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Entertainment, Cable & Media / Consumer

Time Warner Inc. (TWX) – HOLD

TWX: Initiating with a HOLD Rating.

Coverage Initiation

Market Data	
Price (02/05/10)	$27.03
12-Month Price Target	
52-Week range	$32.82-15.65
Shares Out. (MM)	1,181.2
Market cap (MM)	$31,927.8
Avg. daily volume (000)	7,788.3
Financial Data	
Total Debt/Cap.	31.4%
Price/LTM Rev.	1.2x
Tangible BVPS	($6.19)
Net Cash Per Share	($8.99)

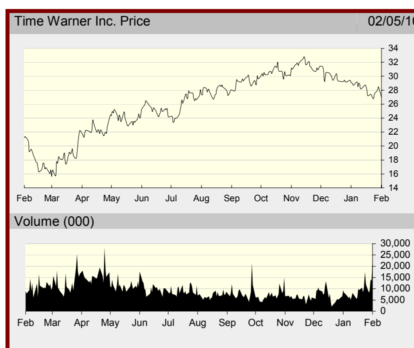
Strategy. We think CEO Jeff Bewkes is really smart. Our biggest strategic question is around what Bewkes wants his legacy to be? Is it to shrink TWX, drive higher ROICs, and return capital to shareholders? Our concern with this path is that it risks multiple contraction from 7x today to 5x OIBDA, a typical mature company multiple. Or is it to buy offshore assets to drive growth (are these really big enough to drive meaningful growth over the next 24 months)? Or is it a transformative acquisition that can drive growth, but may be dilutive near-term?

Valuation: Over 90% of TWX's segment OIBDA comes from producing films and running cable networks, which is nearly identical to Viacom. From a valuation point of view, Viacom appears cheaper at 6.6x 2010E OIBDA vs. TWX's 7.3x 2010E EBITDA. Although TWX is better at managing both businesses (based on 2009A operating income margins), a 0.7x multiple gap is too large for the same business lines in our view, and suggests investors will arbitrage the two choices, capping TWX's trading multiple upside unless VIAb moves up too, while VIAb has less downside risk if investors fall out of love with these lines of business.

Stock Picks. We prefer Viacom (VIAb-Buy) to Time Warner, based on relative valuation of similar asset portfolios. We prefer CBS (CBS, Buy) and NewsCorp (NWSA, Buy) to both of them at this point in the advertising cycle because we think that EPS revisions upward are likely to be more robust at ad-driven companies given their operating leverage coupled with an improving economy.

	FY 12/31/09 A	FY 12/31/10 E		FY 12/31/11 E	
		Old	New	Old	New
Rev. (MM)	$25,781.0		$26,670.1		$27,707.6
Growth	*(2.8%)*	*0.0%*	*3.4%*	*0.0%*	*3.9%*
Op. Mar.	*17.6%*		18.8%		*19.7%*
EPS: 1Q	0.39		0.48		
EPS: 2Q	0.35		0.48		
EPS: 3Q	0.49		0.60		
EPS: 4Q	0.51		0.56		
EPS: Year	1.74		2.12		2.34
Growth	*140.7%*	*0.0%*	*22.0%*	*0.0%*	*10.2%*
P/E Ratio	14.6x	nm	12.7x	nm	11.6x

Note: Pro forma earnings estimates displayed above do not include one-time items or any stock compensation expenses.



Disclosures applicable to this security: B.
Disclosure explanation on the inside back cover of this report.

COMPANY DESCRIPTION

Time Warner Inc. (TWX) is one of the largest media and entertainment companies in the world, operating cable-television channels, filmed entertainment and publishing assets. TWX uses operating scale and strong global brands to create, package and deliver premium-quality, consumer-facing, content for distribution globally through diverse distribution outlets.

TWX's three primary business segments include:

- **<u>Filmed Entertainment</u>** (41% of 2010E revenue) includes Warner Bros. films and TV production. This division also includes DC Comics.

- **<u>Cable Networks</u>** (46% of 2010E revenue) includes its premium pay television programming services through Home Box Office (HBO), and Turner Broadcasting System's (TBS) domestic and international networks. TBS includes CNN, Headline News (HLN), TBS, TNT, Cartoon Network and Boomerang.

- **<u>Publishing</u>** (13% of 2010E revenue) includes its Time Inc. subsidiary which operates both domestically (22 titles) and internationally (over 80 titles). Domestically, titles include Time Magazine, People (which produces a majority of this segments profits), and Sports Illustrated.

INVESTMENT POSITIVES

1. **<u>New Revenue Streams.</u>** We believe the migration of high-quality content to digital platforms will create additional revenue streams over time. We are most optimistic about the pricing power of premium content over mobile devices. A-title quality content will likely remain the most valuable.

2. **<u>Free Cash Flow.</u>** We project that TWX will generate approximately $2.27/share of free cash flow in 2010, which should be available for dividends, share repurchases, and acquisitions. (Please see Table 8.)

3. **<u>Return of Capital</u>.** TWX is underlevered (<2x debt/EBITDA) with $4.8B of cash on Dec 31, 2009. On Feb 3, 2010 Time Warner raised its quarterly dividend by 13% to $0.85 cents a share/year from $0.75 cents/year and boosted its share buyback authorization by $2B to a total of $3B.

4. **<u>Strong Competitive Position</u>**

   - TWX's owns one of the pre-eminent cable network groups in the US, with fully-distributed, mission critical (to MSOs, Telcos, satellite companies) cable channels including, among others, TBS, TNT, Cartoon Network, Boomerang, truTV, TCM (Turner Classic Movies), CNN, and Headline News (HLN). There are only 75 fully-distributed cable networks in the U.S. and TWX owns nearly 10% of them. Offshore, Turner International operates 23 cable brands, including eight US channel brands, plus 15 non-U.S. cable brands in various countries. CNN's channels reach nearly 200 countries.

- Warner Bros. film studio is the pre-eminent film studio in the US, with one of the finest content libraries on the planet.

- Time Inc. is one of the largest, most prestigious, and oldest magazine companies in America.

5. **Restructuring Almost Done.** TWX has completed the spin-off of Time Warner Cable (TWC-BUY) and AOL (NR). We expect Time Inc (the magazine division) to be restructured or sold next. This ongoing corporate simplification should be a positive for TWX's trading multiple over time.

6. **Portfolio Diversification**:

➢ **Asset Mix.** The bulk of TWX's profits come from two of the fastest growing silos with the most pricing power in the media landscape: film and cable networks. Of total FY 2010E segment OIBDA, Cable Networks are projected to be approximately 69% and Film is projected to be approximately 23%. The balance (8%) of 2010E OIBDA comes from Publishing.

➢ **Business Model Diversification.** Direct-to-consumer payments for content contribute approximately about 40% of revenue, followed by subscription revenue at 35%, advertising at 20%, and other at 5%.

INVESTMENT ISSUES

1. **New Media Monetization.** The transition to the Internet platform has been fraught with economic value destruction for media companies so far (music and newspapers). We believe that the Internet fractures audiences and gives consumers infinite choice, which makes it difficult to capture economics for premium content over the PC. There is a culture of FREE on the Internet that puts downward pressure on old-world content prices. We are more optimistic about monetizing content over mobile platforms.

2. **Cable's Strategic Position?** As advertising revenue moves online, we worry about the long term strategic position of cable networks. For advertisers requiring reach, broadcast networks reach 15-20mm viewers each week with a hit show. This compares to a hit show on TNT or TBS that could reach 3-5mm viewers. At the other end of the spectrum, the Internet offers advertisers hyper-targeting, superior measurement and is cheaper than buying cable network time. We wonder whether cable networks are neither fish nor fowl (ie, neither reach nor inexpensive targeting), implying that advertising dollars (50% of cable segment revenue) may move out of the cable channel ecosystem over time.

3. **Potential Execution Issues.**
    - **Cable Networks.** TWX's entertainment-related cable networks reported audience declines in 4Q09 and both TBS and TNT season-to-date are down high-single digits in key demo targets. Ratings declines puts downward pressure on advertising revenue because: 1) advertising is sold on a CPM (cost per thousand viewers) basis, and 2) lower ratings limit TWX's ability to take advantage of the strong scatter market since valuable advertising inventory must be used for audience make-goods rather than sold for cash. CNN's ratings are down almost 50% and Headline News is down nearly 60% in key demos owing to difficult comps that included political advertising last year.
    - **Filmed Entertainment.** 2010 should be a tough year owing to a record 2009 film slate that included *The Hangover*, *Gran Torino* and *The Blind Side.* Industry wide DVD sales fell 7-15% (depending on who you read) in 2009 and we expect home entertainment revenue to contract again in 2010.
    - **Time Inc.** The future of print media is unclear. A few titles at Time Inc make the bulk of profits. The secular outlook for magazines is uncertain and therefore costs probably still need to come down. It's unclear whether TWX can gracefully exit this business.
4. **Low Advertising Exposure.** The current rebound in the advertising market, coupled with high operating leverage for advertising-driven media companies, makes us prefer advertising-driven business models at this point in the cycle. Only about 25% of TWX's revenues are derived from advertising-related businesses.
5. **Acquisition Risk.** With its glorious balance sheet and the still-low asset prices stemming from 2009's credit squeeze, we wonder *if* TWX will acquire something big. At the same time, we wonder about TWX's long-term strategy and growth prospects if it does *not* buy something big. Without acquisitions, we estimate that the 3 year growth outlook for TWX's EPS is about 10-12%, fairly valued for its 13x PE.

FINANCIAL OUTLOOK

Figure A includes our current estimates, and compares these to current consensus.

Figure A

FYE Dec 31:	1Q10E	2Q10E	3Q10E	4Q10E	2010E
Rev Cur ($mm)	**$6,360**	**$6,280**	**$6,279**	**$7,752**	**$26,670**
Previous ($mm)	-	-	-	-	-
Consensus ($mm)	$6,360	$6,280	NA	NA	$26,670
EPS-Bef Disc Ops	**$0.48**	**$0.48**	**$0.60**	**$0.56**	**$2.12**
Previous	-	-	-	-	-
Consensus	$0.48	$0.48	NA	NA	$2.14
P/E					12.7
Sources: Needham & Company estimates & Yahoo Finance.					

DETAILED QUARTERLY EARNINGS ANALYSIS

Table 1 shows TWX's fiscal 1Q10 estimates vs. 1Q09 actual results.

Table 1

TWX: 1Q09R vs 1Q10E

$ and shares in millions, except per share data

Revenue	**1Q 09R**	**1Q10E**	**Growth**
Filmed Entertainment	$2,633	$2,732	4%
Networks	$2,808	$2,991	6%
Publishing	$806	$802	-1%
Intersegment Eliminations	($161)	($165)	-2%
Total Revenue	**$6,086**	**$6,360**	**4%**
Segment OIBDA			
Filmed Entertainment	$308	$355	15%
Networks	$1,064	$1,151	8%
Publishing	$12	$16	34%
Segment OIBDA	$1,384	$1,523	10%
Asset Impairment, Severance	$0	$0	NM
Corp+Interseg+Merger Costs	($84)	($70)	17%
OIBDA, Adjusted	**$1,300**	**$1,453**	12%
Depreciation & Amort	($252)	($260)	-3%
Goodwill Impairment	$0	$0	
EBIT, after SBC	$1,048	$1,193	14%
Interest Expense	($311)	($275)	
Other Income (expense)	($37)	($15)	59%
Income Before Tax	$700	$903	29%
Income Taxes	($236)	($343)	-45%
Net Income	$464	$560	21%
Less: Minority Interest	($29)	$0	NM
Net Income	$661	$560	-15%
EPS	**$0.55**	**$0.48**	-12.4%
EPS-Operations	**$0.39**	**$0.48**	24.8%

(1) Recast to reflect exclusion of AOL and TWC, per TWX, and Needham & Co. estimates.

Sources: Company Reports, Needham & Company estimates.

FY 2010 PREVIEW

FY2010 Preview. We project TWX FY 2010 revenue of $26.67B, up 3% yr/yr, with segment data as follows:

- **Filmed Entertainment** revenue of $11.315B, up 2% y/y, and OIBDA of $1.461B, up 1% y/y. TWX will try to build upon the success of Filmed Entertainments FY 2009 results with the scheduled release of several franchise films lead by the seventh Harry Potter film, *Harry Potter and the Deathly Hollows (Part 1),* as well as the second installment of *Sex and the City.* In addition, the successful movie releases in 2009 should result in strong home video results.

- **Cable Networks** revenue of $12.387B, up 6% yr/yr, and OIBDA of $4.39B, up 11% y/y. We expect ad sales to continue to improve from 4Q09 results through FY 2010.

- **Publishing** revenue of $3.673B, down 2% y/y, and OIBDA of $495M, up 10% y/y.

OIBDA. We project FY 2010 OIBDA (after corp.) of $6.067B, up 9% yr/yr.

EPS. We project FY 2010 Operating EPS of $2.12, up 15.9% vs. FY 2009 adjusted EPS of $1.83.

VALUATION

Table 2: TWX: Valuation Summary & Conclusions

2010E Valuation Multiples			Embedded Expectations Metrics		
1	EV/Sales	1.7	7	**Breakeven DCF** (Calculated as the 10-Yr EBITDA CAGR required to justify current share price)	2.7%
2	EV/OIBDA	7.3			
3	P/E	12.7			
4	FCF/Share	$2.27			
5	EV/FCF	17.3			
6	FCF Yield	8%			

Source: Needham & Company estimates.

Our HOLD rating is based on several forms of valuation:

1. The **"Breakeven DCF"** valuation methodology uses the current share price to calculate the market's growth expectations for the enterprise, including capital efficiency trends. This valuation methodology concludes that TWX must achieve a 10-year OIBDA compound annual growth rate of approximately 2.7% to justify its current share price. (Please see Table 6.)
2. In Table 7, we summarize several **valuation multiples** for Sales, OIBDA and P/E. TWX's EV/OIBDA trading multiple is approximately 7.3x 2010E.
3. In Table 8, we present **Free Cash Flow** valuation metrics. Our Free Cash Flow analysis shows that TWX is currently valued at about 17.3x 2010E Free Cash flow and has an 8% free cash flow yield, making it fairly valued in our opinion.
4. In Table 9, we present our Comparative Industry valuation metrics which compares TWX with other companies in its industry on several metrics.

MANAGEMENT

Jeff Bewkes is Chairman and CEO of Time Warner Inc. He began serving as Chairman of the Board in January 2009, having been a Director since January 2007. He became CEO of the company in January 2008. From 2006 through 2007 he was president and COO of TWX. He was Chairman of the entertainment & networks group between 2002- 2005. Mr. Bewkes served as chairman and CEO of HBO from 1995-2002. Mr. Bewkes has a BA degree from Yale University and an MBA degree from Stanford Graduate School of Business.

John Martin has been Chief Financial Officer of TWX since January of 2009. Prior to that he was CFO of Time Warner Cable from 2005-2009. Prior to that he was SVP of Investor Relations of TWX between 2002 and 2005.

Barry Meyer has been CEO of Warner Bros since 1999.

Philip Kent has been CEO of Turner Broadcasting System since 2003. Between 2000 and 2003 he was the COO of CNN.

Table 3

TWX: Quarterly Income Statement Projections, 2010E

$ and shares in millions, except per share data

	2010E					Year/Year Change				
	3/31/10E	6/30/10E	9/30/10E	12/31/10E	2010E	3/31/10E	6/30/10E	9/30/10E	12/31/10E	2010E
Revenue										
Filmed Entertainment	$2,732	$2,408	$2,502	$3,673	$11,315	4%	3%	-10%	11%	2%
Networks	$2,991	$3,156	$3,061	$3,180	$12,387	6%	6%	6%	4%	6%
Publishing	$802	$897	$896	$1,079	$3,673	-1%	-2%	-2%	-2%	-2%
Intersegment Eliminations	($165)	($180)	($180)	($180)	($705)	2%	-9%	-11%	13%	-3%
Total Revenue	**$6,360**	**$6,280**	**$6,279**	**$7,752**	**$26,670**	4%	4%	-1%	6%	3%
Normalized OIBDA										
Filmed Entertainment	$355	$277	$425	$404	$1,461	15%	20%	10%	-23%	1%
Networks	$1,151	$1,073	$1,132	$1,034	$4,390	8%	9%	8%	18%	11%
Publishing	$16	$152	$143	$183	$495	34%	6%	3%	17%	10%
Segment OIBDA	$1,523	$1,502	$1,701	$1,621	$6,347	10%	11%	8%	4%	8%
Corp+Interseg+Merger Costs	($70)	($70)	($70)	($70)	($280)	-17%	-24%	13%	63%	0%
OIBDA	**$1,453**	**$1,432**	**$1,631**	**$1,551**	**$6,067**	12%	13%	8%	2%	9%
Depreciation & Amort	($260)	($260)	($260)	($260)	($1,040)	3%	6%	3%	6%	5%
Goodwill/Imp, Legal & Other	$0	$0	$0	$0	$0					
EBIT (Operating Income)	$1,193	$1,172	$1,371	$1,291	$5,027	14%	15%	9%	5%	11%
Interest Expense	($275)	($275)	($275)	($275)	($1,100)	-12%	-7%	-7%	9%	-5%
Other Income (expense)	($15)	($15)	($10)	($10)	($50)					
Income Before Tax	$903	$882	$1,086	$1,006	$3,877	29%	19%	19%	8%	18%
Income Taxes	($343)	($335)	($413)	($382)	($1,473)	-174%	-178%	-171%	-162%	-171%
Net Income Bef. Disc Ops/Acct	$560	$547	$673	$624	$2,404	-15%	5%	2%	-1%	15%
Discontinued Ops	$0	$0	$0	$0	$0					
Net Income	$560	$547	$673	$624	$2,404	-19%	3%	2%	-2%	-5%
Less: Income from Non-Control Ent.	$0	$0	$0	$0	$0					
Net Income-Reported	$560	$547	$673	$624	$2,404	-15%	5%	2%	-1%	-3%
EPS-Reported	**$0.48**	**$0.48**	**$0.60**	**$0.56**	**$2.12**	**-12%**	**10%**	**10%**	**6%**	**2%**
EPS- Adjusted	**$0.48**	**$0.48**	**$0.60**	**$0.56**	**$2.12**	**25%**	**37%**	**23%**	**11%**	**22%**
Avg Diluted Shares Out	1,160	1,145	1,125	1,105	1,134					

Sources: Company Reports, Needham & Company estimates.

Table 4

TWX: Segment Annual Financial Information, 2008A-2011E

$ and shares in millions, except per share data

	Annual[1]				
FYE 12/31:	**2008A**	**2009A**	**2010E**	**2011E**	**'08-'11 CAGR**
Revenue					
Filmed Entertainment	$11,398	$11,066	$11,315	$11,597	0.6%
Networks	$11,154	$11,703	$12,387	$13,155	5.7%
Publishing	$4,608	$3,736	$3,673	$3,655	-7.4%
Intersegment Eliminations	($688)	($724)	($705)	($700)	0.6%
Total Revenue	**$26,516**	**$25,781**	**$26,670**	**$27,708**	**1.5%**
OIBDA					
Filmed Entertainment	$1,228	$1,447	$1,461	$1,566	8.4%
Networks	$3,487	$3,967	$4,390	$4,525	9.1%
Publishing	$749	$452	$495	$665	-3.9%
Subtotal Segment EBITDA	$5,490	$5,866	$6,347	$6,756	7.2%
Corp & Intersegment	$68	($281)	($280)	($260)	
OIBDA (after corp)	**$5,558**	**$5,585**	**$6,067**	**$6,496**	**5.3%**
Depreciation & Amortization	($1,026)	($995)	($1,040)	($1,050)	0.8%
Goodwill Impairment	$0	($45)	$0	$0	
EBIT (Operating Income)	**($2,925)**	**$4,545**	**$5,027**	**$5,446**	NM
Net Interest Expense	($1,327)	($1,155)	($1,100)	($1,050)	-7.5%
Minority Interest (Expense)	($1,309)	$0	($50)	$0	
Other Income (expense), net	($22)	($107)	$0	($25)	4.4%
Income Before Tax	($4,410)	$3,283	$3,877	$4,371	NM
Income Taxes (proj at 37%)	($651)	($1,194)	($1,473)	($1,661)	36.6%
Discontinued Ops & Accting	($8,130)	$428	$0	$0	
Net Income-Reported	**($14,620)**	**$2,517**	**$2,404**	**$2,710**	NM
Net Income Bef. Disc Ops/Acct	**($5,061)**	**$2,517**	**$2,404**	**$2,710**	NM
EPS-Reported	($11.23)	$2.07	$2.12	$2.34	NM
EPS-Operations	**($4.27)**	**$1.74**	**$2.12**	**$2.34**	**NM**
Avg Diluted Shares Out	1,194	1,195	1,134	1,160	-1.0%

(1) Adjusted to reflect the exclusion of TWC and AOL..

Sources: Company Reports, Needham & Company estimates.

Table 5

Time Warner: Standard DCF Calculation, 2010E-2019E

$ and shares in millions, except per share data

Valuation Conclusions		**% of Total**
Sum of PV of Free Cash Flow [1]	$25,767	50%
PV of Terminal Value Discounted at WACC [1]	$19,410	38%
Value of Operations (WACC Method)	**$45,177**	**88%**
Plus: Excess Cash at 12/31/09A	$4,800	
Plus: Non-Consolidated Assets (From PMV)	$1,200	
Less: Minority Interest	($20)	
Less: Unfunded Retirement Liabilities	$0	
Enterprise Value	**$51,157**	**100%**
Less: Debt at 12/31/09A	($15,357)	
Less: Lease Obligations	($4,500)	
Less: Preferred Stock Outstanding	$0	
Less: Value of Options & Restricted Sk, After-tax	($600)	
Common Equity Value	**$30,700**	**60%**
Fully Diluted Shares Out, 2010E	1,134	
DCF Value/Share	**$27.08**	
Current Share Price @ 2/5/10	$27.03	
Upside Potential (DCF-Current Price/Current Price)	**0%**	

Standard Discounted Cash Flow (DCF) Valuation

Why We Calculate: DCF is a rigorous bottoms-up valuation of the enterprise focusing on cash flows (not accounting)

Strengths

1 Focuses on operations. Removes financing
2 Focuses on FCF. Removes non-cash accounting
3 Explicitly forecasts capital needs (WC & CapX)
3 Uses a levered beta (widely available)
4 Ent value focus captures entire business model

Weaknesses

1 Many assumptions. Valuation can be manipulated
2 Terminal value big & based on low visiblity projections
3 Model assumes constant debt/equity ratio
4 Complex to calculate
5 Calculates the enterprise value first, then equity value

[1] **Calculation of the Value of Operations (WACC Method)**

FYE 12/31:	2009A	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	CAGR '10-19E
EBITDA (after sk comp exp & corp):	**$5,585**	**$6,067**	**$6,496**	**$6,509**	**$6,516**	**$6,522**	**$6,522**	**$6,522**	**$6,522**	**$6,522**	**$6,522**	**0.8%**
- Depreciation	($995)	($1,040)	($1,050)	($665)	($683)	($702)	($721)	($740)	($760)	($781)	($802)	
+ Option Exercise Proceec	$56	$50	$50	$50	$50	$50	$50	$50	$50	$50	$50	
+ Int & Inv Income only	$120	$100	$100	$100	$100	$100	$100	$100	$100	$100	$100	
EBIT	$4,766	$5,177	$5,596	$5,994	$5,982	$5,970	$5,951	$5,932	$5,912	$5,891	$5,870	
Cash Taxes (at 35%)	($715)	($1,760)	($1,903)	($2,038)	($2,034)	($2,030)	($2,023)	($2,017)	($2,010)	($2,003)	($1,996)	
Plus: Depreciation	$995	$1,040	$1,050	$665	$683	$702	$721	$740	$760	$781	$802	
Plus: Sk Based Comp Exp	$175	$150	$150	$150	$150	$150	$150	$150	$150	$150	$150	
Working Capital Change	($397)	($263)	($272)	($266)	($273)	($281)	($252)	($222)	($228)	($234)	($241)	
Less: Capital Spending	($561)	($585)	($648)	($665)	($683)	($702)	($721)	($740)	($760)	($781)	($802)	
FCF from Operations	**$4,263**	**$3,758**	**$3,973**	**$3,840**	**$3,825**	**$3,810**	**$3,826**	**$3,843**	**$3,824**	**$3,804**	**$3,784**	**0.1%**
PV Discounted at WACC [2]		$3,758	$3,607	$3,164	$2,861	$2,587	$2,358	$2,150	$1,942	$1,754	$1,584	
Sum of PV of Free Cash Flow											$25,767	
Terminal Value of 2019E FCF [3]											$46,371	
PV of Terminal Value at WACC [2]											$19,410	
Discount Period		0	1	2	3	4	5	6	7	8	9	

[2] **Calculation of WACC:**	
10-Year Risk Free Rate ("RFR")	3.0%
Equity Risk Premium (Ibbotson-Arithmetic)	7.0%
Levered Beta (Bloomberg)	1.20
Target Equity/(Debt + Equity)	80%
Debt Rating	BBB+
Debt Spread	5.0%
Marginal Tax Rate ("T")	35.0%
WACC	**10.2%**

(RFR+(Equity Risk Premium x Beta)) x % Equity/Total Capital + ((RFR + Debt Spread) x (1-T) x % Debt/Total Capital).

[3] **Calculation of Terminal Multiple (WACC Method)**	
WACC	10.2%
Long-term Nominal GDP Growth	2.0%
WACC-GDP Growth	8.2%
FCF Terminal Multiple [1/(WACC-Growth Rate)]	**12.3**
EBITDA Terminal Mutiple	**7.1**

Sources: Company Reports, Needham & Company estimates.

Table 6

Time Warner: Breakeven Discounted Cash Flow Valuation Calculation, 2010E - 2019E

$ and shares in millions, except per share data

Valuation Conclusions		2010E
Sum of PV of Free Cash Flow [1]		$23,207
PV of Terminal Value Discounted at WACC [1]		$22,009
Value of Operations (WACC Method)		**$45,216**
Plus: Excess Cash at 12/31/09A		$4,800
Plus: Non-Consolidated Assets (From PMV)		$1,200
Less: Minority Interest		($20)
Enterprise Value		**$51,196**
Less: Debt at 12/31/09A		($15,357)
Less: Lease Obligations		($4,500)
Less: Preferred Stock Outstanding		$0
Less: Value of Options & Restricted Sk, After-tax		($600)
Common Equity Value		**$30,739**
Fully Diluted Shares Out, 2010E		1,134
Breakeven DCF Value/Share		**$27.11**
Current Share Price @	2/5/10	$27.03
Discount to DCF Value (DCF-Current Price/DCF)		0%

Breakeven Discounted Cash Flow Valuation

Why We Calculate: BE DCF uses the current share price to calculate the market's growth expectations for the enterprise.

Strengths

1 Makes no assumption about growth for first 10 years
2 Prevents over-optimism by working backwards
3 Data widely available and model well understood
4 Explicitly forecasts capital needs (WC & CapX)
5 Uses a levered beta (widely available)

Weaknesses

1 Terminal value big & based on low visiblity projections
2 Model assumes constant debt/equity ratio
3 Complex to calculate
4 Calculates the enterprise value first, then equity value

[1] **Calculation of the Value of Operations (WACC Method)**

FYE 12/31:	2009A	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	Required LT Growth Rate
EBITDA (after sk comp exp & corp):	**$5,585**	**$5,736**	**$5,891**	**$6,050**	**$6,213**	**$6,381**	**$6,553**	**$6,730**	**$6,912**	**$7,098**	**$7,290**	**2.70%**
- Depreciation	($995)	($1,040)	($1,050)	($665)	($683)	($702)	($721)	($740)	($760)	($781)	($802)	
+ Option Exercise Proceec	$56	$50	$50	$50	$50	$50	$50	$50	$50	$50	$50	
+ Int & Inv Income only	$120	$100	$100	$100	$100	$100	$100	$100	$100	$100	$100	
EBIT	$4,766	$4,846	$4,991	$5,534	$5,680	$5,829	$5,982	$6,140	$6,301	$6,468	$6,638	
Cash Taxes (at 35%)	($838)	($1,648)	($1,697)	($1,882)	($1,931)	($1,982)	($2,034)	($2,088)	($2,142)	($2,199)	($2,257)	
Plus: Depreciation	$995	$1,040	$1,050	$665	$683	$702	$721	$740	$760	$781	$802	
Plus: Sk Based Comp Exp	$175	$150	$150	$150	$150	$150	$150	$150	$150	$150	$150	
Working Capital Change	($397)	($263)	($272)	($266)	($273)	($281)	($252)	($222)	($228)	($234)	($241)	
Less: Capital Spending	($561)	($585)	($648)	($665)	($683)	($702)	($721)	($740)	($760)	($781)	($802)	
FCF from Operations	**$4,140**	**$3,540**	**$3,574**	**$3,536**	**$3,625**	**$3,716**	**$3,846**	**$3,980**	**$4,081**	**$4,184**	**$4,291**	
PV Discounted at WACC [2]	-10%	$3,540	$3,244	$2,914	$2,712	$2,524	$1,899	$1,706	$1,519	$1,353	$1,796	
Sum of PV of Free Cash Flow											$23,207	
Terminal Value of 2019E FCF [3]											$52,581	
PV of Terminal Value at WACC [2]											$22,009	
Discount Period		0	1	2	3	4	5	6	7	8	9	

[2] **Calculation of WACC:**

10-Year Risk Free Rate ("RFR")	3.0%
Equity Risk Premium (Ibbotson-Arithmetic)	7.0%
Levered Beta (Bloomberg)	1.20
Target Equity/(Debt + Equity)	80%
Debt Rating	BBB+
Debt Spread	5.0%
Marginal Tax Rate ("T")	35.0%
WACC	**10.2%**

(RFR+(Equity Risk Premium x Beta)) x % Equity/Total Capital + ((RFR + Debt Spread) x (1-T) x % Debt/Total Capital).

[3] **Calculation of Terminal Multiple (WACC Method)**

WACC	10.2%
Long-term Nominal GDP Growth	2.0%
WACC-GDP Growth	8.2%
FCF Terminal Multiple [1/(WACC-Growth Rate)]	**12.3**
EBITDA Terminal Mutiple	**7.2**

Sources: Company Reports, Needham & Company estimates.

Table 7 **TWX: Valuation Multiples (Sales, OIBDA, P/E)** $ and shares in millions, except per share data		
Valuation Conclusions		**2010E**
Market-Based Enterprise Value [1]		$44,502
2010E Sales (From Annual Projections)		$26,670
EV/Sales		**1.7**
Market-Based Enterprise Value [1]		$44,502
2010E OIBDA (From Annual Projections)		$6,067
EV/OIBDA		**7.3**
Target Price		NA
Target Price EV/2011 OIBDA		**NA**
Current Price	2/5/10	$27.03
2010E EPS (From Annual Projections)		$2.12
P/E Ratio		**12.7**
[1] **Calculation of Market-Based Enterprise Value**		
Year End 12/31:		2010E
Current Share Price	02/05/10	$27.03
Fully Diluted Shares Out		1,134
Market Capitalization		**$30,645**
Less: Excess Cash		($4,800)
Less: Non-Consolidated Assets		($1,200)
Plus: Unfunded Retirement Liabilities		$0
Plus: Debt at 12/31/10		$15,357
Plus: Lease Obligations		$4,500
Plus: Preferred Stock Outstanding		$0
Plus: Options & Warrants Outstanding		$600
Market-Based Enterprise Value		**$44,502**
Sources: Company Reports, Needham & Company estimates.		

Table 8 **Time Warner: Free Cash Flow Valuation Metrics** $ and shares in millions, except per share data		
Valuation Conclusions		**2010E**
FCF/Share [2]		$2.27
Current Price	2/5/10	$27.03
FCF Yield		**8%**
FCF [2]		$2,571
2010E OIBDA (From Annual Projections)		$6,067
FCF Conversion Rate (FCF/OIBDA)		**42%**
Market-Based Enterprise Value [1]		$44,502
FCF [2]		$2,571
EV/FCF		**17.3**
Net Debt/EV		24%
Net Debt + Unfunded Retirement Liabs		$10,557
Net Debt/Market Cap		**34.4%**
[2] **Calculation of Free Cash Flow**		
Year End 12/31:		2010E
OIBDA		$6,067
Plus: Option Exercise Proceeds		$50
Less: Cash Interest Expense		($1,100)
Minority Interest		$50
Less: Preferred Dividends		$0
Less: Cash Taxes		($1,648)
Less: Change in Working Capital		($263)
Less: Capital Spending		($585)
Free Cash Flow		**$2,571**
Less: Dividends		($964)
Free Cash Flow After Dividends		$1,607
Shares Outstanding		1,134
FCF/Share		**$2.27**
FCF/Share After Dividends		$1.42
Sources: Company Reports, Needham & Company estimates.		

Table 9

Comparative Valuation Information, 2010E

$ and shares in millions, except per share data

Laura Martin's Coverage				2010E Multiples				Break-	2/5/10		
Sorted by Industry	**Ticker**	**Market Cap ($B)**	**Rating**	**EV/ EBITDA**	**P/E**	**EV/ FCF**	**FCF Yield**	**even DCF**	**Target Price**	**Current Price**	**Target/ Current**
Content Companies											
1 CBS	CBS	$9	BUY	7.8	14.0	17.6	11.1%	7.2%	$17.00	$12.95	31%
2 Disney	DIS	$56	HOLD	8.3	15.5	28.3	4.1%	9.1%	NA	$29.54	
3 NewsCorp	NWS	$39	BUY	8.2	20.3	24.4	4.8%	4.1%	$18.00	$15.23	18%
4 Time Warner Inc	**TWX**	**$31**	**HOLD**	**7.3**	**12.7**	**17.3**	**8.4%**	**2.7%**	**NA**	**$27.03**	
5 Viacom	VIAB	$17	BUY	6.6	11.4	19.0	7.0%	6.2%	$37.00	$28.43	30%
6 Warner Music	WMG	$0.7	BUY	6.6	(7.6)	17.5	18.9%	-4.5%	$7.00	$5.00	40%
Industry Total/Average		$152		7.5	11.1	20.7	9.0%	4.1%	NA	$19.70	NA
Cable Companies											
7 Mediacom	MCCC	$0.3	BUY	6.8	NMF	NMF	NMF	2.7%	$7.00	$4.09	71%
8 Time Warner Cable	TWC	$16	BUY	5.5	12.4	23.1	9.9%	2.1%	$55.00	$45.12	22%
Industry Total/Average		$16		6.1	12.4	23.1	9.9%	2.4%	$31.00	$24.61	46.5%
Total/Average for Entire Page		**$168**		**6.8**	**11.7**	**21.9**	**9.5%**	**3.3%**			**NM**

Sources: Needham & Company estimates, Company documents, FirstCall, Yahoo Finance.

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I, Laura Martin, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company (ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Price, Rating, and Price Target History: Time Warner Inc. (TWX/NYSE) as of 2-5-10

Source: Factset (Prices) / Needham (ratings)

Disclosures applicable to this security: B.

Price, Rating, and Price Target History: Viacom Inc. CL B (VIAB/NYSE) as of 2-5-10

Source: Factset (Prices) / Needham (ratings and target price)

Disclosures applicable to this security: B.

Price, Rating, and Price Target History: CBS Corp. (CBS/NYSE) as of 2-5-10

Source: Factset (Prices) / Needham (ratings and target price)

Disclosures applicable to this security: B.

Price, Rating, and Price Target History: News Corporation (NWSA/NASDAQ) as of 2-5-10

Source: Factset (Prices) / Needham (ratings and target price)

Disclosures applicable to this security: B, G.

	% of companies under coverage with this rating	% for which investment banking services have been provided for in the past 12 months
Strong Buy	6	5
Buy	57	8
Hold	32	4
Under Perform	1	0
Rating Suspended	3	17
Restricted	<1	50
Under Review	0	0

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