TIME WARNER INC.
Form 10-Q
April 26, 2018
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the quarterly period ended March 31, 2018 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 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 No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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 20, 2018**
Common Stock $.01 par value	782,319,431

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MANAGEMENT S DISCUSSION AND ANALYSIS

OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

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, 2018. 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, 2018 and cash flows for the three months ended March 31, 2018.

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, Adult Swim, Cartoon Network, CNN, HBO, Cinemax, Warner Bros. and New Line Cinema. During the three months ended March 31, 2018, the Company generated Revenues of $7.996 billion (up 3% from $7.735 billion in 2017), Operating Income of $1.811 billion (down 13% from $2.080 billion in 2017), Net Income attributable to Time Warner shareholders of $1.643 billion (up 15% from $1.424 billion in 2017) and Cash provided by operations of $1.316 billion (down 10% from $1.461 billion in 2017).

Time Warner Businesses

Time Warner classifies its operations into three reportable segments: Turner, Home Box Office and Warner Bros.

As used in MD&A, the term affiliates refers to distributors that deliver packages of networks to their subscribers, including cable system operators, satellite service distributors and telephone companies (traditional affiliates) and virtual multichannel video programming distributors (virtual MVPDs); and the term OTT services refers to services that deliver video content to consumers over the internet and includes subscription video-on-demand (SVOD) services and advertising-supported VOD (AVOD) services such as social media platforms and user-generated content digital platforms, but does not include virtual MVPDs.

Turner. The Turner segment consists of businesses managed by Turner Broadcasting System, Inc. (Turner). During the three months ended March 31, 2018, the Turner segment recorded Revenues of $3.344 billion (42% of the Company s total Revenues) and Operating Income of $1.092 billion.

Turner creates and programs branded news, entertainment, sports and kids multi-platform content for consumers around the world. The Turner networks and related businesses and brands include TNT, TBS, Adult Swim, truTV, Turner Classic Movies, Turner Sports, Bleacher Report, Cartoon Network, Boomerang, CNN, HLN and iStreamPlanet. The Turner networks generate revenues principally from licensing programming to affiliates that have contracted to receive and distribute this programming to subscribers, from the sale of advertising and from licensing its original programming and its brands and characters for consumer products and other business ventures. Turner also generates revenues from the sale of advertising and sponsorships through its digital properties. Turner s programming is available to subscribers of affiliates for viewing live and on demand on television and various internet-connected devices on services provided by affiliates and on Turner s digital properties. Turner is also pursuing direct-to-consumer distribution options for its programming and networks.

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Home Box Office. The Home Box Office segment consists of businesses managed by Home Box Office, Inc. (Home Box Office). During the three months ended March 31, 2018, the Home Box Office segment recorded Revenues of $1.619 billion (20% of the Company s total Revenues) and Operating Income of $516 million.

Home Box Office operates the HBO and Cinemax multichannel premium pay television services, with the HBO service ranking as the most widely distributed multichannel premium pay television service. HBO and Cinemax programming is available in the U.S. to subscribers of affiliates for viewing live and on demand on television and on various internet-connected devices on services provided through affiliates and on Home Box Office s digital properties. In addition, Home Box Office offers HBO NOW, a domestic stand-alone OTT service available through digital distributors and some affiliates on a variety of internet-connected devices. Home Box Office also has entered into arrangements with a number of digital distributors to provide their subscribers access to the HBO and Cinemax services and programming on digital platforms and devices. HBO- and Cinemax-branded premium pay, basic tier television and/or OTT services are distributed in over 65 countries in Latin America, Asia and Europe.

In the U.S., Home Box Office generates revenues principally from licensing programming to affiliates and digital distributors that have contracted to receive and distribute such programming to their customers who subscribe to the HBO or Cinemax services. Home Box Office s agreements with its domestic affiliates are typically multi-year arrangements that provide for annual fee increases and marketing support. The relationship between subscriber totals and the amount of revenues earned under Home Box Office affiliate agreements depends on the specific terms of the applicable agreement, which may include basic and/or pay television subscriber thresholds, volume discounts and other performance-based discounts. Marketing and promotional activities intended to retain existing subscribers and acquire new subscribers may also impact revenue earned. Internationally, Home Box Office generates subscription revenues by licensing programming to international affiliates that have contracted to receive and distribute such programming to their customers. In some countries, Home Box Office also generates subscription revenues from OTT services that are distributed to consumers either directly or through third parties. Additional sources of revenues for Home Box Office are the licensing of its original programming, including *Game of Thrones*, *Westworld* and *Strike Back*, and the home entertainment sales of its original programming via physical and digital formats.

Warner Bros. The Warner Bros. segment consists of businesses managed by Warner Bros. Entertainment Inc. (Warner Bros.) that principally produce and distribute television shows, feature films and games. Warner Bros. television, film and game businesses benefit from a shared infrastructure, including shared production, distribution, marketing and administrative functions and resources. During the three months ended March 31, 2018, the Warner Bros. segment recorded Revenues of $3.238 billion (38% of the Company s total Revenues) and Operating Income of $322 million.

Warner Bros. is a leader in television production and distribution. Warner Bros. generates television product revenues principally from the licensing of programs to broadcast and cable television networks and premium pay television and OTT services. For the 2017/2018 season, Warner Bros. is producing approximately 70 original series in the U.S., including (i) at least four series for each of the five broadcast networks (including *Arrow*, *The Bachelor*, *The Big Bang Theory*, *Black Lightning*, *Blindspot*, *DC s Legends of Tomorrow*, *Deception*, *Ellen s Game of Games*, *The Flash*,

Gotham, *iZombie*, *Lethal Weapon*, *Little Big Shots*, *Lucifer*, *The Middle*, *Mom*, *Riverdale*, *Splitting Up Together*, *Supergirl*, *Supernatural, The Voice* and *Young Sheldon*), (ii) series for basic cable networks (including *Animal Kingdom*, *Claws*, *Krypton*, *People of Earth* and *Queen Sugar*), (iii) series for premium pay television services (including *Shameless* and *Westworld*), (iv) series for SVOD services (including *Castle Rock*, *Fuller House* and *Longmire*), (v) series for first-run syndication (including *The Ellen DeGeneres Show*, *Extra*, *The Real* and *TMZ*) and (vi) animated series for Cartoon Network, Boomerang and the Boomerang-branded SVOD service (including *New Looney Tunes* and *The Tom and Jerry Show*). Warner Bros.   programming also includes short-form live-action series and animated programming for digital platforms. Warner Bros. also licenses the rights to many of its U.S. original television series in international territories. Outside the U.S., Warner Bros. has a global network of production companies in many countries, which allows Warner Bros. to develop programming specifically tailored for the audiences in these territories. These local-language production companies also focus on developing non-scripted programs and formats that can be adapted and sold internationally and in the U.S.

Warner Bros. is a leader in the feature film industry and produces feature films under its Warner Bros. and New Line Cinema banners. Warner Bros. generates theatrical product revenues principally through rental fees from theatrical exhibition of feature films, including the following recently released films: *Blade Runner 2049*, *Game Night*, *It*, *Justice League*, *Rampage*, *Ready Player One* and *Tomb Raider*, and subsequently through licensing fees received from the distribution of films on premium pay television services, broadcast and cable television networks and OTT services.

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Warner Bros. is a leader in the home entertainment and game industries. The segment generates television and theatrical product revenues from the distribution of television and theatrical product in various physical and digital formats (e.g., electronic sell-through (EST) and video-on-demand (VOD)). In addition, the segment generates revenues through the development and distribution of games.

The distribution and sale of home entertainment product in physical formats is a large contributor to the segment s revenues and profits. For the past several years, sales of home entertainment product in physical formats have declined as the home entertainment industry has been undergoing significant changes as home entertainment consumption patterns have shifted. Several factors have contributed to this decline, including consumers shifting to OTT service subscriptions and, to a lesser degree, digital purchases and transactional VOD rentals of content; changing retailer initiatives and strategies (e.g., reduction of floor space devoted to home entertainment product in physical formats); retail store closures; increasing competition for consumer discretionary time and spending; and piracy. During the first quarter of 2018, across the home entertainment industry, consumer spending on home entertainment product in physical formats continued to decline and consumer spending on electronic delivery continued to increase. The electronic delivery of film and television content is growing and becoming more important to the Warner Bros. segment, which has helped to offset some of the decline in sales of home entertainment product in physical formats.

Television Industry

The television industry continues to evolve, with changes in technology, rapid growth in new video services, and a corresponding increase in overall video content consumption and shift in consumer viewing patterns. Consumers are watching an increasing amount of programming on demand and across a wide variety of services and internet-connected devices. Over the past few years, the number of subscribers to multichannel video services provided by traditional affiliates in the U.S. has declined, and the Company expects these declines will continue and possibly accelerate in the future. To counteract this trend, some traditional affiliates are placing greater emphasis on selling smaller bundles of linear networks, resulting in higher subscriber declines for most individual networks than for traditional affiliates in total. In addition, some traditional affiliates as well as media and technology companies have launched virtual MVPD services, many of which offer fewer networks at a lower cost than most of the bundles of linear networks offered by traditional affiliates.

At the same time, the penetration of internet-connected devices has grown, which has led to a growing number and variety of internet-delivered video services that do not require a traditional affiliate subscription or set-top box hardware. These include SVOD services that feature general entertainment programming with broad appeal, such as Amazon Prime Video, Hulu and Netflix, as well as niche SVOD services that offer differentiated programming. Some television networks and premium pay television services, such as HBO, have also launched OTT services. AVOD services, such as YouTube and Facebook, also have continued to gain in popularity. Several of these SVOD and AVOD services have significant and growing subscriber/user bases and have been, and are expected to continue, making significant investments in acquired and original programming.

As a result of these changes, consumers have more options for obtaining video content, including lower-cost alternatives, and consumers are spending an increased amount of time viewing video content through OTT services. The combination of new competitors, changes in viewing habits and declines in subscribers to traditional affiliates multichannel video services has negatively affected overall television ratings and, as a result, television advertising revenues for the industry and certain of the Company s networks. The advantages of digital advertising, including the ability to target consumers, track consumer behavior and measure consumer responsiveness to advertising, and the increased amount of consumer time spent online and on mobile activities have resulted in advertisers shifting more of their advertising budgets from traditional television advertising to digital advertising.

To address these changes, the Company s strategy over the past several years has focused on strengthening its position within the traditional TV ecosystem, enhancing the value of traditional multichannel video service subscriptions for consumers and affiliates and the value of television advertising for advertisers, and pursuing new opportunities outside the traditional TV ecosystem. As part of this strategy, the Company is continuing to invest in high-quality distinctive programming to enhance the value of its networks, as well as continuing to expand the amount of its content that is available on demand to capitalize on the shift in consumption habits. In addition, Turner has introduced new advertising products that provide greater data analytic tools and targeting capabilities to advertisers in order to compete more effectively with non-traditional outlets. The Company is also pursuing a number of initiatives to capitalize on the new opportunities presented by these changes, including launching OTT services and investing in and obtaining distribution of its content through other companies OTT services and virtual MVPD services, as well as investing in short-form content production and digital-first news and entertainment networks.

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AT&T and Time Warner Merger Agreement

On October 22, 2016, Time Warner entered into an Agreement and Plan of Merger (the Merger Agreement) with AT&T Inc. (AT&T), West Merger Sub, Inc. and West Merger Sub II, LLC, pursuant to which Time Warner will combine with AT&T in a stock-and-cash transaction. The Merger Agreement was approved unanimously by the boards of directors of both companies. Time Warner shareholders adopted the Merger Agreement at a special meeting of shareholders held on February 15, 2017. Subject to the satisfaction of the remaining conditions in the Merger Agreement, upon consummation of the merger, Time Warner s shareholders will receive per share consideration consisting of $53.75 in cash and a specified number of shares of AT&T stock, as set forth in the Merger Agreement and determined by reference to the average of the volume weighted averages of the trading price of AT&T common stock on the New York Stock Exchange (NYSE) on each of the 15 consecutive NYSE trading days ending on and including the trading day that is three trading days prior to the closing of the merger (the Average Stock Price). The stock portion of the per share consideration will be subject to a collar such that if the Average Stock Price is between $37.411 and $41.349, Time Warner shareholders will receive shares of AT&T stock equal to $53.75 in value for each share of Time Warner common stock. If the Average Stock Price is below $37.411, Time Warner s shareholders will receive 1.437 AT&T shares for each share of Time Warner common stock. If the Average Stock Price is above $41.349, Time Warner shareholders will receive 1.300 AT&T shares for each share of Time Warner common stock. Should Time Warner terminate the Merger Agreement in specified circumstances, Time Warner may be required to pay AT&T a termination fee equal to $1.725 billion if Time Warner enters into or consummates an alternative transaction with a third party following such termination of the Merger Agreement.

The merger is conditioned on the receipt of certain antitrust and other required regulatory consents. On November 20, 2017, the United States Department of Justice (the DOJ) filed a lawsuit in the United States District Court for the District of Columbia (the Court) under a federal antitrust statute to enjoin the merger. The trial began the week of March 19, 2018 and the parties presentation of their cases is expected to conclude in early May 2018. Time Warner and AT&T have agreed to extend the termination date of the Merger Agreement to April 22, 2018, and each has agreed to waive, until June 21, 2018, its right to terminate the Merger Agreement based on the merger not being completed by April 22, 2018.

The merger with AT&T is consistent with the Company s strategy of ensuring that its content is available to consumers on a wide range of distribution platforms. The Company expects the merger will accelerate the Company s efforts to spur innovation in the media industry and improve the consumer experience with pay television bundles by creating compelling consumer offerings and developing more targeted advertising offerings, and it will accelerate and reduce the risk in Time Warner s strategy to distribute content through other online and mobile services, including those offered directly to consumers.

Recent Developments

Central European Media Enterprises Ltd.

On April 25, 2018, the Company exercised warrants it held to purchase 101 million shares of Class A common stock of Central European Media Enterprises Ltd. s (CME) at an aggregate cost of $101 million. Simultaneously, the Company entered into a standing proxy arrangement whereby it granted the right to vote the Class A common stock it received upon exercise of the warrants, for all matters other than regarding a change of control event, to the independent members of CME s Board of Directors. In accordance with the standing proxy arrangement, such shares will be voted by the proxyholder in a manner that reflects the proportion of all votes cast excluding those shares covered by the standing proxy arrangement. The Company has agreed with CME that the proxy arrangement will be in effect for two years and is not revocable by the Company. In addition, the Company has the right to extend the proxy arrangement for an additional one-year period at its option. The Company will continue to account for its investment in CME s Class A common stock under the equity method of accounting.

On April 25, 2018, CME, CME Media Enterprises B.V. (CME BV), Time Warner and third-party financial institution lenders agreed to extend the maturity dates of CME s 235 million senior unsecured term loan (the 2015 Term Loan) from November 1, 2019 to November 1, 2021 and CME BV s 469 million senior unsecured term loan (the 2016 Term Loan) from February 19, 2021 to April 26, 2023. Time Warner has agreed to continue to guarantee CME s and CME BV s obligations under the term loans as well as related interest rate hedges.

On April 25, 2018, Time Warner, CME and CME BV entered into an amendment and restatement agreement (the 2018 Reimbursement Amendment) to further amend and restate the Amended and Restated Reimbursement Agreement, dated as of November 14, 2014, and as amended and restated as of February 19, 2016. The 2018 Reimbursement Amendment, among other

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things, reduced the guarantee fees payable by CME and CME BV to Time Warner for Time Warner s guarantees of CME s obligations under its 151 million senior unsecured term loan (the 2014 Term Loan) that matures on May 1, 2019 and the 2015 Term Loan, as well as CME BV s obligation under the 2016 Term Loan. The reduced fee to be paid to Time Warner for each of these guarantees is equal to a rate (the all-in rate) ranging between 3.25% and 6.00%, in the case of the 2014 Term Loan and 2015 Term Loan, and between 3.50% and 6.50%, in the case of the 2016 Term Loan, measured quarterly based on CME s consolidated net leverage ratio, less the interest rate on the applicable term loan. The fees are payable in cash. The 2018 Reimbursement Amendment also provides that if CME s consolidated debt level is less than 815 million by September 30, 2018, the all-in rate will be decreased further, in most cases by 50 basis points. The 2018 Reimbursement Amendment also makes less restrictive certain of the maintenance and negative covenants that apply to CME and its subsidiaries.

Also on April 25, 2018, Time Warner, CME and CME BV entered into an amendment and restatement agreement (the 2018 Revolver Amendment) to further amend and restate CME s Amended and Restated Revolving Loan Facility Credit Agreement, dated as of May 2, 2014, and as amended and restated as of February 19, 2016. The 2018 Revolver Amendment increased the size of the revolving credit facility from $50 million to $75 million and extended the maturity date from February 19, 2021 to April 26, 2023. Amounts outstanding under the revolving credit facility generally bear interest at a margin ranging from 3.25% to 6.25% over the applicable Libor rate for Eurodollar loans based on CME s net leverage and, effective with the 2018 Revolver Amendment, are payable entirely in cash. The revolving credit facility continues to contain a commitment fee on the average daily unused amount under the facility of 0.50% per annum. The 2018 Revolver Amendment also makes less restrictive certain of the maintenance and negative covenants that apply to CME and its subsidiaries.

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.

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 from continuing operations has been affected by transactions and certain other items in each period as follows (millions):

	Three Months Ended March 31,	
	2018	2017
Asset impairments	$	$ (1)

Gain (loss) on operating assets, net	(23)	7
Costs related to the AT&T merger	(146)	(82)
Other		(1)
Impact on Operating Income	(169)	(77)
Investment gains (losses), net	(47)	159
Amounts related to the separation or disposition of former Time Warner segments	(13)	(4)
Items affecting comparability relating to equity method investments	21	(1)
Pretax impact	(208)	77
Income tax impact of above items	42	39
Impact of items affecting comparability on net income	$ (166)	$ 116

In addition to the items affecting comparability described above, the Company incurred Restructuring and severance costs of $0 for the three months ended March 31, 2018 and $12 million for the three months ended March 31, 2017. For further information regarding the Restructuring and severance costs, see Consolidated Results and Business Segment Results.

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OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION (Continued)

Asset Impairments

During the three months ended March 31, 2017, the Company recognized miscellaneous asset impairments of $1 million at the Warner Bros. segment.

Gain (Loss) on Operating Assets, Net

During the three months ended March 31, 2018, the Company recognized net losses on operating assets of $23 million, consisting of $24 million of costs at the Warner Bros. segment associated with a fair value adjustment on a contingent consideration arrangement, partially offset by a miscellaneous gain of $1 million at the Turner segment. During the three months ended March 31, 2017, the Company recognized miscellaneous gains on operating assets of $7 million, consisting of $6 million at the Turner segment and $1 million at the Warner Bros. segment.

Costs Related to the AT&T Merger

For the three months ended March 31, 2018 and 2017, the Company recognized $146 million and $82 million, respectively, of costs related to the AT&T merger, consisting of $53 million and $26 million, respectively, at Corporate, $37 million and $22 million, respectively, at the Turner segment, $37 million and $22 million, respectively, at the Warner Bros. segment and $19 million and $12 million, respectively, at the Home Box Office segment. For the three months ended March 31, 2018 and 2017, these costs reflected $44 million and $18 million, respectively, of external transaction costs and $102 million and $64 million, respectively, of costs from merger-related employee retention and incentive programs (as discussed below). For the three months ended March 31, 2018 and 2017, approximately $145 million and $80 million, respectively, of these costs are included in Selling, general and administrative expenses and the remainder in Costs of revenues in the accompanying Consolidated Statement of Operations.

In connection with entering into the Merger Agreement, the Company has granted 5.7 million special retention restricted stock units (Special Retention RSUs) as of March 31, 2018 to certain employees of Time Warner and its divisions, including all executive officers of Time Warner. Half of the Special Retention RSUs will vest 25% per year on each of the first four anniversaries of February 15, 2017, and the remaining half will vest 25% per year on each of the first four anniversaries of February 15, 2018. Pursuant to the Special Retention RSU agreements, vesting as a result of retirement is not permitted unless the employee retires after the merger has closed. In addition, the awards do not accelerate automatically following the closing of the merger. Instead, the employee must remain employed following the closing, and the awards will vest only on the scheduled vesting date or upon termination of employment under certain circumstances, such as termination without cause, for good reason or due to retirement.

In addition, the Company has implemented merger-related cash-based incentive plans, including a retention plan for certain employees of Time Warner and its divisions, including executive officers of Time Warner other than the Chairman and CEO, and a retention and incentive plan focused on the operating divisions 2018 performance in which the executive officers of Time Warner do not participate.

Other

For the three months ended March 31, 2017, Other includes external costs related to mergers, acquisitions or dispositions of $1 million at the Turner segment. External costs related to mergers, acquisitions or dispositions are included in Selling, general and administrative expenses in the accompanying Consolidated Statement of Operations.

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OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION (Continued)

Investment Gains (Losses), Net

Investment gains (losses), net are included in Other income (loss), net in the accompanying Consolidated Statement of Operations. The detail of Investment gains, net is shown in the table below (millions):

	Three Months Ended March 31,	
	2018	**2017**
Sale of interest in Omni Atlanta hotel joint venture	$	$ 99
Fair value adjustments (a)	(45)	54
Gain (loss) on other investments	(2)	6
Investment gains (losses), net	$ (47)	$ 159

(a) Primarily related to warrants to purchase Class A common stock of CME held by the Company, which the Company exercised on April 25, 2018. See Recent Developments.

Amounts Related to the Separation or Disposition of Former Time Warner Segments

For the three months ended March 31, 2018, the Company recognized $13 million of losses related to the disposition of former Time Warner segments, primarily related to changes in the value of a Time Warner Cable Inc. (TWC) tax indemnification receivable. For the three months ended March 31, 2017, the Company recognized $4 million of losses related to the disposition of former Time Warner segments, primarily reflecting pension and other retirement benefits related to employees and former employees of Time Inc. These amounts have been reflected in Other income (loss), net in the accompanying Consolidated Statement of Operations.

Items Affecting Comparability Relating to Equity Method Investments

For the three months ended March 31, 2018, the Company recognized $21 million of income primarily related to its share of net investment gains recorded by equity method investees. For the three months ended March 31, 2017, the Company recognized $1 million of losses related to its share of investment losses recorded by equity method investees. These amounts have been reflected in Other income (loss), net in the accompanying Consolidated Statement of Operations.

Income Tax Impact

The income tax impact reflects the estimated tax provision or tax benefit associated with each item affecting comparability using the effective tax rate for the item. The estimated tax provision or tax benefit can vary based on

certain factors, including the taxability or deductibility of the item and the applicable tax jurisdiction for the item. For the three months ended March 31, 2017, the income tax impact includes a $69 million benefit primarily reflecting the reversal of a valuation allowance related to the use of capital loss carryforwards to offset the gains on the Turner segment s sales of its interest in the joint venture that owns the Omni Atlanta hotel and its Atlanta broadcast television station.

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.

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OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION (Continued)

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

	Three Months Ended March 31,		
	2018	2017	% Change
Turner	$ 3,344	$ 3,088	8%
Home Box Office	1,619	1,568	3%
Warner Bros.	3,238	3,365	(4)%
Intersegment eliminations	(205)	(286)	(28)%
Total revenues	$ 7,996	$ 7,735	3%

For the three months ended March 31, 2018, Revenues at the Turner segment increased driven by higher Subscription and Advertising revenues, Revenues at the Home Box Office segment increased driven by higher Subscription revenues, which were partially offset by lower Content and other revenues, and Revenues at the Warner Bros. segment decreased driven by lower Television and Theatrical product revenues, which were partially offset by higher Games and other revenues. Each of the revenue categories is discussed in greater detail by segment in Business Segment Results.

Costs of Revenues. Costs of revenues were $4.717 billion for the three months ended March 31, 2018 and $4.332 billion for the three months ended March 31, 2017. The increase in Costs of revenues for the three months ended March 31, 2018 primarily reflected higher programming expenses at the Turner segment. The segment variations are discussed in Business Segment Results.

Selling, General and Administrative Expenses. For the three months ended March 31, 2018, Selling, general and administrative expenses increased 10% to $1.402 billion from $1.272 billion for the three months ended March 31, 2017, primarily reflecting higher AT&T merger costs at all segments, higher marketing expense at the Turner and Home Box Office segments and the impact of foreign exchange rates at the Warner Bros. segment. For the three months ended March 31, 2018 and 2017, Selling, general and administrative expenses included approximately $145 million and $80 million, respectively, of costs related to the AT&T merger. The segment variations are discussed in Business Segment Results.

Included in Costs of revenues and Selling, general and administrative expenses is depreciation expense of $128 million for the three months ended March 31, 2018 and $120 million for the three months ended March 31, 2017.

Amortization Expense. Amortization expense was $43 million for the three months ended March 31, 2018 and $45 million for the three months ended March 31, 2017.

Restructuring and Severance Costs. For the three months ended March 31, 2018 and 2017, Restructuring and severance costs primarily related to employee terminations and other exit activities. Restructuring and severance costs are as follows (millions):

	Three Months Ended March 31,	
	2018	**2017**
Turner	$ (2)	$ 2
Home Box Office	13	2
Warner Bros.	(12)	9
Corporate	1	(1)
Total restructuring and severance costs	$	$ 12

Operating Income. Operating Income decreased to $1.811 billion for the three months ended March 31, 2018 from $2.080 billion for the three months ended March 31, 2017. Excluding the items noted under Transactions and Other Items Affecting Comparability totaling $169 million and $77 million of expense for the three months ended March 31, 2018 and 2017, respectively, Operating Income decreased $177 million, primarily reflecting decreases at the Warner Bros., Turner and Home Box Office segments.

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Interest Expense, Net. Interest expense, net detail is shown in the table below (millions):

	Three Months Ended March 31,			
	2018		2017	
Interest expense	$	(255)	$	(308)
Interest income		48		49
Interest expense, net	$	(207)	$	(259)

The decrease in interest expense for the three months ended March 31, 2018 was primarily due to lower average debt balances and lower average interest rates.

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

	Three Months Ended March 31,			
	2018		2017	
Investment gains (losses), net	$	(47)	$	159
Amounts related to the separation or disposition of former Time Warner segments		(13)		(4)
Loss from equity method investees		(20)		(76)
Other		(14)		(7)
Other income (loss), net	$	(94)	$	72

Investment gains (losses), net and amounts related to the separation or disposition of former Time Warner segments are discussed under Transactions and Other Items Affecting Comparability.

Income Tax Benefit (Provision). Income tax benefit was $132 million for the three months ended March 31, 2018 compared to an Income tax provision of $470 million for the three months ended March 31, 2017. The Company s effective tax rate was (9%) for the three months ended March 31, 2018 compared to 25% for the three months ended March 31, 2017. The decrease in the effective tax rate for the three months ended March 31, 2018 was primarily related to the settlement of a U.S. federal tax audit, the 2018 impact of the U.S. tax reform legislation enacted at the end of 2017 and the 2018 extension of an expired tax law retroactive to January 1, 2017.

Net Income. Net Income was $1.642 billion and $1.423 billion for the three months ended March 31, 2018 and 2017, respectively. Excluding the items noted under Transactions and Other Items Affecting Comparability totaling

$166 million of expense and $116 million of income for the three months ended March 31, 2018 and 2017, respectively, Net Income increased $501 million, primarily due to lower income tax expense, partially offset by lower Operating Income.

Net Loss Attributable to Noncontrolling Interests. Net loss attributable to noncontrolling interests was $1 million for both the three months ended March 31, 2018 and 2017.

Net Income attributable to Time Warner shareholders. Net income attributable to Time Warner shareholders was $1.643 billion for the three months ended March 31, 2018 and $1.424 billion for the three months ended March 31, 2017. Basic and Diluted net income per common share were $2.10 and $2.07, respectively, for the three months ended March 31, 2018 and were $1.84 and $1.80, respectively, for the three months ended March 31, 2017.

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Business Segment Results

Turner. Revenues and Operating Income of the Turner segment for the three months ended March 31, 2018 and 2017 are as follows (millions):

	Three Months Ended March 31,		
	2018	**2017**	**% Change**
Revenues:			
Subscription	$ 1,790	$ 1,665	8%
Advertising	1,326	1,213	9%
Content and other	228	210	9%
Total revenues	3,344	3,088	8%
Costs of revenues (a)	(1,697)	(1,413)	20%
Selling, general and administrative (a)	(502)	(455)	10%
Gain on operating assets	1	6	(83)%
Restructuring and severance costs	2	(2)	NM
Depreciation	(52)	(50)	4%
Amortization	(4)	(4)	%
Operating Income	$ 1,092	$ 1,170	(7)%

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

For the three months ended March 31, 2018, the increase in Subscription revenues reflected higher domestic subscription revenues of $66 million due to higher contractual rates, partially offset by a decrease in subscribers. International subscription revenues increased $59 million primarily due to growth in Latin America, mainly due to a new premium pay-television sports offering in Argentina.

For the three months ended March 31, 2018, the increase in Advertising revenues reflected higher domestic revenues of $106 million primarily due to Turner airing the Final Four games of the NCAA Division I Men s Basketball Championship Tournament (the NCAA Tournament) on its networks.

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

	Three Months Ended March 31,		
	2018	2017	% Change
Programming costs:			
Originals and sports	$ 1,219	$ 982	24%
Acquired films and syndicated series	225	210	7%
Total programming costs	1,444	1,192	21%
Other direct operating costs	253	221	14%
Costs of revenues (a)	$ 1,697	$ 1,413	20%

(a) Costs of revenues exclude depreciation.

For the three months ended March 31, 2018, programming costs increased reflecting higher costs for sports programming mainly due to Turner airing the Final Four NCAA Tournament games on its networks and, to a lesser extent, higher costs for original series.

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For the three months ended March 31, 2018, Selling, general and administrative expenses increased primarily due to higher marketing expense of $21 million primarily related to new seasons of original programming and increased costs related to the AT&T merger of $15 million.

Refer to Transactions and Other Items Affecting Comparability for a discussion of Gain on operating assets and costs related to the AT&T merger for the three months ended March 31, 2018 and 2017, which affected the comparability of the Turner segment s results.

Operating Income for the three months ended March 31, 2018 decreased due to higher Costs of revenues and Selling, general and administrative expenses, partially offset by higher Revenues.

Home Box Office. Revenues and Operating Income of the Home Box Office segment for the three months ended March 31, 2018 and 2017 are as follows (millions):

	Three Months Ended March 31,		
	2018	**2017**	**% Change**
Revenues:			
Subscription	$ 1,429	$ 1,302	10%
Content and other	190	266	(29)%
Total revenues	1,619	1,568	3%
Costs of revenues (a)	(833)	(758)	10%
Selling, general and administrative (a)	(227)	(200)	14%
Restructuring and severance costs	(13)	(2)	NM
Depreciation	(26)	(19)	37%
Amortization	(4)	(4)	%
Operating Income	$ 516	$ 585	(12)%

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

For the three months ended March 31, 2018, Subscription revenues increased due to higher domestic subscription revenues of $98 million reflecting increased subscribers and higher contractual rates, partially offset by the $63 million impact of a change in accounting due to the adoption of new revenue recognition guidance and its application to minimum fee provisions in multi-year affiliate distribution arrangements. International subscription

revenues for the three months ended March 31, 2018 increased $29 million primarily reflecting growth in Europe.

For the three months ended March 31, 2018, Content and other revenues decreased primarily due to lower international licensing revenues.

The components of Costs of revenues for the Home Box Office segment are as follows (millions):

	Three Months Ended March 31,		
	2018	**2017**	**% Change**
Programming costs:			
Originals and sports	$ 277	$ 263	5%
Acquired films and syndicated series	320	289	11%
Total programming costs	597	552	8%
Other direct operating costs	236	206	15%
Costs of revenues (a)	$ 833	$ 758	10%

(a) Costs of revenues exclude depreciation.

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The increase in programming costs for the three months ended March 31, 2018 was primarily due to higher acquired programming costs for Home Box Office s domestic and international businesses. The increase in other direct operating costs primarily reflected higher distribution costs.

For the three months ended March 31, 2018, Selling, general and administrative expenses increased primarily due to higher marketing expenses of $12 million and increased costs related to the AT&T merger of $7 million.

Refer to Transactions and Other Items Affecting Comparability for a discussion of costs related to the AT&T merger for the three months ended March 31, 2018 and 2017, which affected the comparability of the Home Box Office segment s results.

The decrease in Operating Income for the three months ended March 31, 2018 was primarily due to higher Costs of revenues and Selling, general and administrative expenses, partially offset by higher Revenues.

Warner Bros. Revenues and Operating Income of the Warner Bros. segment for the three months ended March 31, 2018 and 2017 are as follows (millions):

	Three Months Ended March 31,		
	2018	**2017**	**% Change**
Revenues:			
Theatrical product	$ 1,336	$ 1,377	(3)%
Television product	1,498	1,675	(11)%
Games and other	404	313	29%
Total revenues	3,238	3,365	(4)%
Costs of revenues (a)	(2,334)	(2,331)	%
Selling, general and administrative (a)	(493)	(454)	9%
Gain (loss) on operating assets	(24)	1	NM
Asset impairments		(1)	NM
Restructuring and severance costs	12	(9)	NM
Depreciation	(42)	(44)	(5)%
Amortization	(35)	(37)	(5)%
Operating Income	$ 322	$ 490	(34)%

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

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Revenues primarily relate to theatrical product (which is content made available for initial exhibition in theaters) and television product (which is content made available for initial airing on television or OTT services). The components of Revenues for the three months ended March 31, 2018 and 2017 are as follows (millions):

	Three Months Ended March 31,		
	2018	**2017**	**% Change**
Theatrical product:			
Film rentals	$ 273	$ 443	(38)%
Home video and electronic delivery	394	368	7%
Television licensing	570	485	18%
Consumer products and other	99	81	22%
Total theatrical product	$ 1,336	$ 1,377	(3)%
Television product:			
Television licensing	1,335	1,490	(10)%
Home video and electronic delivery	75	87	(14)%
Consumer products and other	88	98	(10)%
Total television product	$ 1,498	$ 1,675	(11)%

The Warner Bros. segment had the following number of theatrical film, theatrical product home video and electronic delivery and game releases during the three months ended March 31, 2018 and 2017:

	Three Months Ended March 31,	
	2018	**2017**
Theatrical film releases	6	4
Theatrical product home video and electronic delivery releases	4	4
Game releases	1	2

The decrease in Revenues for the three months ended March 31, 2018 included a net favorable impact of foreign exchange rates of approximately $95 million.

Theatrical product revenue from film rentals decreased for the three months ended March 31, 2018, reflecting lower revenues of $149 million from theatrical films released during the first quarter of 2018 compared to the first quarter of

2017 and lower carryover revenues of $21 million from prior period releases.

For the three months ended March 31, 2018, theatrical product revenues from home video and electronic delivery increased primarily due to higher revenues of $55 million from releases during the first quarter of 2018 compared to the first quarter of 2017, partially offset by lower revenues of $29 million from prior period releases, including catalog titles.

The increase in theatrical product revenues from television licensing for the three months ended March 31, 2018 was primarily due to higher international licensing revenues.

The decrease in television product revenues from television licensing for the three months ended March 31, 2018 was primarily due to a change in mix of availabilities.

Games revenues increased for the three months ended March 31, 2018 primarily due to higher carryover revenues of $107 million from prior period releases, partially offset by lower revenues of $9 million from releases during the first quarter of 2018 compared to the first quarter of 2017.

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The components of Costs of revenues for the Warner Bros. segment are as follows (millions):

	Three Months Ended March 31,		
	2018	**2017**	**% Change**
Film and television production costs	$ 1,574	$ 1,667	(6)%
Print and advertising costs	497	492	1%
Other costs, including merchandise and related costs	263	172	53%
Costs of revenues (a)	$ 2,334	$ 2,331	%

(a) Costs of revenues excludes depreciation.
Included in film and television production costs are production costs related to games, as well as theatrical film and game valuation adjustments resulting primarily from revisions to estimates of ultimate revenue and/or costs for certain theatrical films and games. Theatrical film valuation adjustments were $1 million and $10 million for the three months ended March 31, 2018 and 2017, respectively. Game valuation adjustments were $0 and $5 million for the three months ended March 31, 2018 and 2017, respectively. The decrease in film and television production costs for the three months ended March 31, 2018 was primarily a result of lower expenses associated with television product. Other costs, including merchandise and related costs increased for the three months ended March 31, 2018 primarily due to higher distribution-related costs for games as well as higher foreign exchange losses.

Selling, general and administrative expenses increased for the three months ended March 31, 2018 primarily due to the impact of foreign exchange rates and increased costs related to the AT&T merger of $15 million.

Refer to Transactions and Other Items Affecting Comparability for a discussion of Gain (loss) on operating assets, Asset impairments and costs related to the AT&T merger for the three months ended March 31, 2018 and 2017, which affected the comparability of the Warner Bros. segment s results.

The decrease in Operating Income for the three months ended March 31, 2018 was due to lower Revenues and higher Selling, general and administrative expenses.

Corporate. Corporate s Operating Loss for the three months ended March 31, 2018 and 2017 was as follows (millions):

	Three Months Ended March 31,		
	2018	2017	% Change
Selling, general and administrative (a)	$ (124)	$ (108)	15%
Restructuring and severance costs	(1)	1	NM
Depreciation	(8)	(7)	14%
Operating Loss	$ (133)	$ (114)	17%

(a) Selling, general and administrative expenses exclude depreciation.

Refer to Transactions and Other Items Affecting Comparability for a discussion of costs related to the AT&T merger for the three months ended March 31, 2018 and 2017, which affected the comparability of Corporate s results.

For the three months ended March 31, 2018, Operating loss increased primarily due to higher costs related to the AT&T merger of $27 million.

FINANCIAL CONDITION AND LIQUIDITY

Management believes that cash generated by or available to the Company should be sufficient to fund its capital and liquidity needs for the foreseeable future, including scheduled debt repayments and quarterly dividend payments. Time Warner s sources of cash include Cash provided by operations, Cash and equivalents on hand, available borrowing capacity under its committed credit

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facilities and commercial paper program and access to capital markets. Time Warner s unused committed capacity at March 31, 2018 was $5.526 billion, which included $1.691 billion of Cash and equivalents.

Current Financial Condition

At March 31, 2018, Time Warner had $22.253 billion of debt and $1.691 billion of Cash and equivalents, resulting in net debt of $20.562 billion, compared to $23.744 billion of debt and $2.621 billion of Cash and equivalents, or net debt of $21.123 billion, at December 31, 2017. At March 31, 2018, Total equity was $29.806 billion compared to $28.376 billion at December 31, 2017.

The following table shows the significant items contributing to the decrease in net debt from December 31, 2017 to March 31, 2018 (millions):

Balance at December 31, 2017	$	21,123
Cash provided by operations		(1,316)
Capital expenditures		147
Dividends paid to common stockholders		317
Investments and acquisitions, net of cash acquired, including available-for-sale securities		165
Proceeds from the exercise of stock options		(20)
Other investment proceeds		(4)
All other, net		150
Balance at March 31, 2018	$	20,562

Cash Flows

For the three months ended March 31, 2018 and 2017, Cash and equivalents decreased by $930 million and $89 million, respectively. Components of these changes are discussed below in more detail.

Operating Activities

Details of Cash provided by operations are as follows (millions):

	Three Months Ended March 31,			
		2018		2017
Operating Income	$	1,811	$	2,080

Depreciation and amortization		171		165
Net interest payments (a)		(267)		(303)
Net income taxes refunded (paid) (b)		228		(118)
All other, net, including working capital changes		(627)		(363)
Cash provided by operations	$	1,316	$	1,461

(a) Includes cash interest received of $10 million for both the three months ended March 31, 2018 and 2017.
(b) Includes income tax refunds received of $302 million and $4 million for the three months ended March 31, 2018 and 2017, respectively.

Cash provided by operations for the three months ended March 31, 2018 decreased primarily due to an increase in cash used by working capital, mainly due to higher content investments and the timing of receipts, and lower Operating Income, partially offset by lower net income taxes paid.

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Investing Activities

Details of Cash used by investing activities are as follows (millions):

	Three Months Ended March 31, 2018	2017
Investments and acquisitions, net of cash acquired	$ (165)	$ (168)
Capital expenditures	(147)	(98)
Other investment proceeds	4	240
Cash used by investing activities	$ (308)	$ (26)

The increase in Cash used by investing activities for the three months ended March 31, 2018 was primarily due to lower other investment proceeds, including available-for-sale securities and higher capital expenditures. Included in Investments and acquisitions, net of cash acquired for the three months ended March 31, 2018 and 2017 are payments of $75 million and $85 million, respectively, related to the construction and development of office and studio space in the Hudson Yards development on the west side of Manhattan for the Company s new corporate headquarters and its New York City-based employees. Other investment proceeds, including available-for-sale securities, for the three months ended March 31, 2017 primarily related to the sale of the Turner segment s interest in the joint venture that owns the Omni Atlanta hotel.

Financing Activities

Details of Cash used by financing activities are as follows (millions):

	Three Months Ended March 31, 2018	2017
Borrowings	$ 4	$
Debt repayments	(1,535)	(1,144)
Proceeds from the exercise of stock options	20	56
Principal payments on capital leases	(11)	(3)
Dividends paid	(317)	(316)
Other financing activities	(99)	(117)
Cash used by financing activities	$ (1,938)	$ (1,524)

Cash used by financing activities for the three months ended March 31, 2018 increased primarily due to higher debt repayments.

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Outstanding Debt and Other Financing Arrangements

Outstanding Debt and Committed Financial Capacity

At March 31, 2018, Time Warner had total committed capacity, defined as maximum available borrowings under various existing debt arrangements and cash and short-term investments, of $27.810 billion. Of this committed capacity, $5.526 billion was unused and $22.253 billion was outstanding as debt. At March 31, 2018, total committed capacity, outstanding letters of credit, outstanding debt and total unused committed capacity were as follows (millions):

	Committed Capacity (a)	Letters of Credit (b)	Unamortized Discount on Commercial Paper	Outstanding Debt (c)	Unused Committed Capacity
Cash and equivalents	$ 1,691	$	$	$	$ 1,691
Bank credit facilities and commercial paper program (d)	7,000		3	3,180	3,817
Fixed-rate public debt	18,900			18,900	
Other obligations (e)	219	28		173	18