

# Time Warner (NYSE:TWX)

## 1 CONTENT IS KING

**Outperform – PT: \$111.16**

We view Time Warner (NYSE:TWX) as a well-positioned media juggernaut whose recent sell-off presents investors with the opportunity to gain de-risked exposure to content upside while also receiving a 'call-option' on the AT&T (NYSE:T) – TWX arb spread.

### Key Points:

#### Content Is King

There can be no question that the media industry, particularly cable and programming, is facing a coming of age crisis. Technological advancements are ushering in a reformation of the traditional pay-TV business model that has left many in Hollywood scratching their heads as to what to do. Our view is simply that while distribution channels change, the need for premium content does not.

#### Addressing the Elephant in the Room

##### *Well let's get on with it then...*

The key question currently facing TWX investors is whether or not AT&T's acquisition of Time Warner will close despite the pending litigation with the Department of Justice (DOJ). We believe that the deal will ultimately close as the DOJ case rests on thin footing presenting an attractive merger arbitrage opportunity. As of the latest close, the deal spread is trading at a cool 15.4% representing a 43.4% annualized return should the deal close by Q1 of 2018.

#### Triple Play Network Premium

While we have currently taken a stake in the merger, we believe that TWX offers an attractive proposition regardless of the deal closing. The company's Turner network contains a solid portfolio of sought after content in sports (TNT, NBA), entertainment (TBS), and news (CNN) and will continue to command double digit affiliate fee growth through 2018.

#### Value at a Reasonable Price

Based on our sum-of-the-parts valuation, we believe that TWX's FY2018E EV/EBITDA multiple should trade closer to ~10.7x vs. current ~9.7x.

## BLACKVAULT INVESTMENT TEAM

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### Outperform

Time Warner (NYSE:TWX)

#### Media & Entertainment

<b>Price Target</b>	<b>\$111.16</b>
Share Price as of Latest Close	\$90.01
<i>Implied Upside</i>	23.90%
Mkt. Cap, curr.	\$70,081
52-Week Range	\$85.88-\$103.90

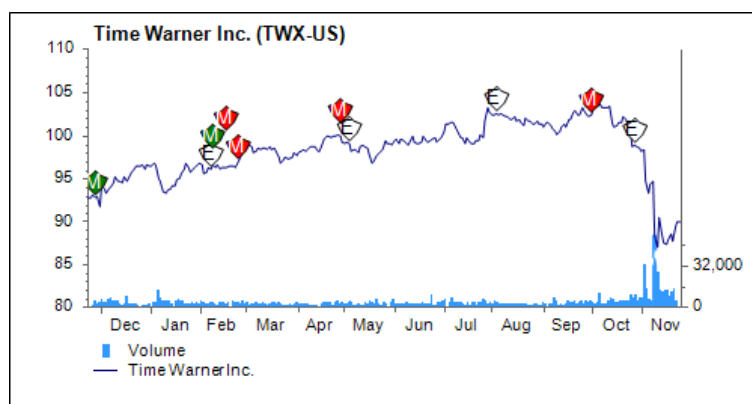
FY Ending	2015A	2016A	2017E	2018E
<b>Revenue(\$)</b>	<b>28,118</b>	<b>29,318</b>	<b>30,841</b>	<b>33,286</b>
<b>EBITDA(\$)</b>	<b>6,718</b>	<b>7,355</b>	<b>8,792</b>	<b>9,352</b>
<b>EPS(\$)</b>	<b>4.24</b>	<b>4.97</b>	<b>6.49</b>	<b>6.58</b>
<b>Consensus EPS(\$)*</b>	<b>4.75</b>	<b>5.86</b>	<b>6.24</b>	<b>6.52</b>

Unless otherwise stated, all metrics are based on BlackVault Investment Research model.

Revenue and EBITDA figures are in millions.

EPS figures are adjusted and do not include one-time items and depreciation and amortization.

(\*) = Consensus EPS based on FactSet

**Exhibit 1: Time Warner Stock Price**

Source: FactSet

**Base Case – PT: \$111.16**

Our base case scenario highlights the opportunity to gain exposure to TWX and receive a 'call-option' on the T-TWX arb spread. We forecast ~\$10.0B in EBITDA for FY2018 driven by mid-high single digit affiliate fee growth for the Turner segment, growth in HBO NOW subscribers, and in-line studio performance. We applied an 8.5x multiple for Turner, 12.5x to HBO, and 13.5x to WB resulting in an EV of ~\$106.4 B and 10.7x multiple. This multiple represents a 22.4% premium to our peer group and highlights our conviction in Time Warner being a prime time player in content.

**Upside Case – PT: \$141.55**

In our upside case, we dive deeper into our content story and illustrate two key points: HBO Now outperformance and TWX as an acquisition candidate. We believe that HBO Now could become a legitimate player in OTT growing to a quarter of the subscribers of Netflix by 2021. Given the market's negligence of HBO Now's large potential growth runway, surprise performance by HBO Now on the subscriber front could drive multiple expansion of the segment to 15.0x from 10.0x. Furthermore, in a fervent M&A environment, we believe Turner and WB could receive a 35% premium to peer set. Taken together, TWX could be valued at 12.6x representing a 5.3% premium to precedent multiples.

**Downside Case – PT: \$83.55**

Our downside case reflects lower affiliate pricing in both Turner and HBO, low-single digit ad market growth, and <\$4.5B box office ex-theatre run-rate. We also illustrate the impact of market pessimism on forward multiples by applying no premium to Turner and HBO and cutting WB premium in half. Overall, the downside case results in a blended EV/EBITDA multiple of 8.6x, which is 1.0% shy of our peer group.

## Investment Thesis

**Triple Play Content Play**

The TWX network presents a best in class content mix. Turner has leveraged its diverse programming package in sports (NBA, MLB, and NCAA), news (CNN), and entertainment (TBS, Adult Swim, and Cartoon Network) to grow affiliate fees at a 9.6% CAGR since 2014 in a competitive media environment. We also love the growth play that HBO represents, particularly in HBO NOW, and the consistent outperformance in the WB segment (#1 rated studio YTD).

**Attractive Strategic Asset**

The media industry is consolidating and strategic content assets, like TWX, will continue to be sought after. T's acquisition attempt and forward buzz from Disney (NYSE: DIS) and Fox (NYSE: FOXA) illustrates the fact that the industry is desperately searching for ways to compete in an environment that is increasingly moving to digital. With that being said, competition will not only be on the premise of digital vs. Pay-TV, but content vs. no content. Big tech is stepping up content investment and Telecoms and Hollywood will have to build a distribution network that serves consumers with valuable programming asset. Simply put, companies like TWX deserve an

**Catalysts**

- Closing of T-TWX deal
- Increase in media M&A activity
- Ratings growth in CNN and NBA
- Higher HBO NOW subscriber growth
- Studio slate success

**Risks**

- Step-up in cord-cuts
- Affiliate fee growth pressure
- T-TWX deal falls apart; DOJ scrutiny
- Weakness in advertising market

## Business Description

### Company Description

Time Warner, Inc. engages in the provision of cable network, filmed entertainment, and publishing services. It operates through the following segments: Turner, Home Box Office, and Warner Bros. The Turner segment consists of cable networks and digital media properties. The Home Box Office segment comprises of premium pay television and over-the-top (OTT) services domestically; and premium pay, basic tier television and OTT services internationally. The Warner Bros. segment produces and distributes television shows, feature films, and videogames. The company was founded on January 10, 1990 and is headquartered in New York, NY.

### Management

#### **Jeffrey L. Bewkes: Chairman & Chief Executive Officer**

Mr. Bewkes served as President and Chief Executive Officer of the Company from January 2008 through December 2008; President and Chief Operating Officer of the Company from January 2006 through December 2007; Chairman, Entertainment & Networks Group, of the Company from July 2002 through December 2005; Chairman and Chief Executive Officer of the Home Box Office division of the Company from 1995 to July 2002; and President and Chief Operating Officer of the Home Box Office division of the Company from 1991 to 1995. • Public Company Directorships: Mr. Bewkes served as a director of Time Inc. for many years, resigning on June 6, 2014 in connection with the Time Separation. Time Inc. became a public company on May 9, 2014. • Key Skills and Qualifications: Mr. Bewkes has more than 30 years of experience at the Company and its subsidiaries, including 24 years of leadership and senior management experience serving as the Chief Executive Officer or in other senior executive positions at the Company and Home Box Office. His unique in-depth knowledge of the Company's history and businesses, including his deep understanding of the Company's operations and strategy and the media and entertainment industry, provide him a strong foundation for leading the Board, as Chairman, and facilitating effective communication between management and the Board.

#### **Howard M. Averill, MBA, CPA: Chief Financial Officer**

Mr. Howard M. Averill is Chief Financial Officer & Executive Vice President at Time Warner, Inc. Mr. Averill was previously employed as Chief Financial Officer & Executive Vice President by Time, Inc., a Principal by Arthur Andersen LLP, Chief Financial Officer by MSNBC.com, Chief Financial Officer by NBC News, Chief Financial Officer & Executive Vice President by NBCUniversal Media LLC, Chief Financial Officer & Executive Vice President by NBCUniversal Television Group, a Principal by PepsiCo, Inc., and a Principal by The Sheraton Corp. He received his undergraduate degree from the University of Vermont and an MBA from the University of North Carolina at Chapel Hill.

#### **Paul T. Cappuccio: General Counsel**

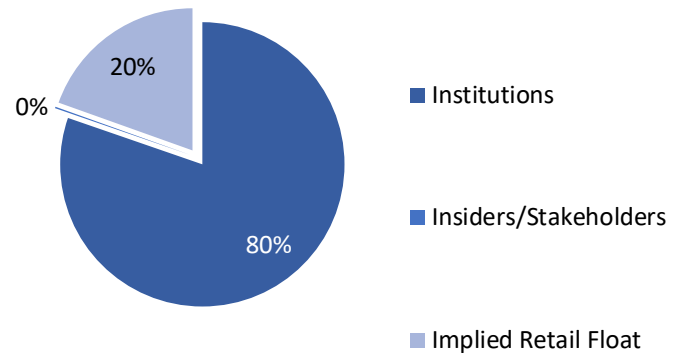
Mr. Paul T. Cappuccio is Executive Vice President & General Counsel at Time Warner, Inc. He is on the Board of Directors at Chipotle Mexican Grill, Inc., Central European Media Enterprises Ltd. and Betaworks Studio LLC. Mr. Cappuccio was previously employed as Senior Vice President & General Counsel by America Online, Inc., Senior Vice President & General Counsel by Historic AOL LLC, Partner by Kirkland & Ellis LLP, and Associate Deputy Attorney General by US Department of Justice. He received his undergraduate degree from Georgetown University and a graduate degree from Harvard Law School.

## Shareholder Ownership

### Exhibit 2: Ownership Summary

#### Ownership Statistics

Shares O/S (m)	778.59
Float (%)	99.8%
Institutions	80.2%
Insiders/Stakeholders	0.2%
Implied Retail Float	19.5%



### Exhibit 3: Top-10 Institutional Holders

Rank	Holder Name	ORD Position	Combined Positions	% O/S	Combined Market Value
1	The Vanguard Group, Inc.	49,446,176	49,446,175	6.351%	4,450,650,302
2	BlackRock Fund Advisors	33,071,860	33,071,861	4.248%	2,976,798,119
3	SSgA Funds Management, Inc.	30,965,240	30,965,239	3.977%	2,787,181,252
4	Dodge & Cox	23,692,768	23,692,769	3.043%	2,132,586,048
5	Massachusetts Financial Services Co.	19,615,868	19,615,869	2.519%	1,765,624,279
6	Vanguard Total Stock Market Index Fund	17,639,514	17,639,514	2.266%	1,587,732,655
7	Dodge & Cox Stock Fund	14,484,477	14,484,477	1.860%	1,303,747,775
8	Vanguard 500 Index Fund	12,900,703	12,900,703	1.657%	1,161,192,277
9	Franklin Mutual Advisers LLC	12,119,906	12,119,906	1.557%	1,090,912,739
10	Capital Research & Management Co. (Global Investors)	10,124,516	10,124,516	1.300%	911,307,685

## Investment Thesis

### Summary Position

#### Have Your Cake and Eat it Too

TWX offers investors the chance to play for content and M&A upside in a classic example of a 'have your cake and eat it too' scenario. We love the performance of Turner Networks. Turner has leveraged its diverse programming package in sports (NBA, MLB, and NCAA), news (CNN), and entertainment (TBS, Adult Swim, and Cartoon Network) to grow affiliate fees at a 9.6% CAGR since 2014 in a competitive media environment. We also love the growth play that HBO represents, particularly in HBO NOW, and the consistent outperformance in the WB segment (#1 rated studio in 2017). We also love the fact that exposure to TWX provides M&A upside in a media environment that is undergoing an unprecedented wave of consolidation. Not only do investors get the chance to take out a 'call-option' on the closing of T-TWX, but they also have the chance to gain upside on TWX's strategic fit in other M&A scenarios (horizontal content mergers).

**CONTENT IS KING; AFFILIATE FEE GROWTH AND M&A UPSIDE**

### The Polished Gem: Turner Networks



37% of 2016 Affiliate Fees



19% of 2016 Affiliate Fees



14% of 2016 Affiliate Fees

#### Affiliate Fee growth off-setting Sub-Losses

The Turner segment is the key strategic asset within the TWX portfolio. Turner represents ~50% of TWX's EBITDA and earns the groups highest EBITDA margins (~40%). The network carries a diverse library of content, but monetization is driven by the big 3: TNT, TBS, and CNN (the 3 drive 75-80% of affiliate fees). Management has confirmed that affiliate fee growth should continue to be supported by 10.0% contract escalators through 2018. While visibility on the next cycle is low, we would point out that Turner's sports and MVPD contracts are longer-term agreements. Furthermore, Turner's exposure to well-performing sports categories further bolsters our confidence in mid-high single digit affiliate fee growth through 2021. We do acknowledge the challenge in Pay-TV subscribers with the overall market contracting by 1.2%/year and are taking the conservative view by assuming a gradual decline in affiliate fee price escalation after 2018.

#### Turner Sports Contracts



**Contract:**  
Through 2025



**Contract:**  
Through 2032

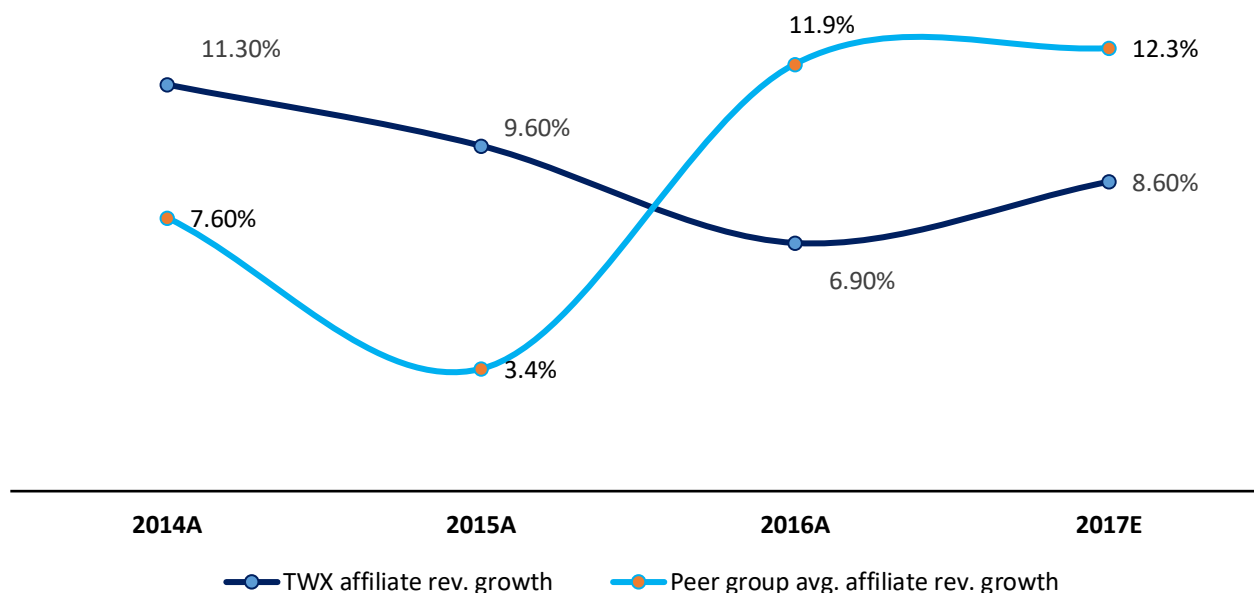


**Contract:**  
Through 2021



**Contract:**  
Through 2019

#### Exhibit 4: Affiliate Fee Growth

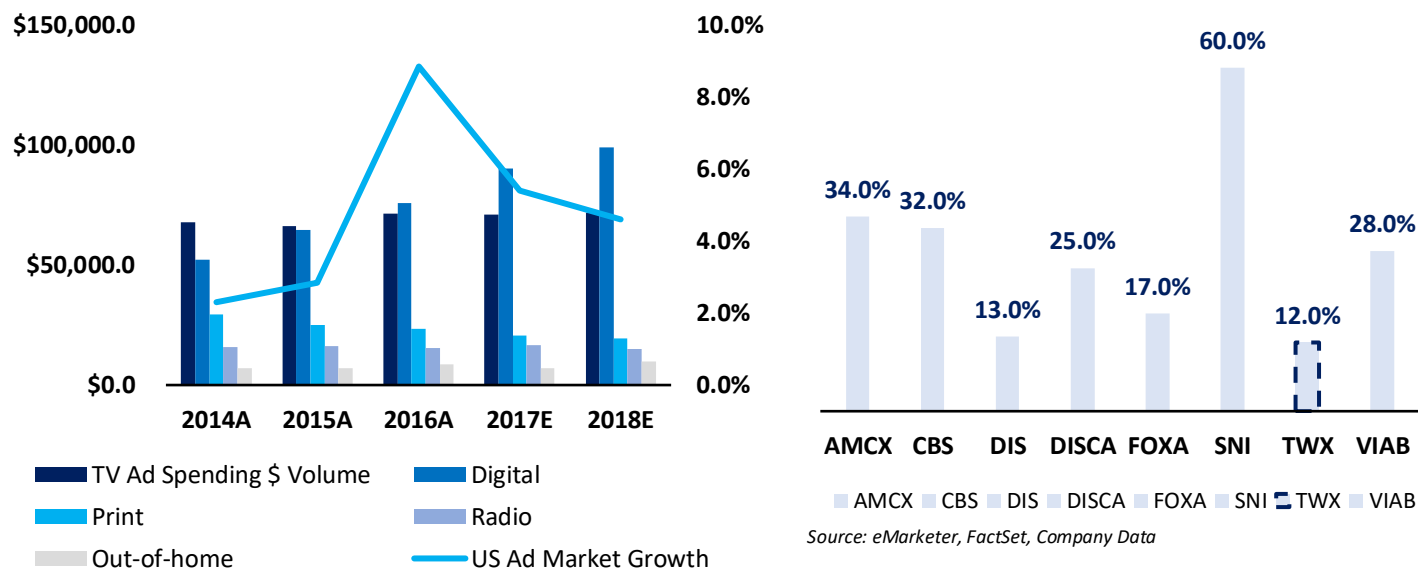


Source: Company Data, BlackVault Estimates

#### Advertising Air Time Down

The advertising market is increasingly shifting to digital with expectations for total digital spend to be ~\$120B by 2021, nearly 50% of all advertising revenue. Currently, digital's market share stands at ~37% and we believe the next 13% will be much harder to win due to skepticism around digital advertising efficacy. We are already seeing signs of scrutiny from major fast moving consumer goods (FMCG) companies (25% of total ad spend) who have recently taken up zero-based budgeting (ZBB) as a way to preserve margins and hit shareholder return targets in light of weak sales growth. We believe that this approach, combined with the recent news surrounding 'click farms', Ads.txt, and 'fake news' should throw cold water on the digital advertising hype and provide room for an upside surprise for TV ad spend.

#### Exhibit 5: Advertising Market Overview



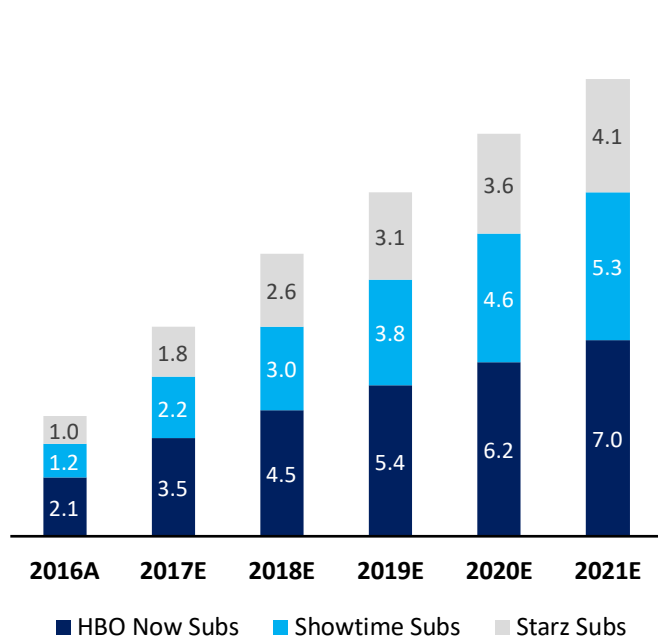
Source: eMarketer, FactSet, Company Data

# Emerging Growth Engine

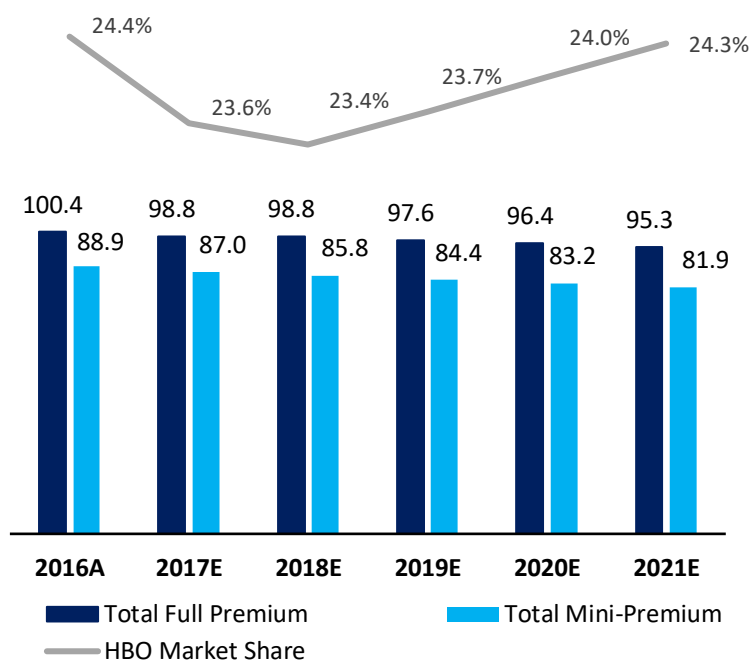
## Content and Growth

Home Box Office (HBO) is a top-notch asset with a strong content mix with a large growth runway in over-the-top (OTT) television. While Pay-TV is suffering, content is not. Consumers still want premium content and OTT streamers that cannot deliver will not succeed. HBO NOW is in a particular position to leverage its content to win over OTT subscribers given its focused library of award winning series including *Game of Thrones*, *he Wire*, *Sopranos*, among others at a reasonable \$15 price point. To illustrate HBO's content strength, the network reigned supreme in the 2017 Emmy's winning 29 awards followed by Netflix and NBC, which one 20 and 15 respectively.

## Exhibit 6: HBO Subscribers



Source: Company data, BlackVault Estimates



Source: SNL Kagan

## Tale of Two Subscribers

HBO is a tale of two subscribers: the linear Pay-TV and OTT. The linear TV model is undergoing a rapid shift from MVPD to SVOD and we believe that the market is right to discount the potential in HBO's linear offering. The domestic linear TV market is expected to decline by 1.6% annually driven by an escalation in cord cutters. To put this into context, cord cutters are expected to make up ~32% of US occupied households by 2021. While investors have reasons to be skeptical, we would point out that HBO will gain market share in premium linear TV with increasing subscriber declines and will nearly quintuple its subscriber count in its OTT service. We have been very impressed by the prospects of HBO Now and believe that the market is underappreciating its ability to become a big player in OTT. To be sure, we took a deeper look at consumer surveys and reviews on HBO Now's competitive positioning. One of the first things that stood out to us was the fact that consumers loved HBO's content, sometimes even more so than Netflix, but not the interface. Here are a few notable reviews we saw:

*"Great content, horrible app function" – HBO content is awesome. The app needs major work though."*






*"HBO can do better" – "Needs a favorites tab to allow you to see what your currently watching."*

*"Worst app ever" – "Being a HBO fan, I was shocked by how awful this app is. Especially the login authentication process."*

Source: iTunes store reviews



## Exhibit 7: Consumer Survey on OTT

					
Easy to watch on a TV	72%	54%	63%	55%	45%
Easy to use on all devices	60%	49%	57%	48%	44%
Interesting original content	60%	36%	41%	45%	35%
Reliable service	58%	48%	52%	44%	36%
Too expensive	5%	11%	10%	18%	23%

Source: Forrester Research

## Pricing and Content

We are a little bit confused by HBO's pricing strategy given its interface problems. Analogous to high equity valuations, higher product pricing sets high expectations and can even cut some consumers out of the mix. According to Forrester, 18% of consumers surveyed said that HBO's (\$14.99) price point was too expensive compared with only 5% for Netflix's (\$7.99) price point. HBO's content offering is strong enough to get 2.1MM subscribers paying double the price of Netflix's despite interface issues. Building upon this, we believe that with improvements to in-app functionality and a quarter price cut, HBO Now can reach 14% of Netflix's domestic subscribers and nearly double its revenue in 2018.

## Exhibit 8: HBO Now Revenue can double with a quarter price cut

2018 HBO Now Revenue Growth based on \$14.99 Price Point		2018 HBO Now Revenue Growth based on \$10.99 Price Point	
2018 avg. HBO Now Domestic Subs (MM)	4.0	Current avg. Netflix Domestic Subs	51.9
% of Netflix Subs	7.7%	Projected share of Netflix Subs	14%
<b>x - HBO Now Subscriber Fee</b>	<b>\$14.99</b>	2018 avg. HBO Now Domestic Subs	7.3
x 12 months	12		
= Gross HBO Now Subscriber Revenue	\$719.5	Current HBO Now Subscriber Fee	\$14.99
x Network Split	100%	x 1 + Price Decrease	-27%
= Net HBO Now Subscriber Revenue	\$719.5	= 2018 HBO Now Subscriber Fee	\$10.99
y/y growth	45.5%	x 2018 avg. HBO Now Domestic Subs	7.3
		x 12 months	12
		= Gross HBO Now Subscriber Revenue	\$958.2
		x Network Split	100%
		= Net HBO Now Subscriber Revenue	\$958.2
		y/y growth	93.7%

Source: BlackVault Estimates



### Exhibit 9: HBO Now Content Offerings as Compared to Peers

	NETFLIX	prime now	hulu	HBO NOW	SHOWTIME
Quantity of Titles	1,197	1,981	1,699	118	46
% Original Content	20%	3%	2%	97%	100%

Source: Gadget Hacks

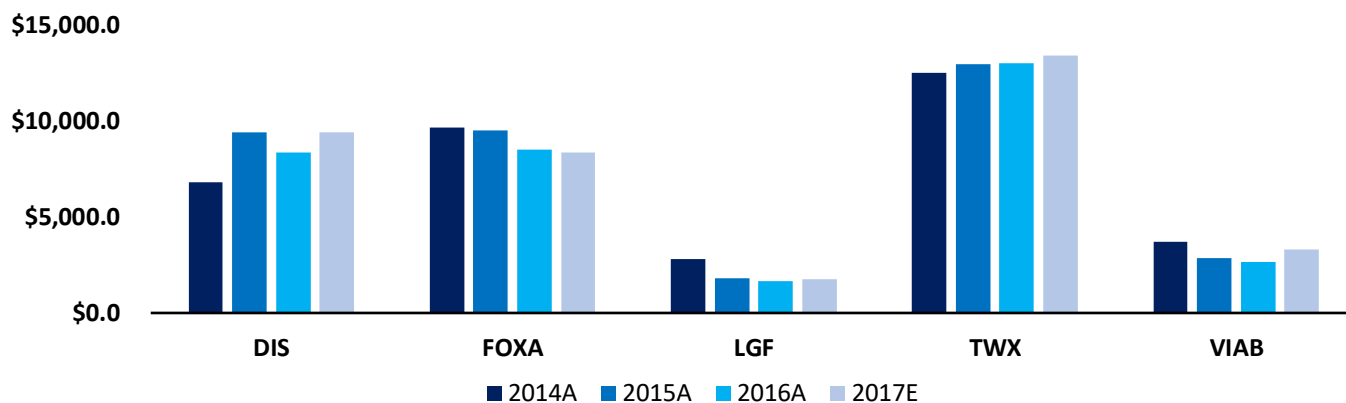
Another critical point to remember is that unlike other OTT providers, HBO Now has the ability to leverage TWX's production infrastructure and title library to create content synergies (Original content is 97% of titles). This is important because HBO Now can achieve a margin advantage from its 100% network split vs. 80% for OTT peers. To sum it up, HBO is the underappreciated upside story for TWX that could be shaped into a formidable player in OTT.

## Warner Bros: Consistent Studio

### Cyclical, but Steady

Warner Bros is a top-of-the-line studio with proven, franchise assets. This is important because studios with deep franchise libraries are better positioned to deliver predictable results and often receive premium multiples to their peer group (a la Disney). Since 2013, Warner Bros has grown revenue at a steady pace at 13-15% margins. We estimate that the studio's ex-theatre and video game run-rates are ~\$4.1B and ~\$1.8B respectively. Through our forecast period, we examined the 2018 slate and applied our estimated run-rates to get to our revenue targets. We further estimated that the TV segment will grow by ~3.5%. Though this is low, we prefer to err on the side of conservatism when it comes to the movie production since unproven title success is hard to predict with any accuracy. Ultimately, we believe that the studio will receive mid-single digit revenue growth on 15-16% margins driven by a combination of proven title releases (DC, Harry Potter) and blockbuster winners.

### Exhibit 10: Revenues by Studio



Source: Company Data, FactSet, BlackVault Estimates

### Exhibit 11: Studio Multiples

Sector	Average	Range	DIS	FOXA	LGF	TWX	VIAB
Film Studios	10.8x	7.5x - 16.0x	16.0x	8.0x	13.5x	9.0x	7.5x
Prem/Disc.			48.1%	(25.9%)	25.0%	(16.7%)	(30.6%)

Source: FactSet, BlackVault Estimates

## Upcoming Slate Looks Good

We examined the studio's upcoming movie slate and believe that there is some upside surprises built into 2018, particularly in Q4, which features a sequel to Fantastic Beasts and Jungle Book. Moreover, 2019's slate is packed with favorites from DC, which should bode well for N24M studio revenue.

## Exhibit 12: 2018 Box-Office Estimates

FY18 Box Office Roll-Up					
(\$ in Millions)	1Q18E	2Q18E	3Q18E	4Q18E	2018E
Domestic	517.5	211.9	217.3	1,007.6	1,954.3
International	414.8	239.5	369.2	1,041.2	2,064.7
<b>Total Box Office</b>	<b>932.3</b>	<b>451.4</b>	<b>586.5</b>	<b>2,048.8</b>	<b>4,018.9</b>

Source: IMDb Pro, BlackVault Estimates

## Exhibit 13: Box Office Release Schedule

FY18 Release Schedule (\$ in Millions)					
1Q18E					
Title	Release	Dom B.O.	Int'l B.O.	Budget	MOVIEmeter rank
Paddington 2	1/12/2018	\$75.0	\$76.8	\$55.0	110.0
12 Strong	1/19/2018	\$50.0	\$50.0	\$35.0	639.0
the 15:17 to Paris	2/9/2018	\$15.0	\$5.0	NA	4,287.0
Game Night	3/2/2018	\$75.0	\$75.0	\$75.0	118.0
Tomb Raider	3/16/2018	\$250.0	\$130.0	\$100.0	445.0
Ready Player One	3/30/2018	\$52.5	\$78.0	\$100.0	342.0
<b>Quarter Total</b>		<b>\$517.5</b>	<b>\$414.8</b>	<b>\$365.0</b>	<b>990.2</b>
2Q18E					
Title	Release	Dom B.O.	Int'l B.O.	Budget	MOVIEmeter rank
Rampage	4/20/2018	\$65.0	\$75.0	\$150.0	28.0
Life of the Party	5/11/2018	NA	NA	NA	3,812.0
A Star is Born	5/18/2018	\$98.2	\$111.5	\$30.0	1,347.0
Ocean's 8	6/8/2018	\$48.8	\$53.0	\$45.0	253.0
Tag	6/29/2018	NA	NA	NA	5,920.0
<b>Quarter Total</b>		<b>\$211.9</b>	<b>\$239.5</b>	<b>\$225.0</b>	<b>2,272.0</b>
3Q18E					
Title	Release	Dom B.O.	Int'l B.O.	Budget	MOVIEmeter rank
The Nun	7/13/2018	\$39.8	\$40.8	\$1.0	790.0
Teen Titans Go! The Movies	7/27/2018	\$50.2	\$50.2	\$45.0	9,308.0
Untitled DC Film	7/27/2018	NA	NA	NA	NA
The Meg	8/10/2018	\$37.4	\$41.8	\$150.0	809.0
Crazy Rich Asians	8/17/2018	NA	NA	NA	4,387.0
Untitled New Line Horror Film	9/7/2018	NA	NA	NA	NA
Smallfoot	9/28/2018	\$90.0	\$236.4	\$45.0	10,236.0
<b>Quarter Total</b>		<b>\$217.3</b>	<b>\$369.2</b>	<b>\$241.0</b>	<b>5,106.0</b>
4Q18E					
Title	Release	Dom B.O.	Int'l B.O.	Budget	MOVIEmeter rank
Jungle Book: Origins	10/19/2018	\$364.0	\$386.8	\$150.0	1,562.0
Fantastic Beasts: The Crimes of Grindelwald	11/16/2018	\$292.5	\$325.6	\$150.0	68.0
Aquaman	12/21/2018	\$351.1	\$328.8	\$160.0	97.0
Untitled WB Event Film #2	12/25/2018	NA	NA	NA	NA
<b>Quarter Total</b>		<b>\$1,007.6</b>	<b>\$1,041.2</b>	<b>\$460.0</b>	<b>575.7</b>

Source: IMDb Pro, BlackVault Estimates

\*Green highlights suggest positive trend/ red highlights suggest negative trend

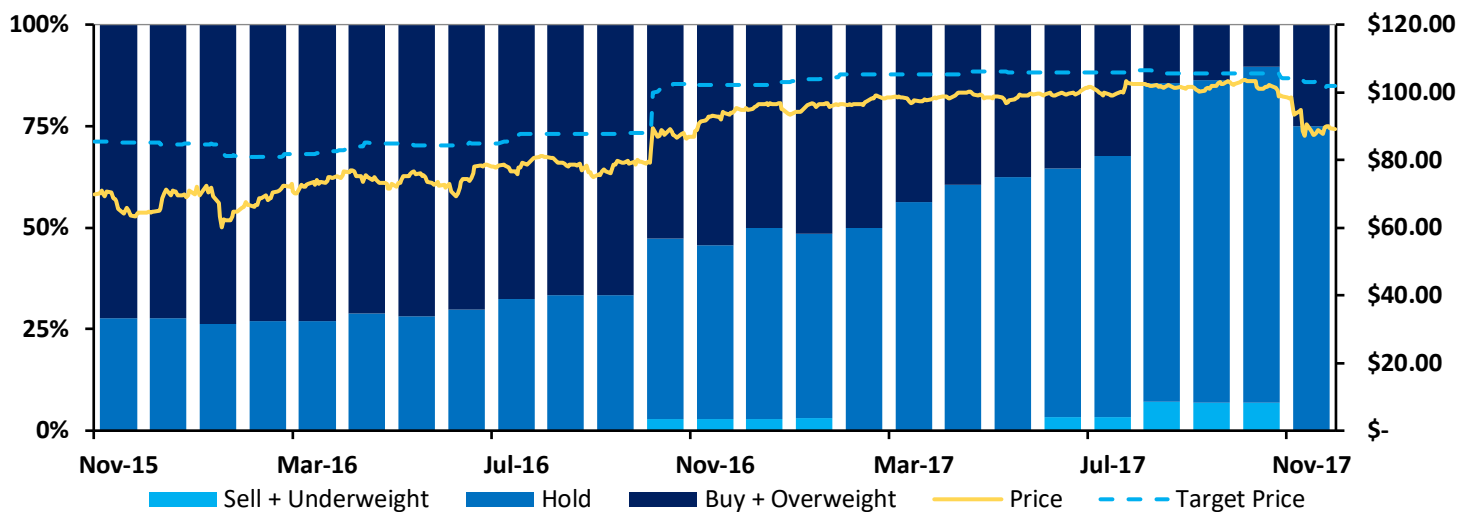
## Valuation

### Word on the Street

#### Waiting on T

The market has become increasingly cautious on TWX as a result of cord cutting fears and anxiety over the closing of T-TWX. 75% of analysts rate TWX a hold, which is a substantial drop from last year where ~50%+ rated the stock a buy. More recently, Street target price sits ~2% below the realized closing price for the T-TWX deal suggesting that there is confidence in the deal closing despite the DOJ suit.

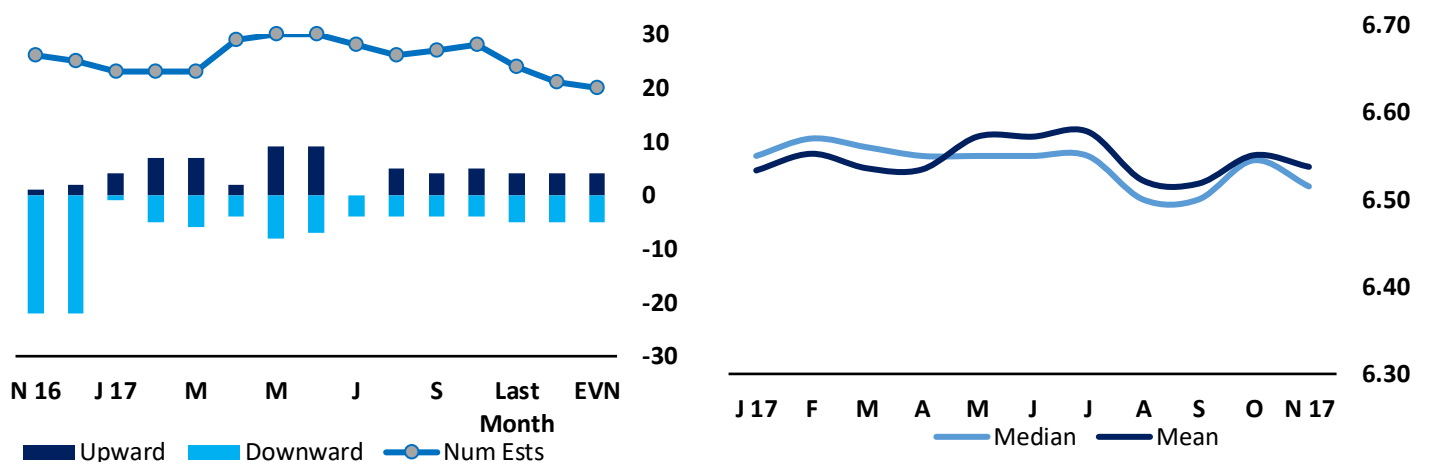
Exhibit 14: Analyst Ratings History



Source: FactSet

Estimates have also trended higher for 2017 while holding flat for 2018. Again, we think that there's substantial overhang on forward estimates due to the lack of visibility on the T-TWX deal and believe that once there is a confirmed outcome, they will begin to reflect a more normalized view of the underlying business.

Exhibit 15: Analyst Estimates



Source: FactSet

## BlackVault Estimates

Our estimates are above consensus by a low-mid single digit margin reflecting our bullish positioning on TWX's content, particularly HBO. We think that HBO can deliver compelling revenue growth at better margins given the fact that its broadband only (BBO) penetration is below 15% and content is 97% TWX owned. Furthermore, consensus appears light on the ad front. 2018 is shaping up to be a strong year for advertising due to the upcoming mid-term election cycle and World Cup. We are also keen to mention that advertisers could give TV another shot in light of recent pessimism around digital ad spending efficacy stabilizing ad revenue in the 2018 cycle.

### Exhibit 16: BlackVault Estimates vs. Street

	<u>BV Estimates</u>		<u>Consensus</u>		<u>% difference</u>	
	FY17	FY18	FY17	FY18	FY17	FY18
Revenue	30,842	32,696	31,031	32,457	(0.6%)	0.7%
EBITDA	8,792	9,126	8,133	8,610	8.1%	6.0%
EPS	\$6.49	\$6.66	\$6.24	\$6.54	4.0%	1.8%

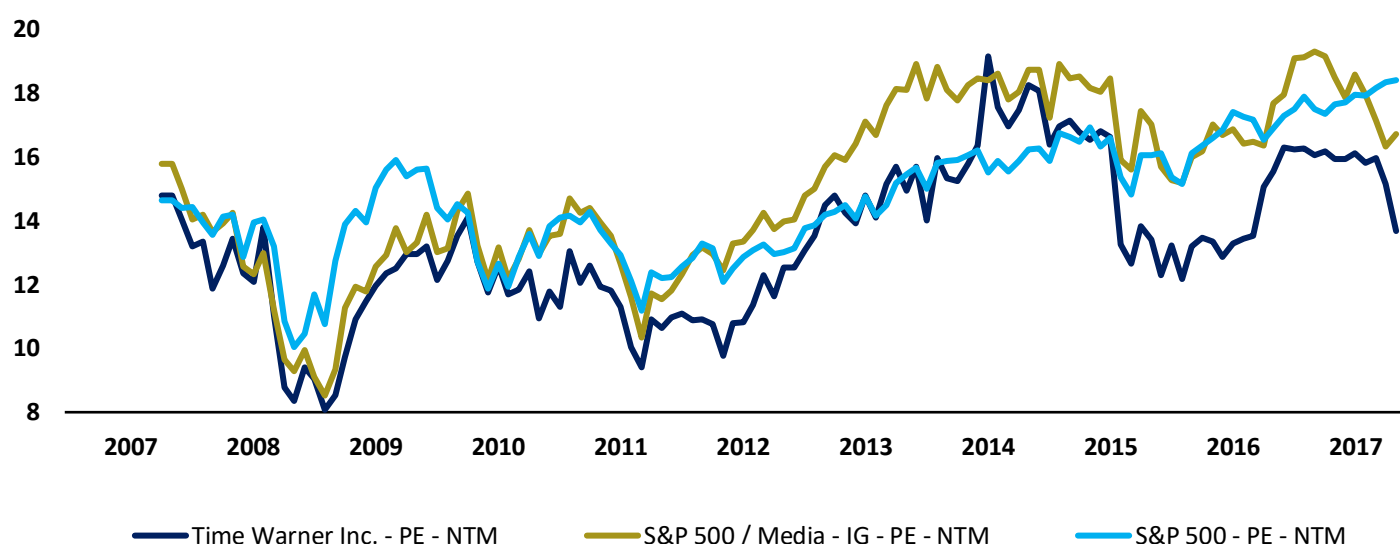
Source: FactSet. BlackVault Estimates

## Valuation

### Deal Newsflow Pushes TWX Below Peer Group

TWX is undervalued on a NTM PE basis compared to its peer group. We find this to be ironic given the fact that double digit affiliate fee growth will continue through 2018, HBO Now is making serious moves in OTT, and WB remains the most consistent studio in Hollywood.

### Exhibit 17: TWX NTM PE vs. Peers/S&P 500



Source: FactSet

## Exhibit 18: Media Coverage Comps

		EV/EBITDA				P/E			
		LTM	2016	2017	2018	LTM	2016	2017	2018
CBS	CBS-US	12.5x	11.1x	13.0x	8.9x	78.1x	16.3x	22.6x	11.2x
Walt Disney	DIS-US	11.4x	10.3x	11.0x	10.2x	18.1x	16.2x	17.3x	15.7x
Time Warner	TWX-US	10.5x	10.0x	12.0x	9.7x	17.2x	14.0x	19.5x	13.8x
21st Century Fox	FOXA-US	10.1x	10.7x	9.6x	8.1x	19.0x	19.0x	17.8x	13.6x
Comcast	CMCSA-US	8.4x	7.9x	8.7x	7.7x	17.5x	17.4x	19.3x	16.3x
Viacom	VIAB-US	7.4x	9.1x	7.5x	6.3x	5.7x	10.6x	5.9x	7.0x
Scripps Networks Interactive	SNI-US	5.6x	5.3x	5.4x	8.7x	17.3x	11.8x	13.8x	14.9x
Lionsgate	LGF.A-US	5.0x	4.7x	5.6x	13.2x	32.3x	110.6x	295.1x	36.9x
Discovery	DISCA-US	4.9x	6.2x	5.9x	5.2x	9.3x	16.9x	14.0x	8.0x
Min		4.9x	4.7x	5.4x	5.2x	5.7x	10.6x	5.9x	7.0x
Max		12.5x	11.1x	13.0x	13.2x	78.1x	110.6x	295.1x	36.9x
Mean		8.4x	8.4x	8.7x	8.7x	23.8x	25.9x	47.3x	15.3x
Median		8.4x	9.1x	8.7x	8.7x	17.5x	16.3x	17.8x	13.8x

Source: BlackVault Research

## Sum-of-the-Parts Valuation

In a media environment that is becoming increasingly more competitive and consolidated, companies that can deliver quality content through multiple distribution channels deserve a premium. Furthermore; due to the recent sell-off in TWX shares, valuations have come down too far and deserve a fresh look. We estimate that the Turner networks can achieve \$4.9B in EBITDA for FY2018 given 9.5% affiliate fee growth and strength in the 2018 ad cycle. The HBO business can generate \$2.8B in EBITDA driven by strength in HBO Now and moderating growth in linear subscriptions. Lastly, WB's 2018 film slate and videogame run-rate can earn the group ~\$2.0B in EBITDA. In light of these trends, we applied a 25% premium to TWX's segment 2018 EV/EBITDA multiples valuing the company at 10.7x 2018 EBITDA. This represents a 22.4% premium to TWX's current 2018 multiple of ~9.7x, but a 0.9% discount to its 5 yr. average. We believe this makes sense given TWX's position in content and attractiveness as an M&A candidate.

## Exhibit 19: Sum-of-the-Parts Valuation

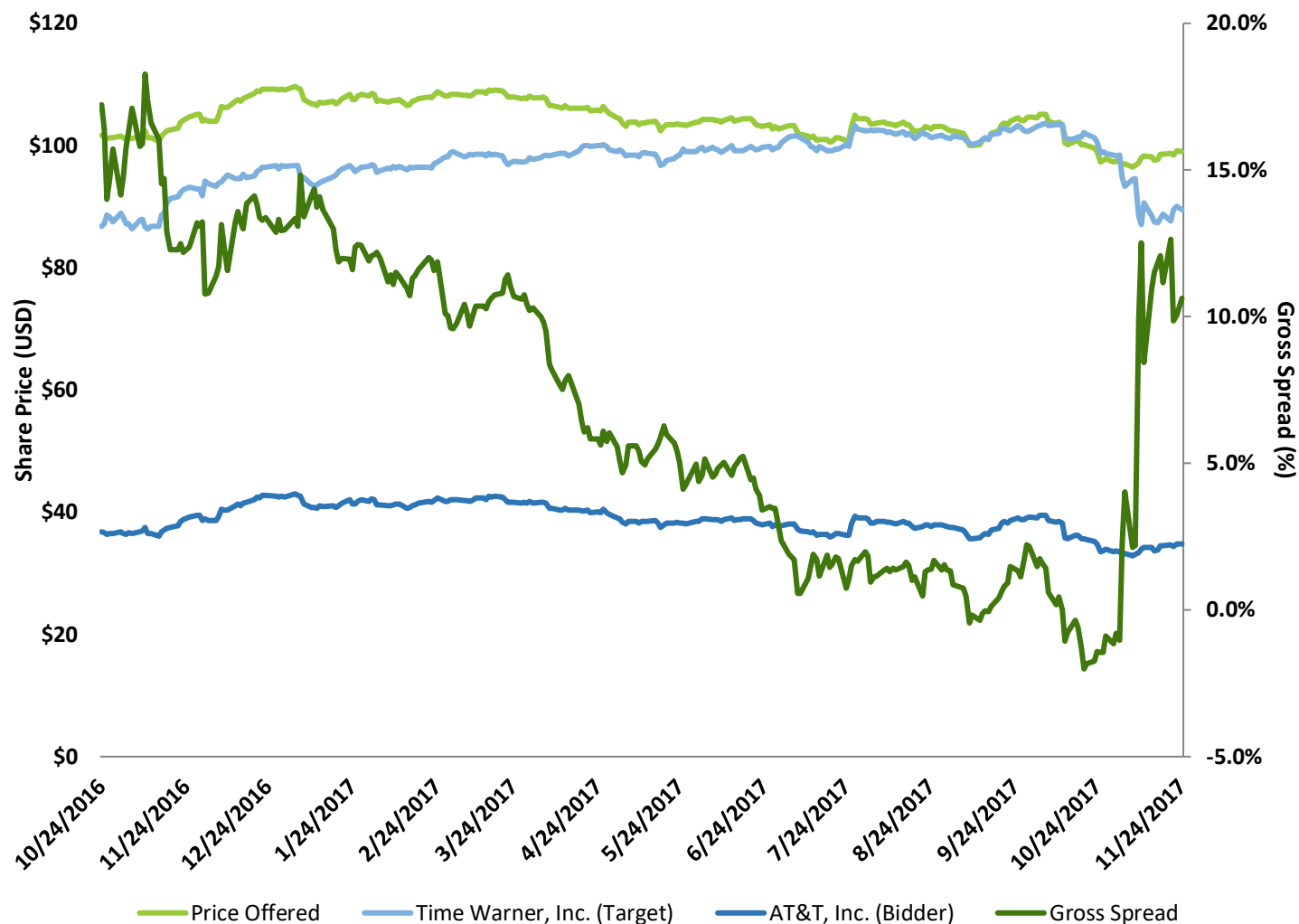
TWX	FY18 EBITDA	Comps EV/EBITDA	Premium	EV/EBITDA	Ent. Value
Turner Networks	4,905.4	6.8x	25%	8.5x	41,767.10
HBO	2,794.3	10.0x	25%	12.5x	34,907.29
Studio	2,054.7	10.8x	25%	13.5x	27,738.04
<b>Total TWX</b>	9,754.4				104,412.43
EV/EBITDA	10.7x				
<b>Enterprise Value</b>	104,412.43				
-Net Debt/pensions	(21,550.0)				
+Equity investment	3,732.0				
<b>Equity Value</b>	86,594.43				
+Diluted Shares	779,000				
Price per share	\$111.16				

Source: BlackVault Estimates

## The AT&T-Time Warner Merger Arbitrage Trade

As our investment thesis is heavily tied to the AT&T – Time Warner deal, we also propose a merger arbitrage paired trade, intending to capture the sizeable spread that has appeared over recent months.

**Exhibit 20: AT&T – Time Warner Merger Arbitrage Overview**



Source: FactSet

The above chart is a useful reference to take a historical look at the price action of both companies following the year since the deal's announcement. Note that the pair have traded in tandem since the deal's announcement, and slowly reached equilibrium before the deal came under fire by the Trump Administration and Department of Justice. The growing spread indicates the market's unease, but we believe given precedent and obvious political meddling that the deal stands a good chance. Thus, the merger arbitrage trade presents a very attractive risk-return profile.

**Exhibit 21: Exchange Ratios Outlined by the Deal:**

Vol-Weighted Avg Price of AT&T	Exchange Ratio
\$36.00	1.437
\$37.41	1.437
\$39.38	1.365
\$41.35	1.3
\$42.00	1.3

The exchange ratio dictates the amount of stock offered. AT&T is also offering \$53.75 per share in cash.

Given the terms of the deal laid down over a year ago, and AT&T's more recent equity pullback, it is useful to resolve the current pricing with a more accurate exchange ratio so as to get a more accurate picture of the spread and effective offer price for TWX shares.

This is the basis for our merger arbitrage model. According to the terms, the exchange ratio will be determined by the volume weighted average price of AT&T in the 14 trading days prior to the deal's closure, measured retroactively on the date the deal closes.

Thus, three cases can be drawn relating AT&T's price as of deal close, stock and cash offered, and effective offer price. The base case utilizes current pricing, and assumes no change between now and deal close. The bullish and bearish cases each assume a bullish or bearish trend in AT&T's stock price, modelling potential effects on the pair trade.

Additionally, the bullish case assumes the deal closes on its most recent scheduled date. The base case reflects our conservatism and accounts for some minor delays with the Department of Justice, closing after Q1 2018. Finally, the bearish case accounts for a full extra year before deal close.

**Base Case – No change in price**

TWX current price	89.50	
AT&T current price	34.81	
Amount of stock offered	1.437	
Amount of cash offered	53.75	
Effective offer price	103.77	
Spread %	14.27	
Expected close	3/31/2018	
		<b>Return</b>
AT&T price at close	34.81	0.0%
TWX price at close	103.77	15.9%
<b>Total Return</b>	<b>15.9%</b>	
<b>Annualized return</b>	<b>46.9%</b>	

**Bullish Case – AT&T recovers recent equity downtrend**

TWX current price	89.50	
AT&T current price	34.81	
Amount of stock offered	1.365	
Amount of cash offered	53.75	
Effective offer price	107.50	
Spread %	18.00	
Date of close	12/31/2017	
		<b>Return</b>
AT&T price at close	39.38	-17.9%
TWX price at close	107.50	20.1%
<b>Total Return</b>	<b>13.1%</b>	
<b>Annualized return</b>	<b>141.1%</b>	

**Bearish Case – AT&T maintains recent equity downtrend**

TWX current price	89.50	
AT&T current price	34.81	
Amount of stock offered	1.437	
Amount of cash offered	53.75	
Effective offer price	96.86	
Spread %	7.36	
Expected close	12/31/2018	
		<b>Return</b>
AT&T price at close	30.00	19.9%
TWX price at close	96.86	8.2%
<b>Total Return</b>	<b>15.9%</b>	
<b>Annualized return</b>	<b>14.6%</b>	



## Exhibit 22: Time Warner Income Statement

TWX Income Statement	Units	Historical			Projected				
		'14A	'15A	'16A	'17E	'18E	'19E	'20E	'21E
Revenues									
Turner Networks	\$MM	10,396.0	10,596.0	11,364.0	11,803.2	12,614.8	12,984.0	13,363.0	13,581.3
HBO	\$MM	5,398.0	5,615.0	5,890.0	6,601.8	7,337.1	7,827.7	8,266.1	8,650.7
Warner Bros	\$MM	12,526.0	12,992.0	13,037.0	13,443.0	13,909.1	13,807.3	14,111.3	14,424.1
Intersegment sales	\$MM	(961.0)	(1,085.0)	(973.0)	(1,006.3)	(1,164.9)	(1,191.0)	(1,229.6)	(1,261.1)
<b>Total Revenue</b>	<b>\$MM</b>	<b>27,359.0</b>	<b>28,118.0</b>	<b>29,318.0</b>	<b>30,841.6</b>	<b>32,696.0</b>	<b>33,428.0</b>	<b>34,510.7</b>	<b>35,395.0</b>
% growth	%		<b>2.8%</b>	<b>4.3%</b>	<b>5.2%</b>	<b>6.0%</b>	<b>2.2%</b>	<b>3.2%</b>	<b>2.6%</b>
COGS	\$MM	(16,716.0)	(16,838.0)	(17,070.0)	(17,752.4)	(19,006.7)	(19,403.8)	(20,075.5)	(20,660.8)
<b>Gross Profit</b>	<b>\$MM</b>	<b>10,643.0</b>	<b>11,280.0</b>	<b>12,248.0</b>	<b>13,089.3</b>	<b>13,689.4</b>	<b>14,024.2</b>	<b>14,435.2</b>	<b>14,734.2</b>
Gross margin	%	38.9%	40.1%	41.8%	42.4%	41.9%	42.0%	41.8%	41.6%
SG&A	\$MM	(4,755.0)	(4,562.0)	(4,893.0)	(4,297.8)	(4,563.3)	(4,681.3)	(4,844.4)	(4,976.4)
<b>EBITDA</b>	<b>\$M</b>	<b>5,888.0</b>	<b>6,718.0</b>	<b>7,355.0</b>	<b>8,791.5</b>	<b>9,126.1</b>	<b>9,342.9</b>	<b>9,590.9</b>	<b>9,757.8</b>
EBITDA margin	%	21.5%	23.9%	25.1%	28.5%	27.9%	27.9%	27.8%	27.6%
D&A	\$M	(733.0)	(681.0)	(669.0)	(690.7)	(764.0)	(776.3)	(799.5)	(819.0)
<b>Operating Income</b>	<b>\$M</b>	<b>5,155.0</b>	<b>6,037.0</b>	<b>6,686.0</b>	<b>8,100.8</b>	<b>8,362.1</b>	<b>8,566.6</b>	<b>8,791.4</b>	<b>8,938.9</b>
EBIT margin	%	18.8%	21.5%	22.8%	26.3%	25.6%	25.6%	25.5%	25.3%
Interest expense	\$MM	(1,353.0)	(1,382.0)	(1,388.0)	(1,225.33)	(1,225.33)	(1,225.33)	(1,225.33)	(1,225.33)
<b>Pretax Income</b>	<b>\$MM</b>	<b>3,802.0</b>	<b>4,655.0</b>	<b>5,298.0</b>	<b>6,875.5</b>	<b>7,136.7</b>	<b>7,341.3</b>	<b>7,566.0</b>	<b>7,713.5</b>
Taxes	\$MM	(637.9)	(1,135.8)	(1,361.6)	(1,816.8)	(1,947.4)	(2,003.2)	(2,064.5)	(2,104.8)
Tax rate	%	16.8%	24.40%	25.70%	26.4%	27.3%	27.3%	27.3%	27.3%
<b>Net Income</b>	<b>\$MM</b>	<b>3,164.14</b>	<b>3,519.20</b>	<b>3,936.45</b>	<b>5,058.64</b>	<b>5,189.34</b>	<b>5,338.06</b>	<b>5,501.48</b>	<b>5,608.74</b>
Diluted EPS (Adj.)	\$/ share	\$3.59	\$4.24	\$4.97	\$6.49	\$6.66	\$6.85	\$7.06	\$7.20
% growth			18.3%	17.1%	30.7%	2.6%	2.9%	3.1%	1.9%
Avg. diluted shares outstanding	# of shares	882.6	829.5	792.3	779.00	779.00	779.00	779.00	779.00

Source: BlackVault Estimates

## Exhibit 23: Turner Networks Income Statement

Turner Network Income Statement	Units	Historical			Projected				
		'14A	'15A	'16A	'17E	'18E	'19E	'20E	'21E
Revenue:									
Subscription	\$M	5,263.0	5,306.0	5,936.0	6,667.1	7,425.8	7,939.6	8,371.2	8,701.8
Advertising & Content	\$M	5,133.0	5,290.0	5,428.0	5,136.1	5,189.0	5,044.4	4,991.8	4,879.4
<b>Total Revenue</b>	<b>\$M</b>	<b>10,396.0</b>	<b>10,596.0</b>	<b>11,364.0</b>	<b>11,803.2</b>	<b>12,614.8</b>	<b>12,984.0</b>	<b>13,363.0</b>	<b>13,581.3</b>
COGS	\$M	(5,102.0)	(4,608.0)	(4,808.0)	(5,216.9)	(5,607.2)	(5,803.8)	(6,006.5)	(6,138.6)
<b>Gross Profit</b>	<b>\$M</b>	<b>5,294.0</b>	<b>5,988.0</b>	<b>6,556.0</b>	<b>6,586.3</b>	<b>7,007.6</b>	<b>7,180.3</b>	<b>7,356.4</b>	<b>7,442.6</b>
Gross margin	%	50.9%	56.5%	57.7%	55.8%	55.3%	55.3%	55.1%	54.8%
SG&A	\$M	(1,728.0)	(1,614.0)	(1,821.0)	(1,937.5)	(2,102.2)	(2,196.2)	(2,293.7)	(2,365.1)
<b>EBITDA</b>	<b>\$M</b>	<b>3,566.0</b>	<b>4,374.0</b>	<b>4,735.0</b>	<b>4,648.8</b>	<b>4,905.4</b>	<b>4,984.1</b>	<b>5,062.7</b>	<b>5,077.5</b>
EBITDA margin	%	34.3%	41.3%	41.7%	39.4%	38.9%	38.4%	37.9%	37.4%
D&A	\$M	(225.0)	(209.0)	(208.0)	(221.5)	(236.7)	(243.6)	(250.7)	(254.8)
<b>Operating Income</b>	<b>\$M</b>	<b>3,341.0</b>	<b>4,165.0</b>	<b>4,527.0</b>	<b>4,427.4</b>	<b>4,668.7</b>	<b>4,740.5</b>	<b>4,812.0</b>	<b>4,822.7</b>
EBIT margin	%	32.1%	39.3%	39.8%	37.5%	37.0%	36.3%	36.0%	35.5%

Source: BlackVault Estimates

## Exhibit 24: HBO Income Statement

HBO Income Statement	Units	Historical			Projected				
		'14A	'15A	'16A	'17E	'18E	'19E	'20E	'21E
Revenue:									
Subscription	\$M	4,578.0	4,748.0	5,003.0	5,790.8	6,424.7	6,869.7	7,260.2	7,594.5
Content & other	\$M	820.0	867.0	887.0	811.0	912.4	958.0	1,005.9	1,056.2
<b>Total Revenue</b>	<b>\$M</b>	<b>5,398.0</b>	<b>5,615.0</b>	<b>5,890.0</b>	<b>6,601.8</b>	<b>7,337.1</b>	<b>7,827.7</b>	<b>8,266.1</b>	<b>8,650.7</b>
COGS	\$M	(2,708.0)	(2,811.0)	(2,996.0)	(3,114.3)	(3,497.8)	(3,770.8)	(4,023.3)	(4,253.8)
<b>Gross Profit</b>	<b>\$M</b>	<b>2,690.0</b>	<b>2,804.0</b>	<b>2,894.0</b>	<b>3,487.6</b>	<b>3,839.3</b>	<b>4,056.9</b>	<b>4,242.8</b>	<b>4,396.9</b>
Gross margin	%	49.8%	49.9%	49.1%	52.8%	52.3%	51.8%	51.3%	50.8%
SG&A	\$M	(746.0)	(831.0)	(840.0)	(956.8)	(1,045.0)	(1,095.3)	(1,136.0)	(1,167.2)
<b>EBITDA</b>	<b>\$M</b>	<b>1,944.0</b>	<b>1,973.0</b>	<b>2,054.0</b>	<b>2,530.8</b>	<b>2,794.3</b>	<b>2,961.6</b>	<b>3,106.8</b>	<b>3,229.7</b>
EBITDA margin	%	36.0%	35.1%	34.9%	38.3%	38.1%	37.8%	37.6%	37.3%
D&A	\$M	(91.0)	(95.0)	(88.0)	(99.9)	(111.0)	(118.4)	(125.0)	(130.9)
<b>Operating Income</b>	<b>\$M</b>	<b>1,853.0</b>	<b>1,878.0</b>	<b>1,966.0</b>	<b>2,430.9</b>	<b>2,683.3</b>	<b>2,843.2</b>	<b>2,981.8</b>	<b>3,098.9</b>
EBIT margin	%	34.3%	33.4%	33.4%	36.8%	36.6%	36.3%	36.1%	35.8%

Source: BlackVault Estimates

## Exhibit 25: Warner Bro's Income Statement

Warner Bro's Income Statement	Units	Historical			Projected				
		'14A	'15A	'16A	'17E	'18E	'19E	'20E	'21E
Revenue:									
Theatre	\$M	5,839.0	5,143.0	5,612.0	5,900.0	6,120.0	5,808.6	5,895.8	5,984.2
TV	\$M	5,099.0	5,635.0	5,819.0	5,784.0	5,986.4	6,196.0	6,412.8	6,637.3
Videogames & other	\$M	1,588.0	2,214.0	1,606.0	1,759.0	1,802.7	1,802.7	1,802.7	1,802.7
<b>Total Revenue</b>	<b>\$M</b>	<b>12,526.0</b>	<b>12,992.0</b>	<b>13,037.0</b>	<b>13,443.0</b>	<b>13,909.1</b>	<b>13,807.3</b>	<b>14,111.3</b>	<b>14,424.1</b>
COGS	\$M	(8,906.0)	(9,419.0)	(9,266.0)	(9,421.2)	(9,901.7)	(9,829.3)	(10,045.7)	(10,268.4)
<b>Gross Profit</b>	<b>\$M</b>	<b>3,620.0</b>	<b>3,573.0</b>	<b>3,771.0</b>	<b>4,021.8</b>	<b>4,007.3</b>	<b>3,978.0</b>	<b>4,065.6</b>	<b>4,155.7</b>
<i>Gross margin</i>	%	28.9%	27.5%	28.9%	29.9%	28.8%	28.8%	28.8%	28.8%
SG&A	\$M	(1,832.0)	(1,787.0)	(1,769.0)	(1,909.7)	(1,952.7)	(1,938.4)	(1,981.1)	(2,025.0)
<b>EBITDA</b>	<b>\$M</b>	<b>1,788.0</b>	<b>1,786.0</b>	<b>2,002.0</b>	<b>2,112.0</b>	<b>2,054.7</b>	<b>2,039.6</b>	<b>2,084.5</b>	<b>2,130.8</b>
<i>EBITDA margin</i>	%	14.3%	13.7%	15.4%	15.7%	14.8%	14.8%	14.8%	14.8%
D&A	\$M	(390.0)	(356.0)	(347.0)	(338.5)	(383.7)	(380.9)	(389.2)	(397.9)
<b>Operating Income</b>	<b>\$M</b>	<b>1,398.0</b>	<b>1,430.0</b>	<b>1,655.0</b>	<b>1,773.5</b>	<b>1,671.0</b>	<b>1,658.8</b>	<b>1,695.3</b>	<b>1,732.9</b>
<i>EBIT margin</i>	%	11.2%	11.0%	12.7%	13.2%	12.0%	12.0%	12.0%	12.0%

Source: BlackVault Estimates

## Exhibit 26: Corporate &amp; Other Income Statement

Corporate & Other	Units	Historical			Projected				
		'14A	'15A	'16A	'17E	'18E	'19E	'20E	'21E
Intersegment sales	\$MM	(961.0)	(1,085.0)	(973.0)	(1,006.3)	(1,185.9)	(1,221.9)	(1,271.1)	(1,313.1)
<i>Intersegment sales as % of rev.</i>	%	(3.4%)	(3.7%)	(3.2%)	(3.2%)	(3.4%)	(3.4%)	(3.4%)	(3.4%)
SG&A	\$MM	(449.0)	(330.0)	(463.0)	(506.2)	(546.3)	(562.8)	(585.5)	(604.8)
<i>SG&amp;A % of rev</i>	%	1.6%	1.2%	1.6%	1.6%	1.6%	1.6%	1.6%	1.6%
D&A	\$MM	(27.0)	(21.0)	(26.0)	(30.8)	(33.3)	(34.3)	(35.7)	(36.9)
<i>D&amp;A % of rev</i>	%	0.1%	0.1%	0.1%	(0.1%)	(0.1%)	(0.1%)	(0.1%)	(0.1%)

Source: BlackVault Estimates

## Disclosures

*The information and opinions included in this report were prepared by BlackVault Investments, LP. This document was furnished by BlackVault Investments, LP and does not constitute as an offering of securities.*

*We are long TWX and short T.*