013, the Company recognized an $8 million gain at the Corporate segment on the disposal of certain corporate assets.

For the three months ended March 31, 2012, the Company recognized a $42 million loss at the Publishing segment in connection with the sale in the first quarter of 2012 of Time Inc. s school fundraising business, QSP (the QSP Business).

Other

Other reflects external costs related to mergers, acquisitions or dispositions of $11 million and $8 million for the three months ended March 31, 2013 and 2012, respectively. External costs related to mergers, acquisitions or dispositions for the three months ended March 31, 2013 consisted of $9 million related to the separation of Time Inc. from Time Warner and $2 million related to the shutdown of certain of Turner s entertainment networks in Spain and for the three months ended March 31, 2012 included $6 million related to the shutdown of Imagine.

Other also reflects legal and other professional fees related to the defense of securities litigation matters for former employees totaling $0 and $2 million for the three months ended March 31, 2013 and 2012, respectively.

External costs related to mergers, acquisitions or dispositions and amounts related to securities litigation and government investigations are included in Selling, general and administrative expenses in the accompanying Consolidated Statement of Operations.

Investment Losses, Net

For the three months ended March 31, 2013, the Company recognized $17 million of net investment losses, consisting of an $88 million impairment of the Company s investment in CME, a $65 million gain on the sale of the Company s investment in a theater venture in Japan, which included a $10 million gain related to a foreign currency contract, and $6 million of net miscellaneous investment gains.

For the three months ended March 31, 2012, the Company recognized $9 million of miscellaneous investment losses.

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Amounts Related to the Separation of Time Warner Cable Inc.

For the three months ended March 31, 2013 and 2012, the Company recognized other income of $5 million and other loss of $1 million, respectively, related to the expiration, exercise and net change in the estimated fair value of Time Warner equity awards held by Time Warner Cable Inc. (TWC) employees, which has been reflected in Other loss, net in the accompanying Consolidated Statement of Operations.

Amounts Related to the Disposition of Warner Music Group

For the three months ended March 31, 2013, the Company recognized $1 million of losses associated with the disposition of Warner Music Group (WMG) in 2004.

Income Tax Impact

The income tax impact reflects the estimated tax provision or tax benefit associated with each item affecting comparability. The estimated tax provision or tax benefit can vary based on certain factors, including the taxability or deductibility of the items and foreign tax on certain items.

Consolidated Results

The following discussion provides an analysis of the Company s results of operations and should be read in conjunction with the accompanying Consolidated Statement of Operations.

Revenues. The components of Revenues are as follows (millions):

	Three Months Ended March 31,		
	2013	2012	% Change
Subscription	$ 2,560	$ 2,471	4%
Advertising	1,464	1,472	(1%)
Content	2,730	2,861	(5%)
Other	185	175	6%
Total revenues	$ 6,939	$ 6,979	(1%)

The increase in Subscription revenues mainly reflected an increase at the Networks segment, partially offset by a decrease at the Publishing segment. Advertising revenues declined slightly as a decrease at the Networks segment was partially offset by an increase at the Publishing segment. The decline in Content revenues was due primarily to a decrease at the Film and TV Entertainment segment.

Each of the revenue categories is discussed in greater detail by segment in Business Segment Results.

Costs of Revenues. For the three months ended March 31, 2013, Costs of revenues decreased to $3.750 billion from $3.976 billion for the three months ended March 31, 2012, respectively, reflecting declines at all of the segments. The segment variations are discussed in Business Segment Results.

Selling, General and Administrative Expenses. For the three months ended March 31, 2013, Selling, general and administrative expenses increased 3% to $1.620 billion from $1.575 billion for the three months ended March 31, 2012 primarily related to increases at the Film and TV Entertainment, Corporate and Networks segments, partly offset by a decline at the Publishing segment. The segment variations are discussed in Business Segment Results.

Included in Costs of revenues and Selling, general and administrative expenses is depreciation expense of $157 million and $154 million for the three months ended March 31, 2013 and 2012, respectively.

Amortization Expense. Amortization expense was $60 million and $61 million for the three months ended March 31, 2013 and 2012, respectively.

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Restructuring and Severance Costs. For the three months ended March 31, 2013 and 2012, the Company incurred Restructuring and severance costs primarily related to employee terminations and other exit activities. Restructuring and severance costs by segment are as follows (millions):

	Three Months Ended March 31,	
	2013	**2012**
Networks	$ 22	$ 14
Film and TV Entertainment	3	6
Publishing	53	6
Corporate	2	-
Total restructuring and severance costs	$ 80	$ 26

Operating Income. Operating Income increased to $1.410 billion for the three months ended March 31, 2013 from $1.247 billion for the three months ended March 31, 2012. Excluding the items noted under Transactions and Other Items Affecting Comparability totaling $30 million and $104 million of expense for the three months ended March 31, 2013 and 2012, respectively, Operating Income increased $89 million, reflecting increases at the Networks and Film and TV Entertainment segments, partly offset by decreases at the Publishing and Corporate segments. The segment variations are discussed under Business Segment Results.

Interest Expense, Net. For the three months ended March 31, 2013, Interest expense, net decreased to $290 million from $320 million for the three months ended March 31, 2012, mainly reflecting a reduction of $15 million related to legal contingencies as well as lower average interest rates.

Other Loss, Net. Other loss, net detail is shown in the table below (millions):

	Three Months Ended March 31,	
	2013	**2012**
Investment losses, net	$ (17)	$ (9)
Amounts related to the separation of TWC	5	(1)
Amounts related to the disposition of WMG	(1)	-
Loss from equity method investees	(6)	(8)
Other	1	18

Other loss, net	$	(18)	$	-

Investment losses, net and amounts related to the separation of TWC and the disposition of WMG are discussed under Transactions and Other Items Affecting Comparability. For the three months ended March 31, 2012, other included an adjustment to reduce a liability for deferred compensation.

Income Tax Provision. Income tax provision increased to $382 million for the three months ended March 31, 2013 from $346 million for the three months ended March 31, 2012. The Company s effective tax rate was 35% for the three months ended March 31, 2013 compared to 37% for three months ended March 31, 2012. The decrease in the effective tax rate was primarily due to a decrease in tax reserves, partially offset by the nondeductible impairment of the Company s investment in CME.

Net Income. Net income increased to $720 million for the three months ended March 31, 2013 from $581 million for the three months ended March 31, 2012. Excluding the items noted under Transactions and Other Items Affecting Comparability totaling $65 million and $78 million of expense for the three months ended March 31, 2013 and 2012, respectively, Net income increased $126 million, primarily reflecting higher Operating Income.

Net Loss Attributable to Noncontrolling Interests. For the three months ended March 31, 2013 and 2012, Net loss attributable to noncontrolling interests was $0 and $2 million, respectively.

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Net Income Attributable to Time Warner Inc. Shareholders. Net income attributable to Time Warner Inc. shareholders was $720 million and $583 million for the three months ended March 31, 2013 and 2012, respectively. Basic and Diluted net income per common share attributable to Time Warner Inc. common shareholders were $0.77 and $0.75, respectively, for the three months ended March 31, 2013 and were $0.60 and $0.59, respectively, for the three months ended March 31, 2012.

Business Segment Results

Networks. Revenues and Operating Income of the Networks segment for the three months ended March 31, 2013 and 2012 are as follows (millions):

	Three Months Ended March 31,		
	2013	**2012**	**% Change**
Revenues:			
Subscription	$ 2,269	$ 2,154	5%
Advertising	1,084	1,096	(1%)
Content	295	306	(4%)
Other	47	46	2%
Total revenues	3,695	3,602	3%
Costs of revenues[(a)]	(1,716)	(1,739)	(1%)
Selling, general and administrative[(a)]	(586)	(567)	3%
Asset impairments	(18)	(52)	(65%)
Restructuring and severance costs	(22)	(14)	57%
Depreciation	(78)	(79)	(1%)
Amortization	(7)	(8)	(13%)
Operating Income	$ 1,268	$ 1,143	11%

[(a)] Costs of revenues and Selling, general and administrative expenses exclude depreciation.

The increase in Subscription revenues for the three months ended March 31, 2013 was primarily due to an increase in domestic subscription revenues of $93 million driven largely by higher domestic rates and an increase in international subscription revenues of $22 million, mainly reflecting subscriber growth.

Advertising revenues for the three months ended March 31, 2013 declined slightly as domestic growth of $12 million was more than offset by lower international advertising revenues of $24 million, primarily reflecting lower international news demand and the absence of revenues from Turner s general entertainment network, Imagine, in India and its TNT television operations in Turkey due to their shutdowns in the first half of 2012 (the Imagine and TNT Turkey Shutdowns). The domestic growth was mainly due to higher pricing, partially offset by fewer National Collegiate Athletic Association Division I Men s Basketball Championship tournament (the NCAA Tournament) games in the first quarter of 2013 as compared to the prior year quarter due to timing of the tournament and lower domestic news demand.

The decrease in Content revenues for the three months ended March 31, 2013 was due primarily to the absence of revenues from Turner s TNT television operations in Turkey due to its shutdown.

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The components of Costs of revenues for the Networks segment are as follows (millions):

	Three Months Ended March 31,		
	2013	**2012**	**% Change**
Programming costs:			