TIME WARNER INC
Form 10-K/A
September 13, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K/A
Amendment No. 1

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2005
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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, $.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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, and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

As of the close of business on February 17, 2006, there were 4,418,053,277 shares of the registrant s Common Stock and 87,245,036 shares of the registrant s Series LMCN-V Common Stock outstanding. The aggregate market

value of the registrant s voting and non-voting common equity securities held by non-affiliates of the registrant (based upon the closing price of such shares on the New York Stock Exchange on June 30, 2005) was approximately $74.67 billion.

Documents Incorporated by Reference:

Description of document	Part of the Form 10-K
Portions of the definitive Proxy Statement to be used in connection with the registrant s 2006 Annual Meeting of Stockholders	Part III (Item 10 through Item 14) (Portions of Items 10 and 12 are not incorporated by reference and are provided herein; portions of Item 11 are not incorporated by reference and are provided in the registrant s definitive Proxy Statement)

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Restatement of Prior Financial Information

As previously disclosed by Time Warner Inc. (Time Warner or the Company), the Securities and Exchange Commission (SEC) had been conducting an investigation into certain accounting and disclosure practices of the Company. On March 21, 2005, the Company announced that the SEC had approved the Company s proposed settlement, which resolved the SEC s investigation of the Company. Under the terms of the settlement with the SEC, the Company agreed, without admitting or denying the SEC s allegations, to be enjoined from future violations of certain provisions of the securities laws and to comply with the cease-and-desist order issued by the SEC to AOL LLC (formerly America Online, Inc., AOL), a subsidiary of the Company, in May 2000. The Company also agreed to appoint an independent examiner, who was to either be or hire a certified public accountant. The independent examiner was to review whether the Company s historical accounting for transactions (as well as any subsequent amendments) with 17 counterparties identified by the SEC staff, principally involving online advertising revenues and including three cable programming affiliation agreements with related online advertising elements, was appropriate, and provide a report to the Company s Audit and Finance Committee of its conclusions, originally within 180 days of being engaged. The transactions that were to be reviewed were entered into (or amended) between June 1, 2000 and December 31, 2001, including subsequent amendments thereto, and involved online advertising and related transactions for which the majority of the revenue was recognized before January 1, 2002.

The independent examiner began his review in June 2005 and, after several extensions of time, recently completed that review, in which he concluded that certain of the transactions under review with 15 counterparties, including three cable programming affiliation agreements with advertising elements, were accounted for improperly because the historical accounting did not reflect the substance of the arrangements. Under the terms of its SEC settlement, the Company is required to restate any transactions that the independent examiner determined were accounted for improperly. Accordingly, on August 15, 2006, the Company determined it would restate its consolidated financial results for each of the years ended December 31, 2000 through December 31, 2005 and for the six months ended June 30, 2006. The financial statements presented in this report reflect the impact of the adjustments being made in the Company s financial results.

The transactions being restated are principally transactions in which (i) AOL secured online advertising commitments from counterparties (and subsequently delivered on such commitments) at the same time that the Company entered into commitments with those same counterparties to purchase products or services or to make an investment in such counterparties and (ii) in the case of three counterparties, Time Warner Cable, a subsidiary of the Company, entered into cable programming affiliation agreements at the same time it committed to deliver (and did subsequently deliver) network and online advertising services to those same counterparties. Total advertising revenue recognized by the Company under these transactions was $584 million ($24 million in 2000, $378 million in 2001, $107 million in 2002, $67 million in 2003 and $8 million in 2004). Included in the $584 million is $37 million related to operations that have been subsequently classified as discontinued operations and $12 million of amounts that were reclassified to another revenue category (content or other) in connection with the restatement. In addition to reversing the recognition of revenue, based on the independent examiner s conclusions and as described more fully below, the Company has recorded corresponding reductions in the cost of the products or services that were acquired or investments that were made contemporaneously with the execution of the advertising agreements. In addition, the independent examiner concluded that approximately $119 million in marketing expenses were not recognized in the appropriate accounting period.

Included in the $584 million of restated advertising revenues is $310 million of advertising revenues in which the advertising arrangements were secured by AOL contemporaneously with the purchase of products or services or making an investment. In restating these transactions, the Company has reduced the cost of the related products, services or investment, which has had the effect of increasing earnings during certain of the periods. The remaining balance of the $584 million (or $274 million) consists of advertising arrangements that were secured contemporaneously with cable programming affiliation agreements. In restating these advertising arrangements, the Company is reducing cable programming costs over the life of the related cable programming affiliation arrangements (which range from 10 to 12 years), which has the effect of increasing earnings during certain of the periods restated and in future periods.

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In addition to the revenue impact, the net effect of restating these transactions is that the Company s net income has been reduced by $1 million in 2000 and $161 million in 2001 and has been increased by $62 million in 2002, $18 million in 2003, $30 million in 2004 and $16 million in 2005. Included in the 2002 incremental net income of $62 million is a $42 million decrease in the aggregate goodwill impairment charge recognized by the Company during 2002. While the restatement results in changes in the classification of cash flows, it has not impacted total cash flow during the periods.

Except for the information affected by the restatement and the elimination of the condensed consolidating financial statements discussed below, the Company has not updated the information contained herein for events or transactions occurring subsequent to the date the Company s Annual Report on Form 10-K for the year ended December 31, 2005 (the 2005 Form 10-K) was filed with the SEC. The Company therefore recommends that this Annual Report on Form 10-K/A be read in conjunction with the Company s reports filed subsequent to the filing date of the 2005 Form 10-K.

Amended Items

The Company hereby amends the following items, financial statements, exhibits or other portions of the 2005 Form 10-K as set forth herein.

PART II

Item 6. ***Selected Financial Data.***

The selected financial information of the Company for the five years ended December 31, 2005 is amended to read in its entirety as set forth at pages 129 through 130 herein and is incorporated herein by reference.

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations.***

The information set forth under the caption Management s Discussion and Analysis of Results of Operations and Financial Condition is amended to read in its entirety as set forth at pages 6 through 62 herein and is incorporated herein by reference.

Item 7A. ***Quantatative and Qualitative Disclosures About Market Risk.***

The information set forth under the caption Market Risk Management is amended to read in its entirety as set forth at pages 54 through 56 herein and is incorporated herein by reference.

Item 8. ***Financial Statements and Supplementary Data.***

The consolidated financial statements of the Company and the report of the Independent Registered Public Accounting Firm thereon are amended to read in their entirety as set forth at pages 63 through 127, and page 128 herein, respectively, and are incorporated herein by reference.

Quarterly Financial Information (unaudited) is amended to read in its entirety as set forth at pages 131 through 132 herein and is incorporated herein by reference.

At the time the Company filed the 2005 Form 10-K, certain debt securities of Time Warner Companies, Inc., which were guaranteed by the Company and certain subsidiaries of the Company, were listed on the New York Stock Exchange. Accordingly, the 2005 Form 10-K included the condensed consolidating financial statements required under Rule 3-10 of Regulation S-X. In June 2006, the Time Warner Companies, Inc. debt was delisted from the New York Stock Exchange and deregistered under Section 12(b) of the Securities Exchange Act of 1934, and the requirement to include the condensed consolidating financial statements was suspended. Because the Company is no longer required to include this supplementary data, such supplementary data has not been restated or included in this Annual Report on Form 10-K/A.

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PART IV

Item 15. ***Exhibits and Financial Statements Schedules.***

(a)(1) (2) Financial Statements and Schedules:

Item 15(a)(1) (2) is amended to replace subparagraph (i) thereof to read in its entirety as follows:

(i) The list of consolidated financial statements and schedules set forth in the accompanying Index to Consolidated Financial Statements and Other Financial Information at page 5 herein is incorporated herein by reference. Such consolidated financial statements and schedules are filed as part of this Annual Report on Form 10-K/A.

(3) *Exhibits:*

The list of exhibits set forth in, and incorporated from, the Exhibit Index is amended to include the following additional exhibits, each of which is filed herewith:

23 Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.

31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, with respect to the Registrant s Annual Report on Form 10-K/A for the fiscal year ended December 31, 2005.

31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, with respect to the Registrant s Annual Report on Form 10-K/A for the fiscal year ended December 31, 2005.

32 Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, with respect to the Registrant s Annual Report on Form 10-K/A for the fiscal year ended December 31, 2005.

This certification will not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934 (15 U.S.C. 78r) or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, except to the extent that

the Company specifically incorporates it by reference.

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Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TIME WARNER INC.

By: /s/ Wayne H. Pace
Name: Wayne H. Pace
Title: Executive Vice President and Chief Financial Officer

Date: September 13, 2006

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INTRODUCTION

Management s discussion and analysis of results of operations and financial condition (MD&A) is provided as a supplement to the accompanying consolidated financial statements and notes to help provide an understanding of Time Warner Inc. s (Time Warner or the Company) financial condition, changes in financial condition 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 years ended December 31, 2005. This analysis is presented on both a consolidated and a business segment basis. In addition, a brief description is provided of significant transactions and events that impact the comparability of the results being analyzed.

Financial condition and liquidity. This section provides an analysis of the Company s cash flows for the three years ended December 31, 2005, as well as a discussion of the Company s outstanding debt and commitments that existed as of December 31, 2005. Included in the analysis of outstanding debt is a discussion of the amount of financial capacity available to fund the Company s future commitments, as well as a discussion of other financing arrangements.

Critical accounting policies. This section discusses accounting policies that are considered important to the Company s financial condition and results of operations, require significant judgment and require estimates on the part of management in application. The Company s significant accounting policies, including those considered to be critical accounting policies, are summarized in Note 1 to the accompanying consolidated financial statements.

Market risk management. This section discusses how the Company manages exposure to potential loss arising from adverse changes in interest rates, foreign currency exchange rates and changes in the market value of financial instruments.

Use of Operating Income before Depreciation and Amortization

The Company utilizes Operating Income before Depreciation and Amortization, among other measures, to evaluate the performance of its businesses. Operating Income before Depreciation and Amortization is considered an important indicator of the operational strength of the Company s businesses. Operating Income before Depreciation and Amortization eliminates the uneven effect across all business segments of considerable amounts of noncash depreciation of tangible assets and amortization of certain intangible assets that were recognized in business combinations. A limitation of this measure, however, is that it does not reflect the periodic costs of certain capitalized tangible and intangible assets used in generating revenues in the Company s businesses. Management evaluates the investments in such tangible and intangible assets through other financial measures, such as capital expenditure budgets, investment spending levels and return on capital.

Operating Income before Depreciation and Amortization should be considered in addition to, not as a substitute for, the Company s Operating Income and Net Income, as well as other measures of financial performance reported in accordance with U.S. generally accepted accounting principles. A reconciliation of Operating Income before Depreciation and Amortization to both Operating Income and Net Income is presented under Results of Operations.

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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 HBO, CNN, AOL, *People, Sports Illustrated, Time* and Time Warner Cable. The Company produces and distributes films, including *The Lord of the Rings* trilogy, the *Harry Potter* series, *Batman Begins* and *Wedding Crashers*, as well as television programs, including *ER, Two and a Half Men, Cold Case* and *Without a Trace*. During 2005, the Company generated revenues of $43.652 billion (up 4% from $42.081 billion in 2004), Operating Income before Depreciation and Amortization of $7.816 billion (down 17% from $9.414 billion in 2004), Operating Income of $4.548 billion (down 27% from $6.217 billion in 2004), Net Income of $2.921 billion (down 14% from $3.394 billion in 2004) and Cash Provided by Operations of $4.965 billion (down 25% from $6.617 billion in 2004). Included in the amounts above are charges of $2.865 billion and $536 million related to securities litigation and the government investigations for 2005 and 2004, respectively, as discussed further in Other Recent Developments.

Time Warner Businesses

Time Warner classifies its operations into five reportable segments: AOL, Cable, Filmed Entertainment, Networks and Publishing.

AOL. America Online, Inc. (AOL) operates a leading network of web brands and the largest Internet access subscription service in the United States, with 25.5 million total AOL brand subscribers in the U.S. and Europe at the end of 2005. In 2005, AOL reported total revenues of $8.283 billion (19% of the Company s overall revenues), $1.899 billion in Operating Income before Depreciation and Amortization and $1.177 billion in Operating Income. AOL generates its revenues primarily from subscription fees charged to subscribers and from providing advertising services.

AOL is organized into four business units: Access, Audience, Digital Services and International. This structure reflects AOL s emphasis on increasing Advertising revenues, including paid-search, which the Company believes will continue to grow for the foreseeable future.

Historically, AOL s primary product offering has been an online subscription service that includes dial-up telephone Internet access. This product, offered under a variety of different terms and price plans, generates the substantial majority of AOL s revenues. Over the past several years, the AOL Access business unit has experienced significant declines in U.S. subscribers to the AOL service and in related Subscription revenues, and these declines are expected to continue. These decreases are due primarily to the continued industry-wide maturing of the premium dial-up services business, as consumers migrate to high-speed services and lower-cost dial-up services. AOL continues to develop, change, test and implement marketing and new product strategies to attract and retain subscribers. AOL has recently entered into a number of agreements with high-speed access providers to offer the AOL service along with high-speed Internet access.

AOL s Audience business unit generates Advertising revenues from the sale of banner advertising on a fixed impression or fixed placement basis, as well as from the sale of paid-search and other pay-for-performance advertising on AOL s and Advertising.com Inc. s (Advertising.com) networks of Internet properties, which include owned and third-party properties, as well as certain Internet properties owned by other divisions of the Company. Currently, a significant majority of Advertising revenues are generated from traffic by subscribers to the AOL subscription service. The strategy of the Audience business unit focuses on generating Advertising revenue by increasing the reach of its audience and depth of its usage across its web properties, including properties such as AOL.com, AIM, MapQuest and Moviefone. A key component of this strategy was the third quarter 2005 re-launch of the publicly available version of the AOL.com web portal that includes a substantial portion of AOL s content, features and tools that were historically available only to AOL subscribers. AOL seeks to generate Advertising revenue from increased traffic to AOL.com through sales of branded advertising and performance-based advertising, including paid-search, as well as from increased utilization and optimization of AOL advertising inventory. The acquisition of Advertising.com in the third quarter of 2004 has provided incremental growth in Advertising revenues, primarily through third-party

performance-based advertising.

AOL s Digital Services business unit works to develop next-generation digital services, including a variety of wireless, voice and other premium services and applications that appeal to AOL members and Internet users.

AOL s International business unit, which primarily includes AOL Europe, has an Internet access business, sells advertising and develops and offers premium digital services. AOL Europe has focused on increasing revenues from advertising and paid services. Due to the regulatory environment in the countries in which AOL Europe operates, AOL Europe is able to offer competitive bundled

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broadband services to consumers and, accordingly, its bundled broadband subscribers are growing as a percentage of total subscribers as consumers migrate from dial-up plans. This trend is expected to continue.

Cable. Time Warner s cable business, Time Warner Cable Inc. and its subsidiaries (TWC Inc.), is the second-largest cable operator in the U.S. (in terms of basic cable subscribers served). TWC Inc. managed approximately 10.957 million basic cable subscribers (including approximately 1.557 million subscribers of unconsolidated investees) at the end of 2005, in highly clustered and technologically upgraded systems in 27 states. TWC Inc. delivered revenues of $9.498 billion (22% of the Company s overall revenues), $3.672 billion of Operating Income before Depreciation and Amortization and $2.008 billion in Operating Income during 2005. As part of the strategy to expand TWC Inc. s cable footprint and improve the clustering of its cable systems, TWC Inc., through a subsidiary, entered into agreements on April 20, 2005 to acquire, in conjunction with Comcast Corporation (Comcast), substantially all of the assets of Adelphia Communications Corporation (Adelphia). Please refer to Other Recent Developments for further details.

TWC Inc. principally offers three products video, high-speed data and Digital Phone. Video is TWC Inc. s largest product in terms of revenues generated; however, the potential growth of its customer base within TWC Inc. s existing footprint for video cable service is limited, as the customer base has matured and industry-wide competition has increased. Nevertheless, TWC Inc. is continuing to increase its video revenues through rate increases and its offerings of advanced digital video services such as Digital Video, Video-on-Demand (VOD), Subscription-Video-on-Demand (SVOD) and Digital Video Recorders (DVRs), which are available throughout TWC Inc. s footprint. TWC Inc. s digital video subscribers provide a broad base of potential customers for these advanced services. Video programming costs represent a major component of TWC Inc. s expenses and are expected to continue to increase, reflecting an expansion of service offerings and contractual rate increases across TWC Inc. s programming lineup.

High-speed data service has been one of TWC Inc. s fastest-growing products over the past several years and is a key driver of its results. TWC Inc. expects continued strong growth in residential high-speed data subscribers and revenues for the foreseeable future; however, the rate of growth of both subscribers and revenue could be impacted by intensified competition with other service providers for subscribers.

TWC Inc. s voice product, Digital Phone, first launched in May 2003, was rolled out across TWC Inc. s footprint during 2004. As of December 31, 2005, Digital Phone was available to nearly 85% of TWC Inc. s homes passed and over one million subscribers received the service. For a monthly fixed fee, Digital Phone customers typically receive unlimited local, in-state and U.S., Canada and Puerto Rico long-distance calling, as well as call waiting, caller ID and enhanced 911 services. In the future, TWC Inc. intends to offer additional plans with a variety of local and long-distance options. Digital Phone enables TWC Inc. to offer its customers a convenient package of video, high-speed data and voice services and to compete effectively against similar bundled products available from its competitors. TWC Inc. expects strong growth in Digital Phone subscribers and revenues for the foreseeable future.

In addition to the subscription services, TWC Inc. also earns revenue by selling advertising time to national, regional and local businesses.

Filmed Entertainment. Time Warner s Filmed Entertainment businesses, Warner Bros. Entertainment Inc. (Warner Bros.) and New Line Cinema Corporation (New Line), generated revenues of $11.924 billion (26% of the Company s overall revenues), $1.289 billion in Operating Income before Depreciation and Amortization and $943 million in Operating Income during 2005.

One of the world s leading studios, Warner Bros. has diversified sources of revenues with its film and television businesses, combined with an extensive film library and global distribution infrastructure. This diversification has helped Warner Bros. deliver consistent long-term growth and performance. New Line is the world s oldest independent film company. Its primary source of revenues is the creation and distribution of theatrical motion pictures.

Warner Bros. continues to develop its industry-leading television business, including the successful releases of television series into the home video market. For the 2005-2006 television season, Warner Bros. has more current prime-time productions on the air than any other studio, with prime-time series on all six broadcast networks

(including *Two and a Half Men, ER, Without a Trace, The O.C., Cold Case* and *Smallville*).

The sale of DVDs has been one of the largest drivers of the segment s profit growth over the last few years and Warner Bros. extensive library of theatrical and television titles positions it to continue to benefit from DVD sales; however, the Company has

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begun to see slower growth in DVD sales due to several factors, including increasing competition for consumer discretionary spending, piracy, the maturation of the DVD format and the fragmentation of consumer time.

Piracy, including physical piracy as well as illegal online file-sharing, continues to be a significant issue for the filmed entertainment industry. Due to technological advances, piracy has expanded from music to movies and television programming. The Company has taken a variety of actions to combat piracy over the last several years, including a pilot program to release low-cost DVDs and VCDs in China and to coordinate worldwide release dates for franchise films, and will continue to do so, both individually and together with cross-industry groups, trade associations and strategic partners.

Networks. Time Warner s Networks group comprises Turner Broadcasting System, Inc. (Turner), Home Box Office Inc. (HBO) and The WB Television Network (The WB Network). The Networks segment delivered revenues of $9.611 billion (20% of the Company s overall revenues), $2.999 billion in Operating Income before Depreciation and Amortization and $2.738 billion in Operating Income during 2005.

The Turner networks including such recognized brands as TBS, TNT, CNN, Cartoon Network and CNN Headline News are among the leaders in advertising-supported cable TV networks. For the fourth consecutive year, more prime-time viewers watched advertising-supported cable TV networks than the national broadcast networks. In 2005, TNT ranked first among advertising-supported cable networks in total day and prime-time delivery of its key demographics, adults 18-49 and adults 25-54. TBS ranked first among advertising-supported cable networks in prime-time delivery of its key demographic, adults 18-34.

The Turner networks generate revenues principally from the sale of advertising time and monthly subscriber fees paid by cable systems, direct-to-home (DTH) satellite operators and other affiliates. Turner has benefited from strong ratings and a strong advertising market. Key contributors to Turner s success are its continued investments in high-quality programming focused on sports, network premieres, licensed and original series, news and animation, as well as a strong brand and operating efficiency.

HBO operates the HBO and Cinemax multichannel pay television programming services, with the HBO service ranking as the nation s most widely distributed pay television network. HBO generates revenues principally from monthly subscriber fees from cable system operators, satellite companies and other affiliates. An additional source of revenue is the ancillary sales of its original programming, including such programs as *The Sopranos, Sex and the City, Six Feet Under, Band of Brothers* and *Deadwood.*

The WB Network is a broadcast television network, whose target audience consists primarily of young adults in the 12-34 demographic. The WB Network generates revenues almost exclusively from the sale of advertising time. As discussed in more detail in Other Recent Developments, on January 24, 2006, Warner Bros. and CBS Corp. (CBS) announced an agreement in principle to form a new fully-distributed national broadcast network, to be called The CW. At the same time, Warner Bros. and CBS are preparing to cease the standalone operations of The WB Network and UPN, respectively, at the end of the 2005/2006 television season (September 2006).

Publishing. Time Warner s Publishing segment consists principally of magazine publishing, book publishing and a number of direct-marketing and direct-selling businesses. The segment generated revenues of $5.846 billion (13% of the Company s overall revenues), $1.259 billion in Operating Income before Depreciation and Amortization and $1.028 billion in Operating Income during 2005.

Time Inc. publishes over 150 magazines globally, including *People, Sports Illustrated, Southern Living, In Style, Real Simple, Entertainment Weekly, Time, Fortune, Cooking Light*, and *What s on TV*. It generates revenues primarily from advertising, magazine subscription and newsstand sales, and its growth is derived from higher circulation and advertising on existing magazines, new magazine launches and acquisitions. Time Inc. owns IPC Media (the U.K. s largest magazine company) and is the majority shareholder of magazine subscription marketer Synapse Group, Inc. In addition, Time Inc. continues to invest in new magazines, including *Pick Me Up*, a weekly women s magazine, and *TV Easy*, a weekly TV listings magazine, which IPC Media launched in the U.K. during 2005. In the first quarter of 2005, Time Inc. acquired the remaining 51% stake it did not already own in Essence Communications Partners (Essence),

the publisher of *Essence*. In the third quarter of 2005, Time Inc. acquired Grupo Editorial Expansión (GEE), a Mexican publisher with a portfolio of 15 consumer and business magazines, primarily for the Mexican market. Time Inc. s book publishing operations are conducted primarily by Time Warner Book Group Inc. (TWBG), which had 69 books on *The New York Times* bestseller list in 2005. Time Inc. s direct-selling division, Southern Living At Home, sells home decor products through independent consultants at parties hosted in people s homes throughout the U.S. As discussed in more detail in Other Recent Developments, on February 6, 2006, the Company announced an agreement to sell TWBG to Hachette Livre SA (Hachette), a

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wholly-owned subsidiary of Lagardère SCA (Lagardère), for approximately $538 million in cash, not including working capital adjustments.

Other Recent Developments

Amounts Related to Securities Litigation

In July 2005, the Company reached an agreement in principle for the settlement of the securities class action lawsuits included in the matters consolidated under the caption *In re: AOL Time Warner Inc. Securities & ERISA Litigation* described in Note 17 to the accompanying consolidated financial statements. The settlement is reflected in a written agreement between the lead plaintiff and the Company. On September 30, 2005, the court issued an order granting preliminary approval of the settlement and certified the settlement class. The court held a final approval hearing on February 22, 2006, and the parties are now awaiting the court s ruling. At this time, there can be no assurance that the settlement of the securities class action litigation will receive final court approval. In connection with reaching the agreement in principle on the securities class action, the Company established a reserve of $2.4 billion during the second quarter of 2005. Ernst & Young LLP also has agreed to a settlement in this litigation matter and will pay $100 million. Pursuant to the settlement, in October 2005, Time Warner paid $2.4 billion into a settlement fund (the MSBI Settlement Fund) for the members of the class represented in the action. In addition, the $150 million previously paid by Time Warner into a fund in connection with the settlement of the investigation by the U.S. Department of Justice (DOJ) was transferred to the MSBI Settlement Fund, and Time Warner is using its best efforts to have the $300 million it previously paid in connection with the settlement of its Securities and Exchange Commission (SEC) investigation, or at least a substantial portion thereof, transferred to the MSBI Settlement Fund.

In addition to the $2.4 billion reserve established in connection with the agreement in principle regarding the settlement of the MSBI consolidated securities class action, during the second quarter of 2005, the Company established an additional reserve totaling $600 million in connection with the other related securities litigation matters described in Note 17 to the accompanying consolidated financial statements that are pending against the Company. This $600 million amount continues to represent the Company s current best estimate of the amounts to be paid in resolving these matters, including the remaining individual shareholder suits (including suits brought by individual shareholders who decided to opt-out of the settlement in the primary securities class action), the derivative actions and the actions alleging violations of The Employee Retirement Income Security Act (ERISA). Of this amount, subsequent to December 31, 2005, the Company has paid, or has agreed to pay, approximately $335 million, before providing for any remaining potential insurance recoveries, to settle certain of these claims.

The Company reached an agreement with the carriers on its directors and officers insurance policies in connection with the securities and derivative action matters described above (other than the actions alleging violations of ERISA). As a result of this agreement, in the fourth quarter, the Company recorded a recovery of approximately $185 million (bringing the total 2005 recoveries to $206 million), which is expected to be collected in the first quarter of 2006 and is reflected as a reduction to Amounts related to securities litigation and government investigations in the accompanying consolidated statement of operations for the year ended December 31, 2005 (Note 1).

Government Investigations

As previously disclosed by the Company, the SEC and the DOJ had been conducting investigations into accounting and disclosure practices of the Company. Those investigations focused on advertising transactions, principally involving the Company s AOL segment, the methods used by the AOL segment to report its subscriber numbers and the accounting related to the Company s interest in AOL Europe prior to January 2002. During 2004, the Company established $510 million in legal reserves related to the government investigations, the components of which are discussed in more detail in the following paragraphs.

The Company and its subsidiary, AOL, entered into a settlement with the DOJ in December 2004 that provided for a deferred prosecution arrangement for a two-year period. As part of the settlement with the DOJ, in December 2004, the Company paid a penalty of $60 million and established a $150 million fund, which the Company could use to settle related securities litigation. The fund was reflected as restricted cash on the Company s accompanying

consolidated balance sheet at December 31, 2004. During October 2005, the $150 million was transferred by the Company into the MSBI Settlement Fund described above under the heading Amounts Related to Securities Litigation.

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In addition, on March 21, 2005, the Company announced that the SEC had approved the Company s proposed settlement, which resolved the SEC s investigation of the Company.

Under the terms of the settlement with the SEC, the Company agreed, without admitting or denying the SEC s allegations, to be enjoined from future violations of certain provisions of the securities laws and to comply with the cease-and-desist order issued by the SEC to AOL in May 2000. The settlement also required the Company to:

- Pay a $300 million penalty, which will be used for a Fair Fund, as authorized under the Sarbanes-Oxley Act;

- Adjust its historical accounting for Advertising revenues in certain transactions with Bertelsmann, A.G. (Bertelsmann) that were improperly or prematurely recognized, primarily in the second half of 2000, during 2001 and during 2002; as well as adjust its historical accounting for transactions involving three other AOL customers where there were Advertising revenues recognized in the second half of 2000 and during 2001;

- Adjust its historical accounting for its investment in and consolidation of AOL Europe; and

- Agree to the appointment of an independent examiner, who will either be or hire a certified public accountant. The independent examiner will review whether the Company s historical accounting for transactions with 17 counterparties identified by the SEC staff, principally involving online advertising revenues and including three cable programming affiliation agreements with related advertising elements, was in conformity with GAAP, and provide a report to the Company s audit and finance committee of its conclusions, originally within 180 days of being engaged. The transactions that would be reviewed were entered into between June 1, 2000 and December 31, 2001, including subsequent amendments thereto, and involved online advertising and related transactions for which revenue was principally recognized before January 1, 2002.

The Company paid the $300 million penalty in March 2005; however, it is unable to deduct the penalty for income tax purposes, be reimbursed or indemnified for such payment through insurance or any other source, or use such payment to setoff or reduce any award of compensatory damages to plaintiffs in related securities litigation pending against the Company. As described above, in connection with the pending settlement of the consolidated securities class action, the Company is using its best efforts to have the $300 million, or a substantial portion thereof, transferred to the MSBI Settlement Fund. The historical accounting adjustments were reflected in the restatement of the Company s financial results for each of the years ended December 31, 2000 through December 31, 2003, which were included in the Company s Annual Report on Form 10-K for the year ended December 31, 2004 (the 2004 Form 10-K).

The independent examiner recently completed his review and, as a result of the conclusions, the Company s consolidated financial results have been restated as reflected in this report. For more information on the restatement, see Restatement of Prior Financial Information on page 1.

AOL-Google Alliance

During December 2005, the Company announced that AOL is expanding its current strategic alliance with Google Inc. (Google) to enhance its global online advertising partnership and make more of AOL s content available to Google users. Under the alliance, Google and AOL will continue to provide search technology to AOL s network of Internet properties worldwide. Other key aspects of the alliance include:

- Creating an AOL Marketplace through white labeling of Google s advertising technology, which enables AOL to sell search advertising directly to advertisers on AOL-owned properties;

- Expanding display advertising available for AOL to sell throughout the Google network;

- Making AOL content more accessible to Google Web crawlers;

Collaborating in video search and showcasing AOL s premium video service within Google Video;

Enabling Google Talk and AIM instant messaging users to communicate with each other, provided certain conditions are met; and

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Providing AOL marketing credits for promotion of AOL s content on Google s Internet properties.

In addition, Google will invest $1 billion for a 5% equity interest in a limited liability company that will own all of the outstanding equity interests in AOL. The Company expects these transactions with Google to close during the first quarter of 2006.

The WB Network

On January 24, 2006, Warner Bros. and CBS Corp. (CBS) announced an agreement in principle to form a new fully-distributed national broadcast network, to be called The CW. At the same time, Warner Bros. and CBS are preparing to cease the standalone operations of The WB Network and UPN, respectively, at the end of the 2005/2006 television season (September 2006). Warner Bros. and CBS will each own 50% of the new network and will have joint and equal control. In addition, Warner Bros. has reached an agreement in principle with Tribune Corp. (Tribune), currently a subordinated 22.25% limited partner in The WB Network, under which Tribune will surrender its ownership interest in The WB Network and will be relieved of funding obligations. In addition, Tribune will become one of the principal affiliate groups for the new network.

Upon the closing of this transaction, the Company will account for its investment in The CW under the equity method of accounting. The Company anticipates that prior to the closing of this transaction the Company is expected to incur restructuring charges ranging from $15 million to $20 million related to employee terminations. In addition, the Company may incur costs in terminating certain programming arrangements that will not be contributed to the new network or utilized in another manner.

Sale of Time Warner Book Group

On February 6, 2006, the Company announced an agreement to sell TWBG to Hachette for approximately $538 million in cash, not including working capital adjustments. This transaction is expected to close in the first half of 2006 and the Company expects to record a pretax gain of approximately $180 million to $220 million. In 2005, TWBG had revenues of $571 million and Operating Income of $74 million.

Sale of Canal Satellite Digital

On February 7, 2006, Warner Bros. entered into an agreement for the sale of its equity investment interest in Canal Satellite Digital (CSD), a Spanish satellite pay television operator, together with its interest in Cinemania, the Spanish library movie channel, for approximately $90 million in cash and stock. This transaction is expected to close in the second quarter of 2006 and the Company expects to record a pretax equity investment gain of approximately $40 million.

Sale of Turner South

On February 23, 2006, the Company announced an agreement to sell the Turner South network (Turner South), a subsidiary of Turner, to Fox Cable Networks, Inc. (Fox) for approximately $375 million in cash. This transaction is expected to close in the second or third quarter of 2006 and the Company expects to record a pretax gain of approximately $110 million to $130 million. In 2005, Turner South had revenues of $49 million and an Operating Loss of $7 million.

Common Stock Repurchase Program

On July 29, 2005, Time Warner s Board of Directors authorized a common stock repurchase program that allowed Time Warner to repurchase, from time to time, up to $5 billion of common stock over a two-year period ending in July 2007. In October 2005, Time Warner s Board of Directors approved an increase in the amount authorized to be repurchased under the stock repurchase program to an aggregate of up to $12.5 billion of common stock. In February 2006, the Board of Directors authorized a further increase in the stock repurchase program and an extension of the program s ending date. Under the extended program, the Company is authorized to purchase up to an aggregate of $20 billion of common stock during the period from July 29, 2005 through December 31, 2007. Purchases under the stock repurchase program may be made from time to time on the open market and in privately negotiated transactions. Size and timing of these purchases will be based on a number of factors, including price and business and market conditions. As announced on February 1, 2006, the Company increased the pace of stock repurchases during the first quarter of 2006. At existing price levels, the Company intends to continue the current pace of purchases under

its stock repurchase program within its stated objective of maintaining a net debt-to-Operating Income before Depreciation and Amortization ratio of approximately 3-to-1,

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and expects it will purchase approximately $15 billion of its common stock under the program by the end of 2006, and the remainder in 2007. From the program s inception through February 23, 2006, the Company repurchased approximately 235 million shares of common stock for approximately $4.2 billion (including 67 million shares for approximately $1.2 billion since February 1, 2006) pursuant to trading programs under Rule 10b5-1 of the Securities Exchange Act of 1934, as amended.

Common Stock Dividends

On May 20, 2005, the Company announced that it would begin paying a regular quarterly cash dividend of $0.05 per share on its common stock beginning in the third quarter 2005. Under this dividend program, on September 15, 2005 and December 15, 2005, the Company paid cash dividends of $0.05 per share on its common stock to shareholders of record on August 31, 2005 and November 30, 2005, respectively. The total amount of dividends paid during 2005 was $466 million.

Magazine Circulation Practices Investigation

As previously disclosed, Time Inc. has received a grand jury subpoena from the United States Attorney s Office for the Eastern District of New York in connection with an investigation of certain magazine circulation-related practices. Time Inc. is responding to the subpoena and is cooperating with the investigation. Following discussions with the Audit Bureau of Circulations (ABC) concerning Time Inc. s reporting of sponsored sales subscriptions, ABC has confirmed that the vast majority of Time Inc. s sponsored subscriptions for the first half of 2005 were properly classified. Time Inc. has informed its advertisers of such conclusion.

Adelphia Acquisition Agreement

On April 20, 2005, a subsidiary of the Company, Time Warner NY Cable LLC (TW NY), and Comcast each entered into separate definitive agreements with Adelphia to, collectively, acquire substantially all the assets of Adelphia for a total of $12.7 billion in cash (of which TW NY will pay $9.2 billion and Comcast will pay the remaining $3.5 billion) and 16% of the common stock of TWC Inc. (the Adelphia Acquisition).

At the same time that Comcast and TW NY entered into the Adelphia agreements, Comcast, TWC Inc. and/or their respective affiliates entered into agreements providing for the redemption of Comcast s interests in TWC Inc. and Time Warner Entertainment Company, L.P. (TWE) (the TWC Inc. Redemption Agreement and the TWE Redemption Agreement, respectively, and, collectively, the TWC Inc. and TWE Redemption Agreements). Specifically, Comcast s 17.9% interest in TWC Inc. will be redeemed in exchange for stock of a subsidiary of TWC Inc. holding cable systems serving approximately 587,000 subscribers (as of December 31, 2004), as well as approximately $1.9 billion in cash. In addition, Comcast s 4.7% interest in TWE will be redeemed in exchange for interests in a subsidiary of TWE holding cable systems serving approximately 168,000 subscribers (as of December 31, 2004), as well as approximately $133 million in cash. TWC Inc., Comcast and their respective subsidiaries will also swap certain cable systems to enhance their respective geographic clusters of subscribers (Cable Swaps).

After giving effect to the transactions, TWC Inc. will gain systems passing approximately 7.5 million homes (as of December 31, 2004), with approximately 3.5 million basic subscribers. TWC Inc. will then manage a total of approximately 14.4 million basic subscribers. Time Warner will own 84% of TWC Inc. s common stock (including 83% of the outstanding TWC Inc. Class A Common Stock, which will become publicly traded at the time of closing, and all outstanding shares of TWC Inc. Class B Common Stock) and own a $2.9 billion indirect economic interest in TW NY, a subsidiary of TWC Inc.

The transactions are subject to customary regulatory review and approvals, including antitrust review by the Federal Trade Commission (FTC) pursuant to the Hart-Scott-Rodino Act, review by the Federal Communications Commission (FCC) and local franchise approvals, as well as, in the case of the Adelphia Acquisition, the Adelphia bankruptcy process, which involves approvals by the bankruptcy court having jurisdiction over Adelphia s Chapter 11 case and Adelphia s creditors. On January 31, 2006, the FTC completed its antitrust review of the transaction and closed its investigation without further action. The parties are awaiting final clearance from the FCC and local franchise approvals, as well as completion of the bankruptcy process. The parties expect to close the Adelphia

Acquisition during the second quarter of 2006.

The closing of the Adelphia Acquisition is not dependent on the closing of the Cable Swaps or the transactions contemplated by the TWC Inc. and TWE Redemption Agreements. Furthermore, if Comcast fails to obtain certain necessary governmental authorizations, TW NY has agreed to acquire the cable operations of Adelphia that would have been acquired by Comcast, with the purchase price payable in cash or TWC Inc. stock at the Company s discretion.

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Investment in Google

In May 2004, AOL exercised a warrant for approximately $22 million and received approximately 7.4 million shares of Series D Preferred Stock of Google. Each of these shares converted automatically into shares of Google s Class B common stock immediately prior to the closing of Google s initial public offering on August 24, 2004. In connection with this offering, AOL converted approximately 2.4 million shares of its Google Class B common stock into an equal number of shares of Google s Class A common stock. Such Class A shares were sold in the offering for $195 million, net of the underwriters discounts and commissions, and the Company recorded a gain of approximately $188 million in the third quarter of 2004, which is included as a component of Other income, net, in the accompanying consolidated statement of operations. Beginning in March 2005, the Company entered into agreements to sell its remaining 5.1 million shares at an average share price of approximately $185. The sales under such agreements settled on May 3, 2005, and the Company received total cash consideration of approximately $940 million, resulting in a gain of approximately $925 million recognized in the second quarter of 2005, which is included as a component of Other income, net, in the accompanying consolidated statement of operations.

Mandatorily Convertible Preferred Stock

As of December 31, 2004, the Company had outstanding one share of its Series A mandatorily convertible preferred stock, par value $0.10 per share, face value of $1.5 billion (the Series A Preferred Stock), held by a trust for the benefit of Comcast, that was issued on March 31, 2003, as part of the restructuring of TWE (TWE Restructuring). In accordance with the terms of the stock, on March 31, 2005, the Series A Preferred Stock was automatically converted into 83,835,883 shares of common stock of the Company, valued at $1.5 billion, and such amount was reclassified to shareholders equity in the accompanying consolidated balance sheet.

Urban Cable Works of Philadelphia, L.P.

On November 22, 2005, TWC Inc. purchased the remaining 60% interest in Urban Cable Works of Philadelphia, L.P. (Urban Cable), an operator of cable systems in Philadelphia, Pennsylvania with approximately 47,000 basic subscribers. The purchase price consisted of $51 million in cash, net of cash acquired, and the assumption of $44 million of Urban Cable s third-party debt. Prior to TWC Inc. s acquisition of the remaining interest, Urban Cable was an unconsolidated joint venture of TWC Inc., which was 40% owned by TWC Inc. and 60% owned by an investment group led by Inner City Broadcasting (Inner City). Under a management agreement, TWC Inc. was responsible for the day-to-day management of Urban Cable. During 2004, TWC Inc. made cash payments of $34 million to Inner City to settle certain disputes regarding the joint venture. In conjunction with the Adelphia Acquisition described above, Urban Cable will be transferred to Comcast as part of the Cable Swaps. For additional details, refer to the subsection above titled Adelphia Acquisition Agreement. From the time it was consolidated through December 31, 2005, Urban Cable contributed Subscription revenues and Operating Income of $7 million and $1 million, respectively.

RESULTS OF OPERATIONS

New Accounting Principles To Be Adopted

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement of Financial Accounting Standards (Statement) No. 123 (Revised), Share-Based Payment (FAS 123R). FAS 123R requires all companies to measure compensation costs for all share-based payments (including employee stock options) at fair value and recognize such costs in the statement of operations. As a result, the application of the provisions of FAS 123R will have a significant impact on Operating Income before Depreciation and Amortization, Operating Income, net income and earnings per share. In April 2005, the SEC amended the compliance dates for FAS 123R from fiscal *periods* beginning after June 15, 2005 to fiscal *years* beginning after June 15, 2005. The Company has continued to account for share-based compensation using the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). The Company will adopt FAS 123R beginning January 1, 2006 and elect the modified retrospective method of transition. This method of transition requires that the

financial statements of all prior periods be adjusted on a basis consistent with the pro-forma disclosures required for those periods by FASB Statement No. 123, Accounting for Stock-Based Compensation, the predecessor to FAS 123R.

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In accordance with APB 25 and related interpretations, compensation expense for stock options is recognized in income based on the excess, if any, of the quoted market price of the stock at the grant date of the award or other measurement date over the amount an employee must pay to acquire the stock. The compensation costs related to stock options recognized by the Company pursuant to APB 25 were minimal. If a company measures share-based compensation using APB 25, it must also disclose what the impact would have been if it had measured share-based compensation using the fair value of the equity award on the date it was granted as provided in FAS 123, the predecessor of FAS 123R. See Note 1 for the pro forma impact if compensation costs for the Company s stock option plans had been determined based on the fair value method set forth in FAS 123.

Reclassifications

Certain reclassifications have been made to the prior years financial information to conform to the December 31, 2005 presentation.

Significant 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 certain significant transactions and other items in each period as follows:

	Year Ended December 31,		
	2005	2004	2003
		(millions)	
Amounts related to securities litigation and government investigations	$ (2,865)	$ (536)	$ (56)
Merger and restructuring costs	(117)	(50)	(109)
Asset impairments	(24)	(10)	(318)
Gain on disposal of assets, net	23	21	14
Impact on Operating Income	(2,983)	(575)	(469)
Microsoft Settlement			760
Investment gains, net	1,011	424	593
Net gain on WMG option	53	50	
Impact on Other income, net	1,064	474	1,353
Pretax impact	(1,919)	(101)	884
Income tax impact	518	(73)	(372)
After-tax impact	$ (1,401)	$ (174)	$ 512

Amounts Related to Securities Litigation and Government Investigations

As previously discussed, during 2005, the Company expensed $3 billion in legal reserves related to securities litigation. During 2004, the Company established $510 million in legal reserves related to the government investigations. In addition, the Company has incurred legal and other professional fees related to the SEC and DOJ investigations into the Company s accounting and disclosure practices and the defense of various shareholder lawsuits totaling $71 million, $74 million and $81 million in 2005, 2004 and 2003, respectively. In addition, the Company realized insurance recoveries of $206 million, $48 million and $25 million in 2005, 2004 and 2003, respectively, including, as discussed under Other Recent Developments above, $185 million recognized in December 2005 in connection with the agreement reached with carriers of its directors and officers insurance policies related to the

securities and derivative action matters (other than the actions alleging violations of ERISA).

Merger and Restructuring Costs

During the year ended December 31, 2005, the Company incurred restructuring costs of approximately $109 million primarily related to various employee terminations, including approximately 1,330 employees across the segments. Specifically, the AOL and Cable segments incurred restructuring costs primarily related to various employee terminations of $17 million and $35 million, respectively, which were partially offset by a $7 million and a $1 million reduction in restructuring costs, respectively, reflecting changes in estimates of previously established restructuring accruals. Additional restructuring costs, primarily related to various employee terminations, of $33 million at the Filmed Entertainment segment, $4 million at the Networks segment and $28 million at the Publishing segment were also incurred during 2005. In addition, during the year ended December 31, 2005, the Cable segment expensed approximately $8 million of non-capitalizable merger-related costs associated with the Adelphia Acquisition (Note 14).

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During the year ended December 31, 2004, the Company incurred restructuring costs at the AOL segment related to various employee terminations of $55 million, which were partially offset by a $5 million reduction in restructuring costs, reflecting changes in estimates of previously established restructuring accruals. The total number of employees terminated in 2004 was approximately 860. During the year ended December 31, 2003, the Company incurred restructuring costs related to various employee and contractual lease terminations of $109 million, including $52 million at the AOL segment, $15 million at the Cable segment, $21 million at the Networks segment and $21 million at the Publishing segment. The total number of employees terminated in 2003 was approximately 975 (Note 14).

Asset Impairments

During 2005, the Company recorded a $24 million noncash impairment charge related to goodwill associated with America Online Latin America, Inc. (AOLA). During 2005, AOLA filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code and has announced that it intends to liquidate, sell or wind up its operations. During 2004, the Company recognized a $10 million impairment charge related to a building that was held for sale at the AOL segment. During 2003, the Company s results included $318 million of noncash impairment charges, including $219 million related to intangible assets of the winter sports teams at the Networks segment and $99 million at the Publishing segment related to goodwill and intangible assets of the Time Warner Book Group.

In the fourth quarter of each year, the Company performs its annual impairment review for goodwill and intangible assets. The 2005, 2004 and 2003 annual impairment reviews for goodwill and intangible assets did not result in any impairment charges being recorded (Note 1).

Gains on Disposal of Assets, Net

For the year ended December 31, 2005, the Company recorded a $5 million gain related to the sale of a property in California at the Filmed Entertainment segment, an approximate $5 million gain related to the sale of a building and a $5 million gain from the resolution of previously contingent gains related to the 2004 sale of Netscape Security Solutions at the AOL segment and an $8 million gain at the Publishing segment related to the collection of a loan made in conjunction with the Company s 2003 sale of Time Life Inc. (Time Life), which was previously fully reserved due to concerns about recoverability.

For the year ended December 31, 2004, the Company recognized a $13 million gain related to the sale of AOL Japan and a $7 million gain related to the sale of Netscape Security Solutions at the AOL segment, an $8 million gain at the Publishing segment related to the sale of a building, partially offset by an approximate $7 million loss at the Networks segment related to the sale of the winter sports teams.

During the year ended December 31, 2003, the Company recognized a $43 million gain on the sale of its interest in U.K. cinemas, which previously had been consolidated by the Filmed Entertainment segment, partially offset by a loss of $29 million on the sale of Time Life at the Publishing segment.

Microsoft Settlement

In the second quarter of 2003 the Company recognized a gain of approximately $760 million as a result of the settlement with Microsoft Corporation of then-pending litigation between Microsoft and Netscape Communications Corporation, a subsidiary of AOL (the Microsoft Settlement).

Investment Gains, Net

For the year ended December 31, 2005, the Company recognized net gains of $1.011 billion primarily related to the sale of investments, including a $925 million gain on the sale of the Company s remaining investment in Google, a $36 million gain, which had been previously deferred, related to the Company s 2002 sale of a portion of its interest in Columbia House and an $8 million gain on the sale of its 7.5% remaining interest in Columbia House and simultaneous resolution of a contingency for which the Company had previously accrued. Investment gains were partially offset by $16 million of writedowns to reduce the carrying value of certain investments that experienced other-than-temporary declines in market value including a $13 million writedown of the Company s

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investment in n-tv KG (NTV-Germany), a German news broadcaster. The year ended December 31, 2005 also included $1 million of losses to reflect market fluctuations in equity derivative instruments.

For the year ended December 31, 2004, the Company recognized net gains of $424 million, primarily related to the sale of investments, including a $188 million gain related to the sale of a portion of the Company s interest in Google and a $113 million gain related to the sale of the Company s interest in VIVA Media AG (VIVA) and VIVA Plus and a $44 million gain on the sale of the Company s interest in Gateway Inc. (Gateway). Investment gains were partially offset by $15 million of writedowns to reduce the carrying value of certain investments that experienced other-than-temporary declines in market value and $14 million of losses related to market fluctuations in equity derivative instruments.

For the year ended December 31, 2003, the Company recognized net gains of $593 million, primarily from the sale of investments, including a $513 million gain from the sale of the Company s interest in Comedy Central, a $52 million gain from the sale of the Company s interest in chinadotcom, a $50 million gain from the sale of the Company s interest in Hughes Electronics Corp. (Hughes) and gains of $66 million on the sale of the Company s equity interests in international cinemas not previously consolidated. The Company also recognized $8 million of gains related to market fluctuations in equity derivative instruments. Investment gains were partially offset by $212 million of writedowns to reduce the carrying value of certain investments that experienced other-than-temporary declines in market value. Included in the 2003 charges were a writedown of $77 million related to the Company s equity interest in AOL Japan and a $71 million writedown related to the Company s equity interest in NTV-Germany (Note 6).

Net Gain on WMG Option

During 2005, the Company entered into an agreement with Warner Music Group (WMG) pursuant to which WMG agreed to a cash purchase of the Company s option to acquire shares of WMG that it received in connection with the sale of WMG in 2004. Under the agreement, the cash purchase of the option would be made at the time of the WMG public offering at a price based on the initial public offering price per share, net of any underwriters discounts. As a result of the estimated public offering price range, the Company adjusted the value of the option in the first quarter of 2005 from $85 million to $165 million. In the second quarter of 2005, WMG s registration statement was declared effective and it completed its initial public offering at a reduced price from its initial estimated range, and the Company received approximately $138 million from the sale of its option. As a result of these events, for the year ended December 31, 2005, the Company recorded a $53 million net gain related to this option. For the year ended December 31, 2004, the Company recorded a $50 million fair value adjustment to increase the option s carrying value (Note 3).

2005 vs. 2004

Consolidated Results

Revenues. The components of revenues are as follows:

	Year Ended December 31,		
	2005	2004	% Change
		(millions) (restated)	
Subscription	$ 22,222	$ 21,605	3%
Advertising	7,612	6,947	10%
Content	12,615	12,350	2%
Other	1,203	1,179	2%
Total revenues	$ 43,652	$ 42,081	4%

The increase in Subscription revenues primarily related to increases at the Cable and Networks segments, offset partially by a decline at the AOL segment. The increase at the Cable segment was principally due to the continued penetration of advanced services (primarily high-speed data, advanced digital video services and Digital Phone) and video rate increases. The increase at the Networks segment was due primarily to higher subscription rates at Turner and HBO and, to a lesser extent, an increase in the number of subscribers at Turner and HBO. The AOL segment declined primarily as a result of lower domestic AOL brand subscribers.

The increase in Advertising revenues was primarily due to growth at the AOL, Networks and Publishing segments. The increase at the AOL segment was due primarily to revenues associated with Advertising.com, which was acquired on August 2, 2004, and growth

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in paid-search and traditional advertising. The increase at the Networks segment was primarily driven by higher CPMs (advertising cost per one thousand viewers), sellouts and delivery at Turner s entertainment networks, partly offset by a decline at The WB Network as a result of lower ratings. The increase at the Publishing segment was due to contributions from new magazine launches, acquisitions and growth at *Real Simple, People, Southern Living* and *In Style,* offset partly by lower Advertising revenues at certain magazines, including *Sports Illustrated, Time* and *Fortune.*

The increase in Content revenues was principally due to increases at the Filmed Entertainment, Publishing and Networks segments. The increase at the Filmed Entertainment segment was driven by increases in both theatrical and television product revenues. The increase at the Publishing segment was due primarily to a number of best-selling titles at Time Warner Book Group. The increase at the Networks segment was due primarily to HBO s broadcast syndication sales of *Sex and the City* and, to a lesser extent, increases in other ancillary sales of HBO s original programming, partially offset by lower licensing revenue at HBO associated with fewer episodes of *Everybody Loves Raymond.* In addition, the increase in Content revenues was partially offset by the absence of the winter sports teams at Turner, which were sold at the end of the first quarter of 2004.

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

Costs of Revenues. For 2005 and 2004, costs of revenues totaled $25.046 billion and $24.402 billion, respectively, and as a percentage of revenues were 57% and 58%, respectively. The improvement in costs of revenues as a percentage of revenues related primarily to improved margins at the AOL and Networks segments, offset by a decrease in margin at the Filmed Entertainment segment. The segment variations are discussed in detail in Business Segment Results.

Selling, General and Administrative Expenses. For 2005 and 2004, selling, general and administrative expenses increased 2% to $10.478 billion in 2005 from $10.261 billion in 2004 primarily from increases at all segments except the AOL segment and Corporate. The segment variations are discussed in detail in Business Segment Results.

Amounts Related to Securities Litigation and Government Investigations. As previously discussed in Other Recent Developments, results for the year ended December 31, 2005 include $3 billion in legal reserves related to securities litigation. During the year ended December 31, 2004, the Company established $510 million in legal reserves related to the government investigations. In addition, the Company has incurred legal and other professional fees related to the SEC and DOJ investigations into the Company s accounting and disclosure practices and the defense of various shareholder lawsuits totaling $71 million and $74 million in 2005 and 2004, respectively. In addition, the Company realized insurance recoveries of $206 million and $48 million in 2005 and 2004, respectively. As discussed under Other Recent Developments above, in December 2005, the Company recognized a $185 million settlement on directors and officers insurance policies related to the securities and derivative action matters (other than the actions alleging violations of ERISA) (Note 1).

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Reconciliation of Operating Income before Depreciation and Amortization to Operating Income and Net Income.

The following table reconciles Operating Income before Depreciation and Amortization to Operating Income. In addition, the table provides the components from Operating Income to Net Income for purposes of the discussions that follow:

	Year Ended December 31,		
	2005	2004	% Change
	(restated, millions)		
Operating Income before Depreciation and Amortization	$ 7,816	$ 9,414	(17%)
Depreciation	(2,671)	(2,571)	4%
Amortization	(597)	(626)	(5%)
Operating Income	4,548	6,217	(27%)
Interest expense, net	(1,266)	(1,533)	(17%)
Other income, net	1,125	522	116%
Minority interest expense, net	(289)	(250)	16%
Income before income taxes, discontinued operations and cumulative effect of accounting change	4,118	4,956	(17%)
Income tax provision	(1,197)	(1,717)	(30%)
Income before discontinued operations and cumulative effect of accounting change	2,921	3,239	(10%)
Discontinued operations, net of tax		121	NM
Cumulative effect of accounting change, net of tax		34	NM
Net income	$ 2,921	$ 3,394	(14%)

Operating Income before Depreciation and Amortization. Time Warner s Operating Income before Depreciation and Amortization decreased 17% to $7.816 billion in 2005 from $9.414 billion in 2004. Excluding the items previously discussed under Significant Transactions and Other Items Affecting Comparability totaling $2.983 billion and $575 million of net expense for 2005 and 2004, respectively, Operating Income before Depreciation and Amortization increased $810 million (or 8%) principally as a result of growth at all segments except for the Filmed Entertainment segment.

The segment variations are discussed in detail under Business Segment Results.

Depreciation Expense. Depreciation expense increased to $2.671 billion in 2005 from $2.571 billion in 2004. The increase in depreciation expense primarily related to the Cable segment, partially offset by a decrease at the AOL segment. The increase in depreciation expense at the Cable segment reflects continued higher spending on customer premise equipment that is depreciated over a shorter useful life compared to the mix of assets previously purchased. The decrease in depreciation expense at the AOL segment relates primarily to a decline in network assets as a result of membership declines.

Amortization Expense. Amortization expense decreased to $597 million in 2005 from $626 million in 2004. The decrease relates primarily to a decline in amortization expense at the Publishing segment as a result of certain short-lived intangibles, such as customer lists, becoming fully amortized beginning in the latter part of 2004.

Operating Income. Time Warner s Operating Income decreased to $4.548 billion in 2005 from $6.217 billion in 2004. Excluding the items previously discussed under Significant Transactions and Other Items Affecting Comparability totaling $2.983 billion and $575 million of net expense for 2005 and 2004, respectively, Operating Income improved $739 million primarily as a result of the improvement in Operating Income before Depreciation and Amortization, offset partially by the increase in depreciation expense as discussed above.

Interest Expense, Net. Interest expense, net, decreased to $1.266 billion in 2005 from $1.533 billion in 2004 due primarily to lower average net debt levels and higher interest rates on cash investments.

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Other Income, Net. Other income, net, detail is shown in the table below:

	Year Ended December 31,	
	2005	2004
	(restated, millions)	
Investment gains, net	$ 1,011	$ 424
Net gain on WMG option	53	50
Income from equity investees	61	36
Other		12
Other income, net	$ 1,125	$ 522

The changes in investment gains, net, and the net gain on the WMG option are discussed above in detail under Significant Transactions and Other Items Affecting Comparability. Excluding the impact of these items, Other income, net, increased in 2005 as compared to the prior year, principally from an increase in income from equity method investees, primarily related to lower losses from the NASCAR joint venture.

Minority Interest Expense, Net. Time Warner had $289 million of minority interest expense in 2005 compared to $250 million in 2004. The increase relates primarily to larger profits recorded by TWC Inc., in which Comcast has a minority interest.

Income Tax Provision. Income tax expense was $1.197 billion in 2005 compared to $1.717 billion in 2004. The Company s effective tax rate was 29% and 35% in 2005 and 2004, respectively. The change in the effective tax rate is primarily a result of the favorable impact of state tax law changes in Ohio and New York, an ownership restructuring in Texas and certain other methodology changes, partially offset by the non-deductible expenses related to a portion of the settlement reserve for the securities litigation in 2005 compared with the nondeductible expenses related to a portion of the SEC and DOJ settlements in 2004.

The state law changes relate to the method of taxation in Ohio and the method of apportionment in New York. In Ohio, the income tax is being phased-out and replaced with a gross receipts tax, while in New York the methodology for income apportionment is changing over time to a single receipts factor from a three factor formula. These tax law changes resulted in a reduction in certain deferred tax liabilities related to these states. Accordingly, the Company has recognized these reductions as noncash tax benefits totaling approximately $170 million for Ohio and $135 million for New York State in the second quarter of 2005. In addition, an ownership restructuring of the Company s partnership interests in Texas and certain methodology changes resulted in a reduction of deferred state tax liabilities. The Company has also recognized this reduction as a noncash tax benefit of approximately $100 million in the fourth quarter of 2005.

U.S. federal tax attribute carryforwards at December 31, 2005, consist primarily of $5.0 billion of net operating losses, $44 million of capital losses, $166 million of research and development tax credits and $180 million of alternative minimum tax credits. In addition, the Company has approximately $1.8 billion of net operating losses in various foreign jurisdictions that are primarily from countries with unlimited carryforward periods. However, many of these foreign losses are attributable to specific operations that may not be utilized against certain other operations of the Company. The utilization of the U.S. federal carryforwards as an available offset to future taxable income is subject to limitations under U.S. federal income tax laws. If the net operating losses are not utilized, they expire in varying amounts, starting in 2019 and continuing through 2023. The capital losses expire in 2008. Research and development tax credits not utilized will expire in varying amounts starting in 2017 and continuing through 2024. Alternative minimum tax credits do not expire. In addition, the Company holds certain assets that have tax basis greater than book basis. The Company has established deferred tax assets for such differences. However, in the event

that such assets are sold or the tax basis otherwise realized, it is anticipated that such realization would generate additional losses for tax purposes. Because of the uncertainties surrounding the Company s capacity to generate enough capital gains to utilize such losses, the Company has in most instances offset these deferred tax assets with a valuation allowance (Note 9).

Income before Discontinued Operations and Cumulative Effect of Accounting Change. Income before discontinued operations and cumulative effect of accounting change was $2.921 billion in 2005 compared to $3.239 billion in 2004. Basic and diluted net income per share before discontinued operations and cumulative effect of accounting change were $0.63 and $0.62, respectively, in 2005, compared to $0.71 and $0.69, respectively, in 2004. Excluding the items previously discussed under Significant Transactions and Other Items Affecting Comparability totaling $1.401 billion and $174 million of net expense in 2005 and 2004, respectively, Income before discontinued operations and cumulative effect of accounting change improved by $909 million primarily due to higher Operating Income, lower interest expense and the change in income tax provision as discussed above.

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Discontinued Operations, Net of Tax. Included in the 2004 results are a pre-tax loss of $2 million and a tax benefit of $123 million, from the operations of the Music business (Note 3).

Cumulative Effect of Accounting Change, Net of Tax. The Company recorded a $34 million benefit, net of tax, as a cumulative effect of accounting change upon the consolidation of AOLA in 2004 in accordance with FASB Interpretation No. 46 (Revised), Consolidation of Variable Interest Entities.

Net Income and Net Income Per Common Share. Net income was $2.921 billion in 2005 compared to $3.394 billion in 2004. Basic and diluted net income per common share were $0.63 and $0.62, respectively, in 2005 compared to $0.74 and $0.72, respectively, in 2004. Net income includes the items previously addressed under Income before Discontinued Operations and Cumulative Effect of Accounting Change, Discontinued operations, net of tax, and the Cumulative effect of accounting change, net of tax.

Business Segment Results

AOL. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the AOL segment for the years ended December 31, 2005 and 2004 are as follows:

	Year Ended December 31,		
	2005	2004	% Change
		(restated, millions)	
Revenues:			
Subscription	$ 6,755	$ 7,477	(10%)
Advertising	1,338	1,005	33%
Other	190	210	(10%)
Total revenues	8,283	8,692	(5%)
Costs of revenues[a]	(3,788)	(4,178)	(9%)
Selling, general and administrative[a]	(2,572)	(2,681)	(4%)
Gain on disposal of consolidated businesses	10	20	(50%)
Asset impairments	(24)	(10)	140%
Restructuring costs	(10)	(50)	(80%)
Operating Income before Depreciation and Amortization	1,899	1,793	6%
Depreciation	(548)	(652)	(16%)
Amortization	(174)	(176)	(1%)
Operating Income	$ 1,177	$ 965	22%

[a] Costs of revenues and selling, general and administrative expenses exclude depreciation.

The reduction in Subscription revenues primarily reflects a decline in domestic Subscription revenues (from $5.725 billion in 2004 to $4.993 billion in 2005). Subscription revenues at AOL Europe were essentially flat. AOL s domestic Subscription revenues declined due primarily to a decrease in the number of domestic AOL brand subscribers and related revenues. AOL Europe s Subscription revenues were flat primarily as a result of a decline in subscribers and related revenues, essentially offset by the favorable impact of foreign currency exchange rates ($26 million).

The number of AOL brand domestic and European subscribers is as follows at December 31, 2005, September 30, 2005, and December 31, 2004 (millions):

	December 31, 2005	**September 30, 2005**	**December 31, 2004**
Subscriber category:			
AOL brand domestic[(a)] $15 and over	13.7	14.7	17.5
Under $15	5.8	5.4	4.7
Total AOL brand domestic	19.5	20.1	22.2
AOL Europe	6.0	6.1	6.3

(a) AOL includes in its subscriber count individuals, households or entities that have provided billing information and completed the registration process sufficiently to allow for an initial log-on to the AOL service.

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The average monthly Subscription revenue per subscriber (ARPU) for each significant category of subscribers, calculated as average monthly subscription revenue (including premium subscription services revenues) for the category divided by the average monthly subscribers in the category for the applicable period, is as follows:

	Year Ended December 31,	
	2005	**2004**
Subscriber category:		
AOL brand domestic $15 and over	$20.88	$20.97
Under $15	13.21	13.07
Total AOL brand domestic	18.97	19.44
AOL Europe	22.01	21.48

Domestic subscribers to the AOL brand service include subscribers during introductory free-trial periods and subscribers at no or reduced monthly fees through member service and retention programs. Total AOL brand domestic subscribers include free-trial and retention members of approximately 11% at both December 31, 2005 and September 30, 2005, and 13% at December 31, 2004. AOL has recently entered into agreements with high-speed Internet access providers to offer the AOL service along with high-speed Internet access. Since AOL s share of the revenues under these agreements is less than $15, subscribers will be included in the under $15 category price plans. In addition, during the first quarter of 2006, AOL announced price increases on certain AOL brand service price plans, including increasing the $23.90 plan to $25.90. The price increases are expected to have a temporary adverse impact on the number of AOL brand subscribers. The price increases and the recent agreements with high-speed Internet access providers are also expected to result in the further migration of subscribers from higher-priced to lower-priced AOL service plans in 2006 and, accordingly, a further decline in Subscription revenues and AOL brand domestic ARPU in 2006.

In 2005, the largest component of the AOL brand domestic $15 and over price plans was the $23.90 price plan, which provides unlimited access to the AOL service using AOL s dial-up network and unlimited usage of the AOL service through any other Internet connection. The largest component of the AOL brand domestic under $15 price plans is the $14.95 per month price plan, which includes ten hours of dial-up access and unlimited usage of the AOL service through an Internet connection not provided by AOL, such as a high-speed broadband Internet connection via cable or digital subscriber lines. AOL continues to develop, test, change and implement price plans, service offerings and payment methods to attract and retain members to its AOL service and, therefore, the composition of AOL s subscriber base is expected to change over time.

The decline in AOL brand domestic subscribers on plans priced $15 and over per month resulted from a number of factors, including declining registrations in response to AOL s marketing campaigns, competition from broadband access providers and reduced subscriber acquisition efforts. Further, during the year, subscribers migrated from the premium-priced unlimited dial-up plans, including the $23.90 plan, to lower-priced plans. The decline in AOL brand domestic subscribers overall, and specifically in the $15 and over per month price plans, is expected to continue in the foreseeable future.

Growth in AOL brand domestic subscribers on plans below $15 per month was driven principally by the migration of subscribers from plans $15 and over per month and, to a lesser extent, by new subscribers. AOL expects that the proportion of its subscribers on lower-priced plans will continue to increase. This trend is expected to be accelerated by the impact of the new agreements with high-speed Internet access providers. The growth in subscribers on plans below $15 per month is expected to benefit primarily from subscribers who are currently in the $25.90 (previously the $23.90) price plan.

Within the $15 and over per month category, the decrease in ARPU over the prior year was due primarily to a shift in the mix to lower-priced subscriber price plans, partially offset by an increase in the percentage of revenue

generating customers. Premium subscription services revenues included in ARPU for the year ended December 31, 2005 and 2004 were $87 million and $92 million, respectively.

Within the under $15 per month category, the increase in ARPU over the prior year was due primarily to an improved mix of subscriber price plans and an increase in the percentage of revenue generating customers. Premium subscription services revenues included in ARPU for the year ended December 31, 2005 and 2004 were $32 million and $24 million, respectively.

AOL Europe offers a variety of price plans, including bundled broadband, unlimited access to the AOL service using AOL s dial-up network and limited access plans, which are generally billed based on actual usage. AOL Europe continues to actively market

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bundled broadband plans, as AOL Europe s subscribers have been migrating from dial-up plans to bundled broadband plans, and this trend is expected to continue.

The ARPU for European subscribers increased due to a change in the mix of price plans, with broadband subscribers growing as a percentage of total subscribers, and an increase in premium subscription services revenues. The migration of AOL Europe subscribers to broadband plans is expected to continue to result in increases in ARPU for European subscribers. In addition, 2005 benefited from the positive effect of changes in foreign currency exchange rates. The total number of AOL brand subscribers at AOL Europe reflects a year-over-year decline in subscribers in France, Germany and the U.K.

In addition to the AOL brand service, AOL has subscribers to other lower-priced services, both domestically and internationally, including the Netscape and CompuServe brands. These other brand services are not a significant source of revenues.

Advertising revenues improved primarily due to increased revenues from sales of advertising run on third-party websites generated by Advertising.com, which was acquired in August 2004, and growth in paid-search and traditional advertising. Advertising.com contributed $259 million and $97 million of revenues for the year ended December 31, 2005 and 2004, respectively. Paid-search revenues increased $116 million during 2005. AOL expects Advertising revenues to continue to increase during 2006 due to expected growth in paid-search and traditional online advertising and contributions from Advertising.com s performance-based advertising. However, the rate of growth is expected to be less than experienced in 2005, because the growth rate in 2005 benefited from the absence in 2004 of a full year of Advertising.com s results.

Other revenues primarily include software licensing revenue, revenue from providing the Cable segment access to the AOL Transit Data Network (ATDN) for high-speed access to the Internet and the sale of modems to consumers in order to support high-speed access to the Internet. Other revenues decreased slightly due primarily to a $32 million decrease in ATDN revenue from TWC Inc., reflecting lower pricing under the terms of a new agreement and lower network usage, partially offset by revenue at AOL Europe primarily from increased modem sales.

Costs of revenues decreased 9% and, as a percentage of revenues, decreased to 46% in 2005 from 48% in 2004. The declines related primarily to lower network-related expenses. Network-related expenses decreased 27% to $1.292 billion in 2005 from $1.760 billion in 2004. The decline in Network related expenses was principally attributable to improved pricing and network utilization, decreased levels of long-term fixed commitments and lower usage of AOL s dial-up network associated with the declining dial-up subscriber base. Network costs also benefited from the final refund of $26 million for a portion of service payments made in prior years at AOL Europe. The decline in network costs was partially offset by costs associated with Advertising.com, which was acquired in August 2004. Domestic network expenses are expected to continue to decline in 2006, although at a lower rate than in 2005. However, this decline is expected to be more than offset by increased network expenses at AOL Europe due to the continued migration of AOL Europe dial-up subscribers to bundled broadband plans for which network expenses per subscriber are significantly higher.

The decrease in selling, general and administrative expenses primarily related to a decrease in marketing costs and $23 million of benefits related to the favorable resolution of European value-added tax matters, partially offset by additional costs associated with Advertising.com, a $10 million charge related to a patent litigation settlement and higher general and administrative costs. The decrease in marketing costs primarily resulted from lower spending on member acquisition activities, partially offset by an increase in brand advertising. The year ended December 31, 2004 also included an approximate $25 million adjustment to reduce excess marketing accruals made in prior years, primarily related to AOL Europe.

As previously discussed under Significant Transactions and Other Items Affecting Comparability, the 2005 results include $17 million in restructuring charges, primarily related to a reduction in headcount associated with AOL s efforts to realign resources more efficiently, partially offset by a $7 million reduction in restructuring costs, reflecting changes in estimates of previously established restructuring accruals. In addition, the 2005 results include an

approximate $5 million gain on the sale of a building, a $5 million gain from the resolution of previously contingent gains related to the 2004 sale of Netscape Security Solutions and a $24 million noncash goodwill impairment charge related to AOLA. The 2004 results included a $55 million restructuring charge, partially offset by a $5 million reversal of previously-established restructuring accruals, reflecting changes in estimates, a $13 million gain on the sale of AOL Japan, a $7 million gain on the sale of Netscape Security Solutions and a $10 million impairment charge related to a building that was held for sale.

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The increases in Operating Income before Depreciation and Amortization and Operating Income are due primarily to higher Advertising revenues and lower costs of revenues and selling, general and administrative expenses, partially offset by lower Subscription revenues and the $24 million noncash goodwill impairment charge described above. Operating Income also improved due to lower depreciation expense reflecting a decline in network assets as the result of membership declines.

As noted above, the Company expects a continued decline in AOL s domestic subscribers and related revenues. As a result of the decline in revenues, the Company anticipates Operating Income before Depreciation and Amortization and Operating Income will decline during the first half of 2006 as compared to the comparable 2005 period.

During December 2005, the Company announced that AOL is expanding its current strategic alliance with Google to create a global online advertising partnership and make more of AOL s content available to Google users. Refer to AOL-Google Alliance in Other Recent Developments above for further discussion.

Cable. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Cable segment for the years ended December 31, 2005 and 2004 are as follows:

	Year Ended December 31,		
	2005	2004	% Change
	(restated, millions)		
Revenues:			
Subscription	$ 8,964	$ 7,969	12%
Advertising	534	515	4%
Total revenues	9,498	8,484	12%
Costs of revenues[(a)]	(4,199)	(3,703)	13%
Selling, general and administrative[(a)]	(1,585)	(1,483)	7%
Merger-related and restructuring costs	(42)		NM
Operating Income before Depreciation and Amortization	3,672	3,298	11%
Depreciation	(1,588)	(1,438)	10%
Amortization	(76)	(76)	
Operating Income	$ 2,008	$ 1,784	13%

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

The components of Subscription revenues are as follows:

	Year Ended December 31,	
	2005	2004

			% Change
		(millions)	
Subscription revenues:			
Video services	$ 6,537	$ 6,180	6%
High-speed data	2,145	1,760	22%
Digital Phone	282	29	NM
Total Subscription revenues	$ 8,964	$ 7,969	12%

Subscription revenues increased due to the continued penetration of advanced services (primarily high-speed data, advanced digital video services and Digital Phone) and video rate increases. Strong growth rates for Subscription revenues associated with high-speed data and Digital Phone are expected to continue in 2006.

TWC Inc. subscriber counts include all billable subscribers for each level of service received. Basic cable subscribers include all subscribers who receive basic video cable service. Digital video subscribers reflect all subscribers who receive any level of video service received via digital technology. High-speed data subscribers include all subscribers who receive TWC Inc. s Road Runner Internet service, as well as other Internet services offered by TWC Inc. Digital Phone subscribers include all subscribers who receive telephony service. At December 31, 2005, as compared to December 31, 2004, basic cable subscribers increased 0.7% and totaled 10.957 million (including 1.557 million subscribers of unconsolidated investees, which are managed by TWC Inc.), digital video subscribers increased by 12% to 5.401 million (including 760,000 subscribers of unconsolidated investees, which are managed by TWC Inc.), residential high-speed data subscribers increased by 23% to 4.822 million (including 673,000 subscribers of unconsolidated investees, which are managed by TWC Inc.) and commercial high-speed data subscribers increased by 22% to 211,000

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(including 26,000 subscribers of unconsolidated investees, which are managed by TWC Inc.). Additionally, Digital Phone subscribers increased by 880,000 to 1.100 million (including 150,000 subscribers of unconsolidated investees, which are managed by TWC Inc.).

The increase in Advertising revenues is due to growth of national and local advertising, including an increase in both the rates and volume of advertising spots sold, partly offset by a decline in news advertising related to the 2004 elections.

Costs of revenues increased 13% and, as a percentage of revenues, were 44% for both 2005 and 2004. The increase in costs of revenues is primarily related to increases in video programming costs, higher employee costs and an increase in telephony service costs. Video programming costs increased 11% to $2.040 billion in 2005 due primarily to contractual rate increases across TWC Inc. s programming line-up and the ongoing deployment of new digital video services. Programming costs in the fourth quarter of 2005 reflect a net benefit of approximately $25 million primarily associated with changes in programming estimates (a portion of which were accrued earlier in 2005). Video programming costs in 2006 are expected to increase at a rate similar to that experienced during 2005, reflecting the continued expansion of service offerings and contractual rate increases across TWC Inc. s programming line-up. Employee costs increased primarily due to salary increases and higher headcount resulting from the roll-out of advanced services. Telephony service costs increased approximately $110 million due to the growth of Digital Phone subscribers. Despite the growth in high-speed data subscribers, as discussed above, high-speed data connectivity costs declined 18% in 2005 as connectivity costs have continued to decrease on a per subscriber basis due to industry-wide cost declines; however, such trends are not expected to continue. High-speed data costs are anticipated to increase in 2006 due to higher usage and subscribers.

The increase in selling, general and administrative expenses is primarily the result of higher employee and administrative costs due to salary increases and higher headcount resulting from the continued roll-out of advanced services, partially offset by $34 million of costs incurred in 2004 in connection with the previously discussed Urban Cable dispute.

As previously discussed under Significant Transactions and Other Items Affecting Comparability, during 2005, the Cable segment expensed approximately $8 million of non-capitalizable merger-related costs associated with the Adelphia Acquisition and the Cable Swaps discussed above. Such costs are expected to increase between now and the closing date and continue thereafter. Closing of these transactions is expected to occur during the second quarter of 2006. In addition, the 2005 results include approximately $35 million of restructuring costs, primarily associated with the early retirement of certain senior executives and the closing of several local news channels, partially offset by a $1 million reduction in restructuring charges, reflecting changes in previously established restructuring accruals. These charges are part of TWC Inc. s broader plans to simplify its organizational structure and enhance its customer focus. TWC Inc. is in the process of executing this initiative and expects to incur additional costs associated with the plan as it is implemented in 2006.

Operating Income before Depreciation and Amortization increased principally as a result of revenue growth (particularly high margin high-speed data revenues), offset in part by higher costs of revenues, selling, general and administrative expenses and the merger-related and restructuring charges discussed above.

Operating Income increased due primarily to the increase in Operating Income before Depreciation and Amortization described above, offset in part by an increase in depreciation expense. Depreciation expense increased $150 million due primarily to the continued higher spending on customer premise equipment in recent years, which generally has a significantly shorter useful life compared to the mix of assets previously purchased.

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Filmed Entertainment. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Filmed Entertainment segment for the years ended December 31, 2005 and 2004 are as follows:

	Year Ended December 31,		
	2005	2004	% Change
		(millions)	
Revenues:			
Advertising	$ 4	$ 10	(60%)
Content	11,704	11,628	1%
Other	216	215	
Total revenues	11,924	11,853	1%
Costs of revenues[a]	(9,090)	(8,941)	2%
Selling, general and administrative[a]	(1,517)	(1,438)	5%
Gain on sale of assets	5		NM
Restructuring costs	(33)		NM
Operating Income before Depreciation and Amortization	1,289	1,474	(13%)
Depreciation	(121)	(104)	16%
Amortization	(225)	(213)	6%
Operating Income	$ 943	$ 1,157	(18%)

[a] Costs of revenues and selling, general and administrative expenses exclude depreciation.

Content revenues increased slightly during 2005 as a result of increases from both content made available for initial airing in theaters (theatrical product) and content made available for initial airing on television (television product). The components of Content revenues are as follows:

	Year Ended December 31,		
	2005	2004	% Change
		(millions)	
Theatrical product:			
Theatrical film	$ 2,049	$ 2,254	(9%)
Television licensing	1,701	1,485	15%
Home video	3,619	3,594	1%

Total theatrical product	7,369	7,333	
Television product:			
Television licensing	2,658	3,033	(12%)
Home video	1,188	778	53%
Total television product	3,846	3,811	1%
Consumer product and other	489	484	1%
Total Content revenues	$ 11,704	$ 11,628	1%

The decrease in theatrical film revenues reflects difficult comparisons to the prior year, which included the success of *Harry Potter and the Prisoner of Azkaban* and *Troy* and international overages associated with *The Lord of the Rings: The Return of the King*, partially offset by the 2005 success of *Harry Potter and the Goblet of Fire, Charlie and the Chocolate Factory, Batman Begins* and *Wedding Crashers*, among others. The increase in theatrical product revenues from television licensing primarily related to international availabilities, including a greater number of significant titles in 2005. Home video sales of theatrical product increased slightly as key 2005 releases, including *The Polar Express, Harry Potter and the Prisoner of Azkaban* in most international territories, *Batman Begins, Charlie and the Chocolate Factory* and *Troy*, were comparable to the 2004 key home video releases, including *The Lord of the Rings: The Return of the King, Elf, The Matrix Revolutions, The Last Samurai* and the primarily domestic release of *Harry Potter and the Prisoner of Azkaban.*

The decrease in license fees from television product was primarily attributable to difficult comparisons to 2004, which included the third-cycle syndication continuance license arrangements for *Seinfeld* and network license fees and syndication revenues associated with the final broadcast seasons of *Friends* and *The Drew Carey Show*. The growth in home video sales of television product was primarily attributable to an increased number of titles released in this format, including *Seinfeld.*

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The increase in costs of revenues resulted primarily from higher home video manufacturing and freight costs related to increased volume and an increase in the ratio of higher cost television product, as well as higher advertising and print costs resulting from the quantity and mix of films released, offset partially by lower film costs ($5.484 billion in 2005 compared to $5.870 billion in 2004). Included in film costs are theatrical valuation adjustments, which declined from $215 million in 2004 to $192 million in 2005. Costs of revenues as a percentage of revenues increased to 76% for 2005 from 75% for 2004, due to the quantity and mix of product released.

Selling, general and administrative expenses increased primarily due to higher employee costs related to salary increases and higher occupancy costs, partially offset by a decline related to the distribution fees associated with the off-network television syndication of *Seinfeld* in the prior year.

As previously discussed under Significant Transactions and Other Items Affecting Comparability, 2005 results include approximately $33 million of restructuring costs, primarily related to a reduction in headcount associated with efforts to reorganize resources more efficiently and a $5 million gain related to the sale of a property in California.

Operating Income before Depreciation and Amortization and Operating Income decreased as a result of higher selling, general and administrative expenses and costs of revenues and the 2005 restructuring costs, as discussed above.

Networks. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Networks segment for the years ended December 31, 2005 and 2004 are as follows:

	Year Ended December 31,		
	2005	2004	% Change
	(millions)		
Revenues:			
Subscription	$ 5,405	$ 5,058	7%
Advertising	3,086	2,895	7%
Content	1,014	973	4%
Other	106	128	(17%)
Total revenues	9,611	9,054	6%
Costs of revenues[a]	(4,702)	(4,600)	2%
Selling, general and administrative[a]	(1,906)	(1,753)	9%
Loss on sale of assets		(7)	NM
Restructuring costs	(4)		NM
Operating Income before Depreciation and Amortization	2,999	2,694	11%
Depreciation	(238)	(212)	12%
Amortization	(23)	(21)	10%
Operating Income	$ 2,738	$ 2,461	11%

[a] Costs of revenues and selling, general and administrative

expenses
exclude
depreciation.

The increase in Subscription revenues was due primarily to higher subscription rates at Turner and HBO and, to a lesser extent, an increase in the number of subscribers at Turner and HBO. Included in the 2005 results is a $22 million benefit from the resolution of certain contractual agreements at Turner and the 2004 results included a benefit of approximately $50 million from the resolution of certain contractual agreements at Turner and HBO.

The increase in Advertising revenues was driven primarily by higher CPMs (advertising cost per thousand viewers), sellouts and delivery at Turner s entertainment networks, partially offset by a decline at The WB Network as a result of lower ratings.

The increase in Content revenues was primarily due to HBO s broadcast syndication sales of *Sex and the City* and, to a lesser extent, increases in other ancillary sales of HBO s original programming, partially offset by lower licensing revenues at HBO associated with fewer episodes of *Everybody Loves Raymond* and the absence of the winter sports teams at Turner, which were sold on March 31, 2004 and contributed $22 million of Content revenues in 2004.

The decline in Other revenues was primarily attributable to the sale of the winter sports teams in 2004, which contributed $39 million of Other revenues, partially offset by an increase in Other revenues primarily related to the Atlanta Braves.

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Costs of revenues increased 2% and, as a percentage of revenues, were 49% and 51% in 2005 and 2004, respectively. The increase in costs of revenues was primarily attributable to an increase in programming costs and higher costs associated with increased ancillary sales of HBO s original programming, partially offset by lower costs related to the absence of the winter sports teams due to their sale in March 2004. Programming costs increased to $3.326 billion in 2005 from $3.225 billion in 2004. The increase in programming expenses is primarily due to an increase in original series costs, sports programming costs and news costs at Turner, partially offset by lower acquired programming costs at HBO and The WB Network.

Selling, general and administrative expenses increased primarily due to higher general and administrative costs at Turner, as well as higher marketing and promotional expenses at Turner, including approximately $27 million of increased costs to support the launch of GameTap, partially offset by a decline in marketing and promotional expenses at The WB Network. The 2004 results also included the reversal of bankruptcy-related bad debt reserves of $75 million at Turner and HBO on receivables from Adelphia.

As discussed in Significant Transactions and Other Items Affecting Comparability, 2005 results include $4 million of restructuring costs at The WB Network, primarily related to a reduction in headcount associated with efforts to reorganize its resources more efficiently, and 2004 results included an approximate $7 million loss on the sale of the winter sports teams at Turner.

Operating Income before Depreciation and Amortization and Operating Income increased during 2005 primarily due to an increase in revenues, partially offset by higher costs of revenues and selling, general and administrative expenses, as described above.

On January 24, 2006, Warner Bros. and CBS Corp. (CBS) announced an agreement in principle to form a new fully-distributed national broadcast network, to be called The CW. At the same time, Warner Bros. and CBS are preparing to cease the standalone operations of The WB Network and UPN, respectively, at the end of the 2005/2006 television season (September 2006). Refer to The WB Network in Other Recent Developments above for further discussion.

Publishing. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Publishing segment for the years ended December 31, 2005 and 2004 are as follows:

	Year Ended December 31,		
	2005	2004	% Change
		(millions)	
Revenues:			
Subscription	$ 1,633	$ 1,615	1%
Advertising	2,826	2,692	5%
Content	643	544	18%
Other	744	714	4%
Total revenues	5,846	5,565	5%
Costs of revenues[(a)]	(2,427)	(2,282)	6%
Selling, general and administrative[(a)]	(2,140)	(2,095)	2%
Gain on sale of assets	8	8	
Restructuring costs	(28)		NM
Operating Income before Depreciation and Amortization	1,259	1,196	5%
Depreciation	(132)	(122)	8%
Amortization	(99)	(140)	(29%)

Operating Income	$ 1,028	$ 934	10%

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

Subscription revenues increased primarily reflecting revenues from new magazine launches and acquisitions, partially offset by the timing of subscription allowances, which are netted against revenues.

Advertising revenues increased due to contributions from new magazine launches, acquisitions and growth at *Real Simple, People, Southern Living* and *In Style*, offset partly by lower Advertising revenues at certain magazines, including *Sports Illustrated, Time* and *Fortune*.

Content revenues increased due to a number of best-selling titles at TWBG.

Other revenues increased primarily due to growth at Synapse, a subscription marketing business.

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Costs of revenues increased 6% and, as a percentage of revenues, were 42% and 41% in 2005 and 2004, respectively. Costs of revenues for the magazine publishing business include manufacturing (paper, printing and distribution) and editorial-related costs, which together increased 7% to $1.865 billion primarily due to magazine launch-related costs, the acquisitions of GEE and the remaining interest in the publisher of *Essence* and increases in paper prices. In addition, costs of revenues increased due to costs related to increased sales of several successful titles at TWBG. The recent postal rate increase is anticipated to have a negative impact on costs of approximately $25 million, which will be partially offset by reductions in print costs.

Selling, general and administrative expenses increased 2% primarily due to magazine launch-related costs, the acquisitions of GEE and the remaining interest in the publisher of *Essence* and higher selling expenses related to the success of several titles at TWBG, partially offset by cost reduction efforts and the absence of costs associated with the sponsorship and coverage of the 2004 Summer Olympics.

As previously discussed in Significant Transactions and Other Items Affecting Comparability, 2005 results reflect an $8 million gain related to the collection of a loan made in conjunction with the Company s 2003 sale of Time Life, which was previously fully reserved due to concerns about recoverability and approximately $28 million of restructuring costs, primarily related to a reduction in headcount associated with efforts to reorganize resources more efficiently. The 2004 results reflect an $8 million gain on the sale of a building. In the first quarter of 2006, Time Inc. further reduced headcount, which will result in additional restructuring charges ranging from $5 million to $10 million. As Time Inc. continues to analyze its resource needs, further restructuring charges may be incurred.

Operating Income before Depreciation and Amortization increased primarily due to an increase in revenues, partially offset by higher costs of revenues and selling, general and administrative expenses, including $12 million of higher start-up losses on magazine launches.

Operating Income improved, benefiting from a decline in amortization expense as a result of certain short-lived intangibles, such as customer lists, becoming fully amortized in the later part of 2004. As a result of increased competition related to certain magazine titles, certain indefinite lived trade name intangibles will be assigned a finite life and begin to be amortized starting January 2006. The annual impact of amortizing such trade names beginning in 2006 will be approximately $50 million in additional amortization expense.

As discussed in more detail in Other Recent Developments, on February 6, 2006, the Company announced an agreement to sell TWBG to Hachette for approximately $538 million in cash, not including working capital adjustments.

Corporate. Operating Loss before Depreciation and Amortization and Operating Loss of the Corporate segment for the years ended December 31, 2005 and 2004 are as follows:

	Year Ended December 31,		
	2005	2004	% Change
		(millions)	
Amounts related to securities litigation and government investigations	$ (2,865)	$ (536)	NM
Selling, general and administrative[(a)]	(430)	(484)	(11%)
Operating Loss before Depreciation and Amortization	(3,295)	(1,020)	NM
Depreciation	(44)	(43)	2%
Operating Loss	$ (3,339)	$ (1,063)	NM

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

As previously discussed, the year ended December 31, 2005 results include $3 billion in legal reserves related to securities litigation. The year ended December 31, 2004 results include $510 million in legal reserves related to the government investigations. The Company also incurred legal and other professional fees related to the SEC and DOJ investigations into the Company s accounting and disclosure practices and the defense of various securities litigation matters ($71 million and $74 million in 2005 and 2004, respectively). In addition, the Company realized insurance recoveries of $206 million and $48 million in 2005 and 2004, respectively. As discussed under Other Recent Developments above, in December 2005, the Company recognized a $185 million settlement on directors and officers insurance policies related to securities and derivative action matters (other than the actions alleging violations of ERISA). Legal and other professional fees are expected to continue to be incurred in future periods (Note 1).

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Included in selling, general and administrative expenses in 2004 are $53 million of costs associated with the relocation from the Company s former corporate headquarters. Of the $53 million charge, approximately $26 million relates to a noncash write-off of the fair value lease adjustment, which was established in purchase accounting at the time of the merger of AOL and Time Warner Inc., now known as Historic TW Inc. (Historic TW). For the year ended December 31, 2005, the Company reversed approximately $4 million of this charge, which was no longer required due to changes in estimates.

Excluding the items discussed above, Operating Loss before Depreciation and Amortization and Operating Loss is essentially flat for the year ended December 31, 2005, due primarily to higher compensation, professional fees and financial advisory services costs, offset by lower insurance costs, including a $29 million adjustment to increase self insurance reserves taken in 2004.

2004 vs. 2003

Consolidated Results

Revenues. Consolidated revenues increased 7% to $42.081 billion in 2004 from $39.496 billion in 2003. As shown below, these increases were led by growth in Subscription, Advertising and Content revenues, offset, in part, by declines in Other revenues:

	Year Ended December 31,		
	2004	**2003**	**% Change**
	(restated, millions)		
Subscription	$ 21,605	$ 20,448	6%
Advertising	6,947	6,113	14%
Content	12,350	11,446	8%
Other	1,179	1,489	(21%)
Total revenues	$ 42,081	$ 39,496	7%

The increase in Subscription revenues primarily related to the Cable and Networks segments, and, to a lesser extent, the Publishing segment. This increase was offset partially by a decline at the AOL segment. The increase at the Cable segment was principally due to the continued penetration of new services (primarily high-speed data and advanced digital video services) and video rate increases. The increase at the Networks segment was due to higher subscription rates and an increase in the number of subscribers at both Turner and HBO. The increase at the Publishing segment was due to a decrease in subscription allowances (which are netted against revenue) and the favorable effects of foreign currency exchange rates. The AOL segment declined primarily as a result of lower domestic subscribers and related Subscription revenues, partially offset by growth in international Subscription revenues due primarily to the favorable effects of foreign currency exchange rates.

The increase in Advertising revenues was primarily due to growth at the Publishing, Networks and AOL segments. The increase at the Publishing segment was due to the strength of magazine advertising and the favorable effects of foreign currency exchange rates. The increase at the Networks segment was driven by higher CPMs (advertising cost per one thousand viewers) and sellouts at Turner s entertainment networks. The increase at the AOL segment was due primarily to growth in paid-search advertising and revenues associated with the acquisition of Advertising.com.

The increase in Content revenues was principally due to growth at the Filmed Entertainment segment related to both television and theatrical product. The increase in television product revenues was attributable to an increase in worldwide license fees and an increase in home video sales. Revenues from theatrical product increased primarily as a result of higher television license fees and, to a lesser extent, higher home video sales and worldwide theatrical film revenues.

The decline in Other revenues was primarily attributable to the December 31, 2003 sale of Time Life, a direct-marketing business formerly a part of the Publishing segment. Time Life contributed $312 million to Other revenues in 2003.

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

Costs of Revenues. For 2004 and 2003, costs of revenues totaled $24.402 billion and $23.373 billion, respectively, and as a percentage of revenues were 58% and 59%, respectively. The improvement in costs of revenues as a percentage of revenues related primarily to improved margins at the AOL, Networks and Filmed Entertainment segments, as discussed in detail in Business Segment Results.

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Selling, General and Administrative Expenses. Selling, general and administrative expenses increased 5% to $10.261 billion in 2004 from $9.730 billion in 2003 primarily reflecting increases at all segments, including higher advertising and marketing expenses. The segment variations are discussed in detail in Business Segment Results.

Amounts Related to Securities Litigation and Government Investigations. As previously discussed, during 2004 the Company incurred a $210 million charge in connection with the definitive agreement with the DOJ that resolved the DOJ s investigation of the Company and established a $300 million reserve in connection with the then proposed settlement with the SEC, which the SEC staff requested be used for a Fair Fund, as authorized under the Sarbanes-Oxley Act. The $210 million DOJ settlement amount consists of a $60 million penalty paid to the DOJ and the establishment of a $150 million fund that the Company may use to settle any related shareholder or securities litigation. In 2005, this $150 million was transferred to the MSBI Settlement Fund established in connection with the settlement of the primary securities class action, as described in Other Recent Developments Amounts Related to Securities Litigation above.

In addition, the Company has incurred legal and other professional fees related to the SEC and DOJ investigations into the Company s accounting and disclosure practices and the defense of various shareholder lawsuits totaling $74 million and $81 million in 2004 and 2003, respectively. In addition, the Company realized insurance recoveries of $48 million and $25 million in 2004 and 2003, respectively (Note 1).

Reconciliation of Operating Income before Depreciation and Amortization to Operating Income and Net Income.

The following table reconciles Operating Income before Depreciation and Amortization to Operating Income. In addition, the table provides the components from Operating Income to Net Income for purposes of the discussions that follow:

	Year Ended December 31,		
	2004	**2003**	**% Change**
		(restated, millions)	
Operating Income before Depreciation and Amortization	$ 9,414	$ 8,411	12%
Depreciation	(2,571)	(2,487)	3%
Amortization	(626)	(640)	(2%)
Operating Income	6,217	5,284	18%
Interest expense, net	(1,533)	(1,734)	(12%)
Other income, net	522	1,213	(57%)
Minority interest expense, net	(250)	(218)	15%
Income before income taxes, discontinued operations and cumulative effect of accounting change	4,956	4,545	9%
Income tax provision	(1,717)	(1,381)	24%
Income before discontinued operations and cumulative effect of accounting change	3,239	3,164	2%
Discontinued operations, net of tax	121	(495)	NM
Cumulative effect of accounting change, net of tax	34	(12)	NM
Net income	$ 3,394	$ 2,657	28%

Operating Income before Depreciation and Amortization. Time Warner s Operating Income before Depreciation and Amortization increased 12% to $9.414 billion in 2004 from $8.411 billion in 2003 principally as a result of solid growth at all business segments, partially offset by increased expenses at Corporate. The segment variations are discussed in detail under Business Segment Results.

Depreciation Expense. Depreciation expense increased to $2.571 billion in 2004 from $2.487 billion in 2003. The increase in depreciation expense primarily related to the Cable segment and, to a lesser extent, growth at all other segments except the AOL segment. The growth in depreciation expense at the Cable segment reflects higher levels of spending related to the roll-out of digital services and increased spending on customer premise equipment that is depreciated over a significantly shorter useful life compared to the mix of assets previously purchased. In 2004 and 2003, the AOL segment benefited from an approximate $13 million and $60 million decrease, respectively, to reduce excess depreciation inadvertently recorded at the AOL segment over several prior years. Management does not believe that the understatement of prior years results were material to any of the applicable year s financial statements. Similarly, management does not believe that the adjustments made are material to either the 2004 or 2003 results. Excluding these decreases, depreciation expense at the AOL segment declined due to a reduction in network assets.

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Amortization Expense. Amortization expense decreased to $626 million in 2004 from $640 million in 2003. The decrease relates primarily to a decline in amortization expense at the Publishing segment as a result of certain intangibles with short useful lives, such as customer lists, becoming fully amortized, partially offset by an increase in the amortization associated with customer-related intangible assets at the Cable segment, which were established with the purchase price allocation associated with the TWE Restructuring. The purchase price allocation was finalized on March 31, 2004.

Operating Income. Time Warner s Operating Income increased to $6.217 billion in 2004 from $5.284 billion in 2003, reflecting the changes in business segment Operating Income before Depreciation and Amortization, partially offset by the increase in depreciation expense, as discussed above.

Interest Expense, Net. Interest expense, net, decreased to $1.533 billion in 2004 from $1.734 billion in 2003 due primarily to lower average net debt levels.

Other Income, Net. Other income, net, detail is shown in the table below:

	Year Ended December 31,	
	2004	2003
	(restated, millions)	
Investment gains, net	$ 424	$ 593
Gain on WMG option	50	
Microsoft Settlement		760
Income (losses) from equity investees	36	(94)
Other	12	(46)
Other income, net	$ 522	$ 1,213

The changes in investment gains, net, the gain on the WMG option and the Microsoft Settlement are discussed above in detail under Significant Transactions and Other Items Affecting Comparability. Excluding the impact of these items, Other income, net, improved in 2004 as compared to the prior year, primarily from an increase in income from equity method investees. This increase was principally due to the impact from the consolidation of AOLA in 2004. Prior to the consolidation in 2003, AOLA losses were recognized as losses from equity investees.

Minority Interest Expense. Time Warner had $250 million of minority interest expense in 2004 compared to $218 million in 2003. The increase relates primarily to larger profits recorded by TWC Inc., in which Comcast has a minority interest.

Income Tax Provision. Income tax expense from continuing operations was $1.717 billion in 2004 compared to $1.381 billion in 2003. The Company s effective tax rate for continuing operations was 35% and 30% in 2004 and 2003, respectively. The increase in the effective tax rate results primarily from a decrease in tax benefits realized on capital losses (from $450 million to $110 million) and the impact of legal reserves recognized in 2004 related to the government investigations (as discussed under Significant Transactions and Other Items Affecting Comparability), most of which ultimately may not be deductible for income tax purposes. The increase in the effective tax rate was partially offset by the release of certain tax reserves and related interest which includes amounts recognized from the finalization of prior tax filings as well as additional benefits associated with certain foreign source income.

Income before Discontinued Operations and Cumulative Effect of Accounting Change. Income before discontinued operations and cumulative effect of accounting change was $3.239 billion in 2004 compared to $3.164 billion in 2003. Basic and diluted net income per share before discontinued operations and cumulative effect of accounting change were $0.71 and $0.69 in 2004, respectively, compared to $0.70 and $0.68 in 2003, respectively. In addition, excluding the items previously discussed under Significant Transactions and Other Items Affecting Comparability of $174 million of expense and $512 million of income in 2004 and 2003, respectively, income before

discontinued operations and cumulative effect of accounting change increased by $761 million. This increase reflects primarily the after-tax effect of the increase in Operating Income and lower interest expense.

Discontinued Operations, Net of Tax. The 2004 and 2003 results include the impact of the treatment of the Music segment as a discontinued operation. Included in the 2004 results are a pretax loss of $2 million and a tax benefit of $123 million. The loss and the corresponding taxes relate primarily to adjustments to the initial estimates of the assets sold to, and liabilities assumed by, the acquirers in such transactions and to the resolution of various tax matters surrounding the music business dispositions.

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Included in the 2003 results are a pretax gain of approximately $560 million for the sale of Warner Manufacturing, a $1.1 billion pretax impairment charge taken to reduce the carrying value of the net assets of WMG, a $27 million pretax loss from the music operations and $72 million of income tax benefits.

Cumulative Effect of Accounting Change, Net of Tax. As previously discussed, the Company recorded an approximate $34 million benefit, net of tax, as a cumulative effect of accounting change upon the consolidation of AOLA in 2004 in accordance with FIN 46R. In addition, during 2003 the Company recorded an approximate $12 million charge, net of tax, as the cumulative effect of the adoption of FIN 46.

Net Income and Net Income Per Common Share. Net income was $3.394 billion in 2004 compared to $2.657 billion in 2003. Basic and diluted net income per common share were $0.74 and $0.72 in 2004 compared to $0.59 and $0.57 in 2003, respectively. Net income includes the items discussed above under Significant Transactions and Other Items Affecting Comparability, discontinued operations, net of tax, and cumulative effect of accounting change.

Business Segment Results

AOL. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the AOL segment for the years ended December 31, 2004 and 2003 are as follows:

	Year Ended December 31,		
	2004	2003	% Change
	(restated, millions)		
Revenues:			
Subscription	$ 7,477	$ 7,593	(2%)
Advertising	1,005	781	29%
Other	210	220	(5%)
Total revenues	8,692	8,594	1%
Costs of revenues[(a)]	(4,178)	(4,545)	(8%)
Selling, general and administrative[(a)]	(2,681)	(2,494)	7%
Gain on disposal of consolidated businesses	20		NM
Asset impairments	(10)		NM
Restructuring charges	(50)	(52)	(4%)
Operating Income before Depreciation and Amortization	1,793	1,503	19%
Depreciation	(652)	(656)	(1%)
Amortization	(176)	(175)	1%
Operating Income	$ 965	$ 672	44%

(a) Costs of revenues and selling, general and administrative expenses exclude

depreciation.

The reduction in Subscription revenues primarily reflects a decrease in domestic Subscription revenues (from $6.095 billion in 2003 to $5.725 billion in 2004), offset in part by an increase in Subscription revenues at AOL Europe (from $1.498 billion in 2003 to $1.677 billion in 2004). AOL s domestic Subscription revenues declined due primarily to a decrease in the number of domestic AOL brand subscribers and related revenues, partially offset by an increase in premium service revenue. AOL Europe s Subscription revenues benefited from the favorable impact of foreign currency exchange rates ($156 million) and growth in bundled broadband subscribers. These increases more than offset an increase in value-added taxes (VAT) (which is netted against revenue) due to a change in European tax law that took effect July 1, 2003. In addition, total Subscription revenues benefited from the consolidation of AOLA effective March 31, 2004 ($37 million), and AOL Japan ($37 million), which was consolidated effective January 1, 2004, but then sold on July 1, 2004.

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The number of AOL brand domestic and European subscribers is as follows at December 31, 2004, September 30, 2004 and December 31, 2003 (millions):

	December 31, 2004	September 30, 2004	December 31, 2003
Subscriber category:			
AOL brand domestic[a]			
$15 and over	17.5	18.1	19.9
Under $15	4.7	4.6	4.4
Total AOL brand domestic	22.2	22.7	24.3
AOL Europe	6.3	6.3	6.4

(a) AOL includes in its subscriber count individuals, households or entities that have provided billing information and completed the registration process sufficiently to allow for an initial log-on to the AOL service.

The average monthly Subscription revenue per subscriber (ARPU) for each significant category of subscribers, calculated as average monthly subscription revenue (including premium subscription services revenues) for the category divided by the average monthly subscribers in the category for the applicable period, is as follows:

	Year Ended December 31,	
	2004	2003
Subscriber category:		
AOL brand domestic $15 and over	$20.97	$20.25
Under $15	13.07	12.11
Total AOL brand domestic	19.44	18.98
AOL Europe	21.48	19.03

Domestic subscribers to the AOL brand service include subscribers during introductory free-trial periods and subscribers at no or reduced monthly fees through member service and retention programs. Total AOL brand domestic subscribers include free-trial and retention members of approximately 13% at December 31, 2004 and 17% at December 31, 2003. Domestic subscribers to the AOL brand service also include subscriptions sold at a discount to employees and customers of selected AOL strategic partners. Domestic AOL brand subscribers also include subscribers to AOL s bundled broadband service, which combines the AOL service with high-speed Internet access provided by third-party broadband Internet access providers such as cable companies and telephone companies. AOL did not actively market the bundled broadband service domestically during 2004.

The largest component of the AOL brand domestic $15 and over price plans is the $23.90 price plan, which provides unlimited access to the AOL service using AOL s dial-up network and unlimited usage of the AOL service through any other Internet connection. The largest component of the AOL brand domestic under $15 price plans is the $14.95 per month price plan, which is primarily marketed as a bring your own access (BYOA) plan, which includes unlimited usage of the AOL service through an Internet connection not provided by AOL, such as a high-speed broadband Internet connection via cable or DSL. This BYOA price plan also includes a limited number of hours per month of dial-up telephone access in the U.S. to the AOL service using AOL s dial-up network.

The decline in AOL brand subscribers on plans priced $15 and over per month resulted from a number of factors, principally the continued maturing of dial-up services and subscribers adopting other dial-up and high-speed services, and a reduction in direct marketing response rates over the prior period. Further, during the year, subscribers migrated from the premium priced unlimited dial-up plans, including the $23.90 plan, to lower priced limited dial-up plans, such as the $14.95 plan.

Growth in AOL brand subscribers on plans below $15 per month was driven principally by the migration of subscribers from plans $15 and over per month and, to a lesser extent, by new subscribers on the $14.95 BYOA plan.

Within the $15 and over per month category, the increase in ARPU over the prior year was due primarily to an increase in the percentage of total subscribers who generate revenue. Also contributing to the increase in ARPU was an increase in premium services revenues from subscribers in this category. Premium services revenues included in ARPU for the year ended December 31, 2004 and 2003 were $92 million and $37 million, respectively. ARPU was unfavorably impacted by the mix of subscriber price plans, as subscribers on bundled broadband plans became a smaller portion of the total membership in the $15 and over category.

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ARPU for subscribers in the below $15 per month category increased primarily due to growth in subscribers to the $14.95 price plan year over year, which resulted in a favorable impact as the portion of these subscribers grew in relation to the total membership in the below $15 per month category. Also contributing to the increase in ARPU was an increase in premium services revenues from subscribers in this category. In the below $15 per month category, premium services revenues included in ARPU for the years ended December 31, 2004 and 2003 were $24 million and $8 million, respectively.

AOL Europe offers a variety of price plans, including bundled broadband, unlimited access to the AOL service using AOL s dial-up network and limited access plans, which are generally billed based on actual usage.

ARPU for European subscribers increased primarily because of the positive effect of changes in foreign currency exchange rates related to the strengthening of the Euro and British Pound relative to the U.S. Dollar, as well as a change in the mix of price plans, with bundled broadband subscribers growing as a percentage of total subscribers. The total number of AOL brand subscribers reflects a year-over-year increase in subscribers in the U.K., offset by declines in France and Germany.

In addition to the AOL brand service, the Company has subscribers to lower cost services, both domestically and internationally, including the Netscape and CompuServe brands. These other brand services are not a significant source of revenue.

The increase in Advertising revenues primarily reflects an increase from domestic paid-search advertising contracts (from approximately $200 million in 2003 to $302 million in 2004), $97 million generated by Advertising.com from sales of advertising run on third-party websites and a $33 million increase at AOL Europe, including foreign exchange gains. These increases were partially offset by a decrease in intercompany sales of advertising to other business segments of Time Warner in 2004, as compared to 2003 (from $40 million in 2003 to $11 million in 2004).

Other revenues primarily include software licensing revenue, revenue from providing the Cable segment access to the AOL Transit Data Network for high-speed access to the Internet and merchandising revenue. Other revenues decreased due primarily to AOL s decision in the first quarter of 2003 to reduce the promotion of its merchandise business (i.e., reducing pop-up advertisements) to improve the member experience, partially offset by higher software licensing revenues.

Costs of revenues decreased 8% and, as a percentage of revenues, decreased to 48% in 2004 from 53% in 2003. The declines related primarily to lower network-related expenses, which decreased 28% to $1.760 billion in 2004 from $2.429 billion in 2003. The decline in network-related expenses was principally attributable to improved pricing and decreased levels of service commitments as well as increased amounts of network assets under capital leases (which are included within depreciation expense) versus operating leases. These declines were partially offset by an increase in other costs of service, which included higher domestic salary and consulting costs as well as higher broadband and member service costs at AOL Europe. In addition, there were incremental costs associated with the acquisition of Advertising.com and the consolidation of AOLA and AOL Japan during 2004 (AOL Japan was subsequently sold, effective July 1, 2004).

The increase in selling, general and administrative expenses is primarily related to an increase in marketing costs, additional costs resulting from the acquisition of Advertising.com and higher costs associated with the consolidation of AOLA and the consolidation of AOL Japan for the first half of 2004. The increase in marketing costs resulted from higher spending on member acquisition activities, partially offset by a decline in brand advertising. The increase in marketing expense was partially offset by an approximate $25 million adjustment to reduce excess marketing accruals made in prior years, primarily related to AOL Europe. Management does not believe that the understatement of prior years results was material to any of the years financial statements. Similarly, management does not believe that the adjustment made is material to the 2004 results. The overall increase in marketing costs was also partially offset by the change in the treatment of intercompany advertising barter transactions. During the second quarter of 2003, there was a change in the application of AOL s policy for intercompany advertising barter transactions, which reduced both the amount of intercompany advertising revenues and advertising expenses by $51 million for the year. This change,

however, had no impact on the AOL segment s Operating Income or its Operating Income before Depreciation and Amortization. In addition, because intercompany transactions are eliminated on a consolidated basis, this change in policy did not impact the Company s consolidated results of operations.

As previously discussed under Significant Transactions and Other Items Affecting Comparability, 2004 results included a $55 million restructuring charge partially offset by a $5 million reversal of previously-established restructuring accruals, reflecting changes in estimates, a $13 million gain on the sale of AOL Japan, a $7 million gain on the sale of Netscape Security Solutions and a

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$10 million impairment charge related to a building that is held for sale. Included in 2003 results were $52 million of restructuring charges.

The increases in Operating Income before Depreciation and Amortization and Operating Income are due primarily to a modest increase in overall revenues and lower costs of revenues, offset in part by higher selling, general and administrative expenses.

Cable. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Cable segment for the years ended December 31, 2004 and 2003 are as follows:

	Year Ended December 31,		
	2004	2003	% Change
	(restated, millions)		
Revenues:			
Subscription	$ 7,969	$ 7,233	10%
Advertising	515	466	11%
Total revenues	8,484	7,699	10%
Costs of revenues[a]	(3,703)	(3,323)	11%
Selling, general and administrative[a]	(1,483)	(1,349)	10%
Restructuring charges		(15)	NM
Operating Income before Depreciation and Amortization	3,298	3,012	9%
Depreciation	(1,438)	(1,403)	2%
Amortization	(76)	(58)	31%
Operating Income	$ 1,784	$ 1,551	15%

[a] Costs of revenues and selling, general and administrative expenses exclude depreciation.

Subscription revenues increased due to the continued penetration of new services (primarily high-speed data and advanced digital video services) and video rate increases. High-speed data subscription revenues increased to $1.760 billion for 2004 from $1.422 billion in 2003.

TWC Inc. subscriber counts include all billable subscribers for each level of service received. Basic cable subscribers include all subscribers who receive basic video cable service. Digital video subscribers reflect all subscribers who receive any level of video service received via digital technology. High-speed data subscribers include all subscribers who receive TWC Inc. s Road Runner Internet service, as well as other Internet services offered by TWC Inc. Digital Phone subscribers include all subscribers who receive telephony service. At December 31, 2004, as compared to December 31, 2003, basic cable subscribers declined by 0.3% and totaled 10.884 million (including 1.569 million subscribers of unconsolidated investees, which are managed by TWC Inc.), digital video subscribers

increased by 11% to 4.806 million (including 747,000 subscribers of unconsolidated investees, which are managed by TWC Inc.), residential high-speed data subscribers increased by 21% to 3.913 million (including 551,000 subscribers of unconsolidated investees, which are managed by TWC Inc.) and commercial high-speed data subscribers increased by 35% to 173,000 (including 22,000 subscribers of unconsolidated investees, which are managed by TWC Inc.). Digital Phone subscribers totaled 220,000 (including 38,000 subscribers of unconsolidated investees, which are managed by TWC Inc.).

The increase in Advertising revenues was attributable to an increase in both the rates and volume of advertising spots sold.

Costs of revenues increased 11% and, as a percentage of revenues, were 44% for 2004 compared to 43% for 2003. The increase in costs of revenues is primarily related to increases in video programming costs and higher employee costs. Video programming costs increased 12% to $1.845 billion in 2004 due primarily to contractual rate increases across TWC Inc. s programming line-up (including sports programming). Employee costs increased primarily due to merit increases and higher headcount resulting from the roll-out of new services. High-speed data connectivity costs were relatively flat resulting in a decline on a per subscriber basis.

The increase in selling, general and administrative expenses is primarily the result of higher marketing costs and $34 million incurred in connection with the previously discussed Urban Cable dispute, which was settled in 2004. As a percentage of revenues, selling, general and administrative expenses were constant at approximately 17.5%.

Operating Income before Depreciation and Amortization increased principally as a result of revenue gains, offset in part by higher costs of revenues and selling, general and administrative expenses. As previously discussed in Significant Transactions and Other Items Affecting Comparability, 2003 results also included $15 million of restructuring charges.

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Included in Operating Income before Depreciation and Amortization during 2004 are approximately $45 million of losses associated with the roll-out of the Digital Phone service. At December 31, 2004, Digital Phone service was launched in all of TWC Inc. s divisions.

Operating Income increased due primarily to the increase in Operating Income before Depreciation and Amortization described above, offset in part by an increase in depreciation and amortization expense. Depreciation expense increased $35 million due primarily to the increased investment in customer premise equipment in recent years, which generally has a significantly shorter useful life compared to the mix of assets previously purchased. Amortization expense increased $18 million, primarily as a result of a full year of amortization of customer-related intangibles in 2004 compared to nine months of amortization in 2003. These assets were established in connection with the TWE Restructuring.

Filmed Entertainment. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Filmed Entertainment segment for the years ended December 31, 2004 and 2003 are as follows:

	Year Ended December 31,		
	2004	2003	% Change
		(millions)	
Revenues:			
Advertising	$ 10	$ 6	67%
Content	11,628	10,800	8%
Other	215	161	34%
Total revenues	11,853	10,967	8%
Costs of revenues[a]	(8,941)	(8,430)	6%
Selling, general and administrative[a]	(1,438)	(1,225)	17%
Gain on disposal of consolidated businesses		43	NM
Operating Income before Depreciation and Amortization	1,474	1,355	9%
Depreciation	(104)	(86)	21%
Amortization	(213)	(206)	3%
Operating Income	$ 1,157	$ 1,063	9%

[a] Costs of revenues and selling, general and administrative expenses exclude depreciation.

Content revenues increased during 2004 primarily due to a $631 million and $175 million improvement in revenues from television and theatrical product, respectively. The increase in television product revenues was attributable to a $431 million increase in worldwide license fees and a $200 million increase in home video sales. Revenues from theatrical product included a $106 million increase in television license fees, a $43 million increase in

home video sales and a $26 million increase in worldwide theatrical film revenues.

The increase in worldwide license fees from television product was primarily attributable to the third-cycle syndication continuance license arrangements for *Seinfeld,* partially offset by reduced revenues stemming from the conclusion of *Friends* at the end of the 2003-2004 broadcast season. The growth in home video sales of television product was attributable to an increased number of titles released and now sold in this format, including such properties as *Friends, Babylon 5* and *Smallville.*

The increase in television license fees from theatrical product was due primarily to the network television availability of *The Lord of the Rings: The Fellowship of the Ring* to Turner and The WB Network and from the network television availability of *Harry Potter and the Sorcerer s Stone.* Home video sales from theatrical product increased primarily due to a strong release slate at New Line, including *The Lord of the Rings: The Return of the King, Elf, Freddy vs. Jason* and *The Texas Chainsaw Massacre.* The increase in worldwide theatrical film revenues was attributable primarily to the international success of *Harry Potter and the Prisoner of Azkaban, The Last Samurai* and *Troy* and from international overages associated with *The Lord of the Rings: The Return of the King.* This increase was partially offset by a decline in domestic theatrical revenues primarily resulting from difficult comparisons at New Line to the prior year, which included *The Lord of the Rings: The Return of the King* and *Elf.*

Other revenues increased primarily due to the consolidation of the results of Warner Village in 2004, as previously discussed, which contributed $95 million of Other revenues during 2004. The Company s U.K. cinema interests, which were sold in the second quarter of 2003, contributed Other revenues of $51 million during 2003.

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The increase in costs of revenues resulted from higher film costs ($5.870 billion in 2004 compared to $5.358 billion in 2003), primarily resulting from the quantity and mix of product released and increased production of new episodic television series (new series are generally produced at a cost in excess of their network license fees, with such excess costs expensed as incurred). Included in film costs are theatrical valuation adjustments, which declined from $245 million in 2003 to $215 million in 2004. Marketing and distribution costs increased slightly due to the quantity and mix of films released during these years. Costs of revenues as a percentage of revenues decreased to 75% for 2004 from 77% for 2003.

Selling, general and administrative expenses increased due to additional distribution fees associated with the off-network television syndication of *Seinfeld,* costs resulting from the consolidation of Warner Village in 2004, additional headcount and merit increases and increased rent expense, partially offset by a reduction in employee incentive compensation.

As previously discussed in Significant Transactions and Other Items Affecting Comparability, the Company recorded a $43 million gain on the sale of its interest in U.K. cinemas, which previously had been consolidated, during the second quarter of 2003.

Operating Income before Depreciation and Amortization and Operating Income increased due to an increase in revenues, which was partially offset by increases in costs of revenues, selling, general and administrative expenses and the absence of the gain on disposal of a consolidated business, as discussed above.

Networks. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Networks segment for the years ended December 31, 2004 and 2003 are as follows:

	Year Ended December 31,		
	2004	**2003**	**% Change**
		(millions)	
Revenues:			
Subscription	$ 5,058	$ 4,588	10%
Advertising	2,895	2,675	8%
Content	973	981	(1%)
Other	128	190	(33%)
Total revenues	9,054	8,434	7%
Costs of revenues[(a)]	(4,600)	(4,499)	2%
Selling, general and administrative[(a)]	(1,753)	(1,668)	5%
Impairment of intangible assets		(219)	NM
Loss on sale of assets	(7)		NM
Restructuring charges		(21)	NM
Operating Income before Depreciation and Amortization	2,694	2,027	33%
Depreciation	(212)	(192)	10%
Amortization	(21)	(26)	(19%)
Operating Income	$ 2,461	$ 1,809	36%

(a) Costs of revenues and

selling, general
and
administrative
expenses
exclude
depreciation.

The increase in Subscription revenues was due primarily to higher subscription rates and an increase in the number of subscribers at both Turner and HBO. In addition, 2004 and 2003 each include a benefit (approximately $50 million and $45 million, respectively) related to the favorable resolution of certain contractual agreements, which resulted in previously deferred revenue being recognized when the fees became fixed and determinable.

The increase in Advertising revenues was driven primarily by higher CPMs and sellouts at Turner s entertainment networks.

The slight decrease in Content revenues was primarily due to the success of HBO s first-quarter 2003 home video release of *My Big Fat Greek Wedding* and the absence of Content revenues from the winter sports teams after the first quarter of 2004, partially offset by higher 2004 ancillary sales of HBO s original programming and higher license fees from *Everybody Loves Raymond.*

Other revenues declined primarily due to the sale of the winter sports teams in the first quarter of 2004.

Costs of revenues increased 2%. This increase was primarily due to an increase in programming costs, which grew to $3.225 billion for 2004 from $3.021 billion for 2003. The increase in programming costs is primarily due to higher costs for sports rights,

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network premieres, licensed series and original series at Turner, and higher theatrical film and original series costs at HBO. Costs of revenues for 2004 benefited from the sale of the winter sports teams in the first quarter of 2004 and a reduction in player payroll at the Atlanta Braves. Costs of revenues as a percentage of revenues were 51% and 53% in 2004 and 2003, respectively.

The increase in selling, general and administrative expenses primarily related to higher marketing and promotion costs at Turner and higher general and administrative costs across the networks. These increases were partially offset by a $110 million decrease in bad debt expense that was primarily related to the first and second quarter 2004 reversals of approximately $75 million of bad debt reserves at Turner and HBO on receivables from Adelphia, a major cable operator that declared bankruptcy in 2002, and higher second quarter 2003 bad debt charges incurred at Turner related to certain cable operators. During 2004, the Company sold a portion of its Adelphia receivables to a third-party investor and also collected a portion of its remaining receivables from Adelphia.

As discussed in Significant Transactions and Other Items Affecting Comparability, the 2004 results include an approximate $7 million loss on the sale of the winter sports teams. The 2003 results include a $219 million impairment charge related to the writedown of intangible assets of the winter sports teams and $21 million of restructuring costs at Turner.

Operating Income before Depreciation and Amortization and Operating Income improved during 2004 due to an increase in revenues and the absence of the 2003 impairment and restructuring charges, partially offset by increases in costs of revenues and selling, general and administrative expenses, as described above.

The sale of the winter sports teams was completed on March 31, 2004. The winter sports teams contributed revenues of $66 million and an Operating Loss of $8 million during 2004. For 2003, the winter sports teams contributed approximately $160 million of revenues and an Operating Loss of $37 million.

Publishing. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Publishing segment for the years ended December 31, 2004 and 2003 are as follows:

	Year Ended December 31,		
	2004	2003	% Change
		(millions)	
Revenues:			
Subscription	$ 1,615	$ 1,533	5%
Advertising	2,692	2,459	9%
Content	544	522	4%
Other	714	1,019	(30%)
Total revenues	5,565	5,533	1%
Costs of revenues[a]	(2,282)	(2,288)	
Selling, general and administrative[a]	(2,095)	(2,141)	(2%)
Impairment of goodwill and intangible assets		(99)	NM
Gain (loss) on sale of assets	8	(29)	NM
Merger and restructuring charges		(21)	NM
Operating Income before Depreciation and Amortization	1,196	955	25%
Depreciation	(122)	(116)	5%
Amortization	(140)	(175)	(20%)
Operating Income	$ 934	$ 664	41%

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

Subscription revenues increased primarily due to a decrease in subscription allowances (which are netted against revenues), due in part to timing, and the favorable effects of foreign currency exchange rates.

Advertising revenues benefited from strength in print advertising, including growth at *Real Simple, Time, In Style, Sports Illustrated, Fortune* and *Entertainment Weekly,* among others. The favorable effects of foreign currency exchange rates and new magazine launches also contributed to growth in Advertising revenues.

Content revenues increased due to several strong titles at TWBG. This increase was partially offset by the absence of revenues from Time Life, which was sold at the end of 2003. During 2003, Time Life contributed $40 million of Content revenues.

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Other revenues declined primarily due to the sale of Time Life at the end of 2003, which contributed $312 million of Other revenues during 2003.

Costs of revenues for 2003 included $164 million of costs associated with Time Life. Excluding Time Life, costs of revenues increased 7% and, as a percentage of revenues, were 41% for both 2004 and 2003. Costs of revenues for the magazine publishing business include manufacturing (paper, printing and distribution) and editorial-related costs, which together increased 8% to $1.747 billion due primarily to growth in advertising page volume, magazine launch-related costs and the effects of foreign currency exchange rates.

Selling, general and administrative expenses included $251 million of costs associated with Time Life during 2003. Excluding Time Life, selling, general and administrative expenses increased 11%, driven by higher advertising and marketing expense, due primarily to an increase in consumer promotion costs, incremental magazine launch-related costs and costs associated with the coverage and sponsorship of the 2004 Summer Olympics.

As previously discussed in Significant Transactions and Other Items Affecting Comparability, 2004 results reflect an $8 million gain on the sale of a building and 2003 results include a $99 million impairment charge related to goodwill and intangible assets at the TWBG, a $29 million loss on sale of Time Life and $21 million of restructuring costs.

Excluding the 2004 first quarter gain on the sale of a building, the 2003 impairment charges of goodwill and intangible assets, the losses at Time Life, the loss on the sale of Time Life and restructuring charges in 2003, Operating Income before Depreciation and Amortization increased $21 million, and Operating Income increased $40 million, reflecting an increase in overall revenues, partially offset by higher costs of revenues and selling, general and administrative expenses, including $44 million of incremental start-up operating losses associated with the launch of new magazines. Operating Income also benefited from a decline in amortization as a result of certain short-lived intangibles, such as customer lists, becoming fully amortized.

Corporate. Operating Loss before Depreciation and Amortization and Operating Loss of the Corporate segment for the years ended December 31, 2004 and 2003 are as follows:

	Year Ended December 31,		
	2004	2003	% Change
		(millions)	
Amounts related to the government investigations	$ (536)	$ (56)	NM
Selling, general and administrative[(a)]	(484)	(368)	32%
Operating Loss before Depreciation and Amortization	(1,020)	(424)	NM
Depreciation	(43)	(34)	26%
Operating Loss	$ (1,063)	$ (458)	NM

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

As previously discussed, during 2004 the Company incurred a $210 million charge in connection with the definitive agreement with the DOJ that resolved the DOJ s investigation of the Company and established a

$300 million reserve in connection with the then proposed settlement with the SEC, which the SEC staff requested be used for a Fair Fund, as authorized under the Sarbanes-Oxley Act. The $210 million DOJ settlement amount consists of a $60 million penalty paid to the DOJ and the establishment of a $150 million fund that the Company may use to settle any related shareholder or securities litigation. In 2005, this $150 million was transferred to the MSBI Settlement Fund established in connection with the settlement of the primary securities class action, as described in Other Recent Developments Amounts Related to Securities Litigation, above.

Also included in Corporate Operating Loss before Depreciation and Amortization are legal and other professional fees related to the SEC and DOJ investigations into the Company s accounting and disclosure practices and the defense of various shareholder lawsuits ($74 million and $81 million in 2004 and 2003, respectively). In addition, the Company realized insurance recoveries of $48 million and $25 million in 2004 and 2003, respectively.

Included in selling, general and administrative expenses in 2004 are $53 million of costs associated with the relocation from the Company s former corporate headquarters. Of the $53 million charge, approximately $26 million relates to a noncash write-off of the fair value lease adjustment, which was established in purchase accounting at the time of the merger of AOL and Historic TW.

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Excluding the items previously discussed, Corporate Operating Loss before Depreciation and Amortization increased primarily as a result of higher severance costs and insurance premiums and a $29 million adjustment to increase self insurance liabilities, partially related to prior periods.

FINANCIAL CONDITION AND LIQUIDITY

Current Financial Condition

At December 31, 2005, Time Warner had $20.330 billion of debt, $4.220 billion of cash and equivalents (net debt of $16.110 billion, defined as total debt less cash and equivalents) and $62.679 billion of shareholders equity, compared to $22.375 billion of debt, $6.139 billion of cash and equivalents (net debt of $16.236 billion) and $60.719 billion of shareholders equity at December 31, 2004.

The following table shows the significant items contributing to the decrease in net debt from December 31, 2004 to December 31, 2005 (millions):

Net debt at December 31, 2004	$ 16,236
Cash provided by operations[a]	(4,965)
Capital expenditures and product development costs	3,246
Proceeds from sale of the Company s interest in Google	(940)
Proceeds from the sale of the WMG Option	(138)
Dividends paid to common shareholders[b]	466
Common stock repurchases	2,141
All other, net	64
Net debt at December 31, 2005[c]	$ 16,110

(a) Cash provided by operations reflects $2.754 billion in payments related to the securities litigation and the government investigations.

(b) The Company began paying a quarterly cash dividend of $0.05 per share on its common stock in the third quarter 2005.

(c)

Included in the net debt balance is approximately $258 million that represents the net unamortized fair value adjustment recognized as a result of the merger of AOL and Historic TW.

As noted in Overview Other Recent Developments, on July 29, 2005, Time Warner s Board of Directors authorized a common stock repurchase program that allowed Time Warner to repurchase, from time to time, up to $5 billion of common stock over a two-year period ending in July 2007. In October 2005, Time Warner s Board of Directors approved an increase in the amount authorized to be repurchased under the stock repurchase program to an aggregate of up to $12.5 billion of common stock. In February 2006, the Board of Directors authorized a further increase in the stock repurchase program and an extension of the program s ending date. Under the extended program, the Company is authorized to purchase up to an aggregate of $20 billion of common stock during the period from July 29, 2005 through December 31, 2007. Purchases under the stock repurchase program may be made from time to time on the open market and in privately negotiated transactions. Size and timing of these purchases will be based on a number of factors, including price and business and market conditions. As announced on February 1, 2006, the Company increased the pace of stock repurchases during the first quarter of 2006. At existing price levels, the Company intends to continue the current pace of purchases under its stock repurchase program within its stated objective of maintaining a net debt-to-Operating Income before Depreciation and Amortization ratio of approximately 3-to-1, and expects it will purchase approximately $15 billion of its common stock under the program by the end of 2006, and the remainder in 2007. From the program s inception through February 23, 2006, the Company repurchased approximately 235 million shares of common stock for approximately $4.2 billion (including 67 million shares for approximately $1.2 billion since February 1, 2006) pursuant to trading programs under Rule 10b5-1 of the Securities Exchange Act of 1934, as amended.

In April 2005, a subsidiary of the Company entered into agreements to jointly acquire substantially all of the assets of Adelphia with Comcast for a combination of cash and stock of TWC Inc. TWC Inc. also has agreed to redeem Comcast s interests in TWC Inc. and TWE following the Adelphia Acquisition. Upon closing, these transactions will impact the Company s financial condition and liquidity. For additional details, see Overview Other Recent Developments.

As noted in Overview Other Recent Developments, in December 2005, the Company announced that AOL is expanding its current strategic alliance with Google. In addition, Google will invest $1 billion for a 5% equity interest in a limited liability company that will own all of the outstanding equity interests in AOL. The Company expects these transactions with Google to close during the first quarter of 2006, at which time Google will make the $1 billion investment in AOL.

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As noted in Overview Other Recent Developments, on February 6, 2006, the Company announced an agreement to sell TWBG to Hachette for approximately $538 million in cash, not including working capital adjustments. This transaction is expected to close in the first half of 2006 and the Company expects to record a pretax gain of approximately $180 million to $220 million.

As noted in Overview Other Recent Developments, on February 7, 2006, Warner Bros. entered into an agreement for the sale of its equity investment interest in CSD, for approximately $90 million in cash and stock. This transaction is expected to close in the second quarter of 2006 and the Company expects to record a pretax equity investment gain of approximately $40 million.

As noted in Overview Other Recent Developments, on February 23, 2006, the Company announced an agreement to sell Turner South to Fox for approximately $375 million in cash. This transaction is expected to close in the second or third quarter of 2006 and the Company expects to record a pretax gain of approximately $110 million to $130 million.

As discussed in more detail below, management believes that cash generated by or available to Time Warner should be sufficient to fund its capital and liquidity needs for the foreseeable future, including the quarterly dividend payments, the common stock repurchase program and the Adelphia Acquisition and the redemption of Comcast s interests in TWC Inc. and TWE. Time Warner s sources of cash include cash provided by operations, cash and equivalents, available borrowing capacity under its committed credit facilities ($6.933 billion at Time Warner Inc. and $2.740 billion at TWC Inc. as of December 31, 2005, increased by $10 billion of additional committed credit facilities at TWC Inc. that closed during February 2006), availability under its commercial paper programs, proceeds from the sales of TWBG, Turner South and CSD and the $1 billion investment in AOL by Google. The Company may use a portion of its available borrowing capacity to refinance approximately $1.5 billion of debt maturing in 2006. As discussed further under Bank Credit Agreements and Commercial Paper Programs, the Company refinanced $11 billion of committed credit facilities and secured additional capacity of $10 billion, which will become effective concurrent with the closing of the Adelphia Acquisition.

Cash Flows

Cash and equivalents decreased to $4.220 billion as of December 31, 2005, from $6.139 billion as of December 31, 2004. Components of these changes are discussed in more detail in the pages that follow.

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Operating Activities

Sources of cash provided by operations are as follows:

	Year Ended December 31,		
	2005	2004	2003
		(restated, millions)	
Operating Income before Depreciation and Amortization	$ 7,816	$ 9,414	$ 8,411
Legal reserves related to securities litigation and government investigations, net of payments and recoveries[a]	111	300	
Noncash asset impairments	24	10	318
Net interest payments[b]	(1,306)	(1,578)	(1,633)
Net income taxes paid[c]	(411)	(382)	(489)
Adjustments relating to discontinued operations[d]	(10)	123	350
Merger and restructuring payments[e]	(112)	(90)	(293)
Domestic pension plan contributions	(181)	(358)	(648)
Microsoft Settlement			750
Cash paid for certain litigation settlements			(391)
All other, net, including working capital changes	(966)	(822)	219
Cash provided by operations	$ 4,965	$ 6,617	$ 6,594

[a] 2005 includes approximately $600 million accrued for other securities litigation matters (which have not been paid), less an accrued insurance recovery of $185 million (which is expected to be received in the first quarter of 2006) and payment of the $300 million SEC settlement. 2004 included $300 million accrued related

to the SEC settlement.

(b) Includes interest income received of $230 million, $94 million and $61 million in 2005, 2004 and 2003, respectively.

(c) Includes income tax refunds received of $83 million, $107 million and $15 million in 2005, 2004 and 2003, respectively.

(d) Includes net income (loss) from discontinued operations of $121 million and $(495) million in 2004 and 2003, respectively. Amounts also include working capital-related adjustments associated with discontinued operations of $(10) million, $2 million and $845 million in 2005, 2004 and 2003, respectively.

(e) Includes payments for restructuring and merger-related

costs, as well as payments for certain other merger-related liabilities.

Cash provided by operations was $4.965 billion in 2005 compared to $6.617 billion in 2004. The decrease in cash provided by operations is related primarily to a decrease in Operating Income before Depreciation and Amortization due to payments made in settling securities litigation and the government investigations, an increase in cash used for working capital and a reduction in cash relating to discontinued operations. These decreases were partially offset by lower domestic pension plan contributions in 2005. The changes in components of working capital are subject to wide fluctuations based on the timing of cash transactions related to production schedules, the acquisition of programming, collection of accounts receivable and similar items. The change in working capital between periods primarily reflects the timing of accounts payable and accrual payments, partially offset by higher cash collections on receivables.

Cash provided by operations was $6.617 billion in 2004 compared to $6.594 billion in 2003. The increase in cash provided by operations is related primarily to an increase in Operating Income before Depreciation and Amortization and lower domestic qualified pension plan contributions, tax, interest and merger and restructuring payments in 2004. These increases were partially offset by a reduction in cash provided (used) working capital, a reduction in cash relating to discontinued operations and the absence of net cash received from litigation settlements in 2004. The change in working capital between periods included higher production and programming spending and the timing of accounts payable and accrual payments.

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Investing Activities

Sources of cash provided (used) by investing activities are as follows:

	Year Ended December 31,		
	2005	2004	2003
		(millions)	
Investments and acquisitions, net of cash acquired:			
Essence	$ (129)	$	$
Consolidation of AOLA[a]		33	
Synapse[b]		(120)	(40)
Advertising.com		(445)	
The WB Network[c]			(128)
All other, principally funding of joint ventures	(551)	(345)	(402)
Investments and acquisitions, net from discontinued operations			(52)
Capital expenditures and product development costs from continuing operations	(3,246)	(3,024)	(2,761)
Capital expenditures and product development costs from discontinued operations			(126)
Proceeds from the sale of other available-for-sale securities	51	57	296
Proceeds from sale of the Company s investment in Hughes			783
Proceeds from the sale of the Company s interest in Google	940	195	
Proceeds from the sale of the Company s investment in Gateway		280	
Net proceeds from the sale of WMG[d]		2,501	
Proceeds from the sale of the WMG Option	138		
Proceeds from the sale of investment in VIVA and VIVA Plus		134	
Proceeds from sale of the Company s investment in Comedy Central			1,225
Proceeds from sale of Warner Manufacturing			1,050
All other investment and asset sale proceeds	301	231	232
Cash provided (used) by investing activities	$ (2,496)	$ (503)	$ 77

(a) Represents cash balance of AOLA upon consolidation.

(b) Represents purchase of additional interest in Synapse Group Inc.

(c)

Represents purchase of additional interest in The WB Network.

(d) Represents $2.6 billion of proceeds received from the sale of WMG, less certain working capital adjustments.

Cash used by investing activities was $2.496 billion in 2005 compared to $503 million in 2004. The increase in cash used by investing activities is primarily due to lower proceeds from the sale of assets and an increase in capital expenditures and product development costs, principally at the Company s Cable segment, partially offset by lower investments and acquisitions.

Cash used by investing activities was $503 million in 2004 compared to cash provided by investing activities of $77 million in 2003. The decrease in cash provided (used) by investing activities is due to lower proceeds from sale of assets, an increase in capital expenditures and product development costs and an increase in investments and acquisitions during 2004. Capital expenditures increased across all business segments and included capital expenditures related to the Company s new corporate headquarters and the construction of a building by IPC Media.

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Financing Activities

Sources of cash used by financing activities are as follows:

	Year Ended December 31,		
	2005	2004	2003
		(millions)	
		(restated)	(restated)
Borrowings	$ 6	$ 1,320	$ 2,371
Debt repayments	(1,995)	(4,523)	(7,109)
Redemption of mandatorily redeemable preferred securities of a subsidiary			(813)
Proceeds from exercise of stock options	307	353	372
Principal payments on capital leases	(118)	(190)	(171)
Repurchases of common stock	(2,141)		
Dividends paid	(466)		
Other financing activities	19	25	(11)
Cash used by financing activities	$ (4,388)	$ (3,015)	$ (5,361)

Cash used by financing activities was $4.388 billion in 2005 compared to $3.015 billion in 2004. The increase in cash used by financing activities is due principally to repurchases of common stock made in connection with the Company s common stock repurchase program and dividends paid to common stock shareholders in 2005, partially offset by lower incremental debt repayments in 2005.

Cash used by financing activities was $3.015 billion in 2004 compared to $5.361 billion in 2003. The decrease in cash used by financing activities was due principally to lower incremental debt repayments in 2004 and the absence of the 2003 redemption of mandatorily redeemable preferred securities of a subsidiary.

Capital Expenditures and Product Development Costs

Time Warner s total capital expenditures and product development costs were $3.246 billion in 2005 compared to $3.024 billion in 2004 and $2.887 billion in 2003. Capital expenditures and product development costs from continuing operations were $2.761 billion in 2003. The majority of capital expenditures and product development costs relate to the Company s Cable segment, which had capital expenditures of $1.975 billion in 2005 as compared to $1.712 billion in 2004 and $1.637 billion in 2003.

The Cable segment s capital expenditures comprise the following categories:

	Year Ended December 31,		
	2005	2004	2003
		(millions)	
Cable Segment Capital Expenditures			
Customer premise equipment	$ 866	$ 719	$ 715
Scaleable infrastructure	335	205	173
Line extensions	258	239	214
Upgrades/rebuilds	132	139	175
Support capital	384	410	360
Total capital expenditures	$ 1,975	$ 1,712	$ 1,637

TWC Inc. incurs expenditures associated with the construction and maintenance of its cable systems. Costs associated with the construction of the cable transmission and distribution facilities and new cable service installations are capitalized. TWC Inc. generally capitalizes expenditures for tangible fixed assets having a useful life of greater than one year. Capitalized costs include direct material, direct labor, overhead and, in some cases, interest. Sales and marketing costs, as well as the costs of repairing or maintaining existing fixed assets, are expensed as incurred. Types of capitalized expenditures include customer premise equipment, scaleable infrastructure, line extensions, plant upgrades and rebuilds and support capital. With respect to customer premise equipment, which includes converters and cable modems, TWC Inc. capitalizes installation charges only upon the initial deployment of these assets. All costs incurred in subsequent disconnects and reconnects are expensed as incurred. Depreciation on these assets is provided generally using the straight-line method over their estimated useful lives. For converters and modems useful life is generally 3 to 4 years, and for plant upgrades useful life is up to 16 years.

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The increase in capital expenditures in 2005 is primarily associated with increased spending associated with the continued roll-out of TWC Inc. s advanced digital services, including Digital Phone.

Outstanding Debt and Other Financing Arrangements

Outstanding Debt and Available Committed Financial Capacity

At December 31, 2005, Time Warner had total committed capacity, defined as maximum available borrowings under various existing debt arrangements and cash and short-term investments, of $34.449 billion. Of this committed capacity, $13.893 billion was available to fund future obligations and $20.330 billion was outstanding as debt. (Refer to Note 8 to the accompanying consolidated financial statements for more details on outstanding debt.) At December 31, 2005, total committed capacity, outstanding letters of credit, unamortized discount on commercial paper, outstanding debt and total unused capacity were as follows:

	Committed Capacity	Letters of Credit[a]	Unamortized Discount on Commercial Paper	Outstanding Debt[b]	Unused Committed Capacity[c]
			(millions)		
Cash and equivalents	$ 4,220	$	$	$	$ 4,220
Bank credit agreement and commercial paper programs	11,000	222	4	1,101	9,673
Fixed-rate public debt[c]	18,863			18,863	
Other fixed-rate obligations[d]	366			366	
Total	$ 34,449	$ 222	$ 4	$ 20,330	$ 13,893

(a) Represents the portion of committed capacity reserved for outstanding and undrawn letters of credit.

(b) Represents principal amounts adjusted for fair value adjustments, premiums and discounts.

(c)

The Company has classified $1.546 billion in debt due in 2006 as long-term in the accompanying consolidated balance sheet to reflect management s ability and intent to refinance the obligation on a long-term basis. Such debt refinancing may be from unused committed capacity of the Company s bank credit agreements.

(d) Includes debt due within one year of $92 million, which primarily relates to capital lease obligations.

Bank Credit Agreements and Commercial Paper Programs

In the first quarter of 2006, Time Warner and TWC Inc. entered into $21.0 billion of bank credit agreements, which consist of an amended and restated $7.0 billion five-year revolving credit facility at Time Warner, an amended and restated $6.0 billion five-year revolving credit facility at TWC Inc. (including $2.0 billion of increased commitments), a new $4.0 billion five-year term loan facility at TWC Inc., and a new $4.0 billion three-year term loan facility at TWC Inc. Collectively, these facilities refinanced $11.0 billion of previously existing committed bank financing, while the $2.0 billion increase in the TWC Inc. revolving credit facility and the $8.0 billion of new TWC Inc. term loan facilities are available to finance, in part, the cash portions of the pending Adelphia Acquisition. As discussed below, the increase in the revolving credit facility and the two term loans at TWC Inc. become effective concurrent with the closing of the Adelphia Acquisition.

Time Warner Credit Agreement

Following the refinancing transactions described above, Time Warner has a $7.0 billion senior unsecured five-year revolving credit facility with a maturity date of February 17, 2011 (the TW Facility), which refinanced an existing $7.0 billion revolving credit facility with a maturity date of June 30, 2009. The permitted borrowers under the TW Facility are Time Warner and Time Warner International Finance Limited (the Borrowers). The obligations of both Time Warner and Time Warner International Finance Limited are directly or indirectly guaranteed by AOL, Historic TW, Turner and Time Warner Companies, Inc. The obligations of Time Warner International Finance Limited are also guaranteed by Time Warner.

Borrowings under the TW Facility bear interest at a rate determined by the credit rating of Time Warner, which rate is currently LIBOR plus 0.27% per annum (LIBOR plus 0.39% as of December 31, 2005). In addition, the Borrowers are required to pay a facility fee on the aggregate commitments under the TW Facility at a rate determined by the credit rating of Time Warner, which rate is currently 0.08% per annum (0.11% per annum as of December 31, 2005). The Borrowers also incur an additional usage fee of 0.10% per annum on the outstanding loans and other extensions of credit under the TW Facility if and when such amounts exceed 50% of the aggregate commitments thereunder.

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The TW Facility provides same-day funding and multi-currency capability, and a portion of the commitment, not to exceed $500 million at any time, may be used for the issuance of letters of credit. The TW Facility contains a maximum leverage ratio covenant of 4.5 times the consolidated EBITDA of Time Warner, which is the same leverage ratio covenant in effect at December 31, 2005. The terms and related financial metrics associated with the leverage ratio are defined in the TW Facility agreement. At December 31, 2005, the Company was in compliance with the leverage covenant, with a leverage ratio, calculated in accordance with the agreement, of approximately 1.6 times. The TW Facility does not contain any credit ratings-based defaults or covenants or any ongoing covenant or representations specifically relating to a material adverse change in Time Warner s financial condition or results of operations. Borrowings may be used for general corporate purposes, and unused credit is available to support borrowings under commercial paper programs. As of December 31, 2005, there were no loans outstanding and $67 million in outstanding face amount of letters of credit were issued under the TW Facility.

TWC Inc. Credit Agreements

Following the financing transactions described above, TWC Inc. has a $6.0 billion senior unsecured five-year revolving credit facility with a maturity date of February 15, 2011 (the Cable Revolving Facility). This represents a refinancing of TWC Inc. s existing $4.0 billion of committed revolving bank commitments with a maturity date of November 23, 2009, plus an increase of $2.0 billion effective concurrent with the closing of the Adelphia Acquisition. Also effective concurrent with the closing of the Adelphia Acquisition are two $4 billion term loan facilities (the Cable Term Facilities and, collectively with the Cable Revolving Facility, the Cable Facilities) with maturities of 3 years and 5 years, respectively. TWE is no longer a borrower in respect of any of the Cable Facilities, although TWE and Time Warner NY Cable LLC have guaranteed the obligations of TWC Inc. under the Cable Facilities, and Warner Communications Inc. (WCI) and American Television and Communications Corporation (ATC) (both indirect wholly-owned subsidiaries of Time Warner but not subsidiaries of TWC Inc.) have each guaranteed a pro-rata portion of TWE s guarantee obligations under the Cable Facilities. There are generally no restrictions on the ability of WCI and ATC to transfer material assets to parties that are not guarantors.

Borrowings under the Cable Revolving Facility bear interest at a rate based on the credit rating of TWC Inc., which rate is currently LIBOR plus 0.27% per annum (LIBOR plus 0.39% as of December 31, 2005). In addition, TWC Inc. is required to pay a facility fee on the aggregate commitments under the Cable Revolving Facility at a rate determined by the credit rating of TWC Inc., which rate is currently 0.08% per annum (0.11% per annum as of December 31, 2005). TWC Inc. may also incur an additional usage fee of 0.10% per annum on the outstanding loans and other extensions of credit under the Cable Revolving Facility if and when such amounts exceed 50% of the aggregate commitments thereunder. Borrowings under the Cable Term Facilities bear interest at a rate based on the credit rating of TWC Inc., which rate is currently LIBOR plus 0.40% per annum. In addition, TWC Inc. is required to pay a facility fee on the aggregate commitments under the Cable Term Facilities beginning prior to the closing of the Adelphia Acquisition at a rate determined by the credit rating of TWC Inc., which rate is currently 0.08% per annum.

The Cable Revolving Facility provides same-day funding capability and a portion of the commitment, not to exceed $500 million at any time, may be used for the issuance of letters of credit. The Cable Facilities contain a maximum leverage ratio covenant of 5.0 times the consolidated EBITDA of TWC Inc., which is the same leverage ratio covenant in effect at December 31, 2005. The terms and related financial metrics associated with the leverage ratio are defined in the Cable Facility agreements. At December 31, 2005, TWC Inc. was in compliance with the leverage covenant, with a leverage ratio, calculated in accordance with the agreements, of approximately 1.2 times. The Cable Facilities do not contain any credit ratings-based defaults or covenants or any ongoing covenant or representations specifically relating to a material adverse change in the financial condition or results of operations of Time Warner or TWC Inc. Borrowings under the Cable Revolving Facility may be used for general corporate purposes and unused credit is available to support borrowings under commercial paper programs. Borrowings under the Cable Term Facilities will be used to assist in financing the cash portions of the Adelphia Acquisition. As of December 31, 2005, there were $155 million of letters of credit outstanding under the Cable Revolving Facility, and

approximately $1.101 billion of commercial paper was supported by the Cable Revolving Facility.

Commercial Paper Programs

Time Warner maintains a $5.0 billion unsecured commercial paper program. Included as part of the $5.0 billion commercial paper program is a $2.0 billion European commercial paper program under which Time Warner can issue European commercial paper. The obligations of Time Warner are directly and indirectly guaranteed by AOL, Historic TW, Turner and Time Warner Companies, Inc. Proceeds from the commercial paper program may be used for general corporate purposes, including investments, repayment of debt and acquisitions. Commercial paper borrowings at Time Warner are supported by the unused committed capacity of the $7.0 billion

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TW Facility. As of December 31, 2005, there was no commercial paper outstanding under the Time Warner commercial paper program.

TWC Inc. maintains a $2.0 billion unsecured commercial paper program. Commercial paper borrowings at TWC Inc. are supported by the unused committed capacity of the $6.0 billion Cable Revolving Facility. TWE is a guarantor of commercial paper issued by TWC Inc. In addition, WCI and ATC (both indirect wholly-owned subsidiaries of the Company but not subsidiaries of TWC Inc. or TWE) have each guaranteed a pro-rata portion of TWE s guarantee obligations under the commercial paper issued by TWC Inc. although there are generally no restrictions on the ability of WCI and ATC to transfer material assets (other than their interests in TWC Inc. or TWE) to parties that are not guarantors. The commercial paper issued by TWC Inc. rank pari passu with TWC Inc. s and TWE s other unsecured senior indebtedness. As of December 31, 2005, there was approximately $1.101 billion of commercial paper outstanding under the TWC Inc. commercial paper program.

Other Financing Arrangements

From time to time, the Company enters into various other financing arrangements that provide for the accelerated receipt of cash on certain accounts receivable and film backlog licensing contracts. The Company employs these arrangements because they provide a cost-efficient form of financing, as well as an added level of diversification of funding sources. The Company is able to realize cost efficiencies under these arrangements because the assets securing the financing are held by a legally separate, bankruptcy-remote entity and provide direct security for the funding being provided. These arrangements do not contain any rating-based defaults or covenants. For more details, see Note 8 to the accompanying consolidated financial statements.

The following table summarizes the Company s other financing arrangements at December 31, 2005:

	Committed Capacity[a]	Unused Capacity (millions)	Outstanding Utilization
Accounts receivable securitization facilities	$ 805	$	$ 805
Backlog securitization facility[b]	500	142	358
Total other financing arrangements	$ 1,305	$ 142	$ 1,163

(a) Ability to use accounts receivable securitization facilities and backlog securitization facility depends on availability of qualified assets.

(b) The outstanding utilization on the backlog securitization

facility is classified as deferred revenue on the accompanying consolidated balance sheet.

Covenants and Rating Triggers

Each of the Company s bank credit agreements, public debt and financing arrangements with third-party special purpose entities (SPEs) contain customary covenants. A breach of such covenants in the bank credit agreements that continues beyond any grace period constitutes a default, which can limit the Company s ability to borrow and can give rise to a right of the lenders to terminate the applicable facility and/or require immediate payment of any outstanding debt. A breach of such covenants in the public debt beyond any grace period constitutes a default which can require immediate payment of the outstanding debt. A breach of such covenants in the financing arrangements with SPEs that continues beyond any grace period can constitute a termination event, which can limit the facility as a future source of liquidity; however, there would be no claims on the Company for the receivables or backlog contracts previously sold. Additionally, in the event that the Company s credit ratings decrease, the cost of maintaining the bank credit agreements and facilities and of borrowing increases and, conversely, if the ratings improve, such costs decrease. There are no rating-based defaults or covenants in the bank credit agreements, public debt or financing arrangements with SPEs.

As of December 31, 2005, and through the date of this filing, the Company was in compliance with all covenants in its bank credit agreements, public debt and financing arrangements with SPEs. Management does not anticipate that the Company will have any difficulty in the foreseeable future complying with the existing covenants.

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Film Sale-Leaseback Arrangements

From time to time the Company has entered into arrangements where certain film assets are sold to third-party investors that generate tax benefits to such investors that are not otherwise available to the Company. The specific forms of these transactions differ, but generally are sale-leaseback arrangements with SPEs owned by the respective investors. At December 31, 2005, such SPEs were capitalized with approximately $3.5 billion of debt and equity from the third-party investors. The Company does not guarantee and is not otherwise responsible for the equity and debt in these SPEs and does not participate in the profits or losses of these SPEs, but does have a performance guarantee to produce the film assets sold to these vehicles. The Company does not consolidate these SPEs. Instead, the Company accounts for these arrangements based on their substance. That is, the net benefit received by the Company from these transactions is recorded as a reduction of film costs. These transactions resulted in reductions of film costs totaling $132 million, $177 million and $80 million during the years ended December 31, 2005, 2004 and 2003, respectively.

Film Co-Financing Arrangements

From time to time, the Company enters into arrangements with third parties to jointly finance theatrical production. These arrangements, which are referred to as co-financing arrangements, take various forms; however, in most cases, the form of the arrangements is the sale of a copyright interest in a film to a joint venture investor. The Company records the amounts received for the sale of the copyright interest as a reduction of the cost of the film, as such investors assume full risk for that portion of the film asset acquired in these transactions.

Contractual and Other Obligations

Contractual Obligations

In addition to the previously discussed financing arrangements, the Company has obligations under certain contractual arrangements to make future payments for goods and services. These contractual obligations secure the future rights to various assets and services to be used in the normal course of operations. For example, the Company is contractually committed to make certain minimum lease payments for the use of property under operating lease agreements. In accordance with applicable accounting rules, the future rights and obligations pertaining to firm commitments, such as operating lease obligations and certain purchase obligations under contracts, are not reflected as assets or liabilities on the accompanying consolidated balance sheet.

The following table summarizes the Company s aggregate contractual obligations at December 31, 2005, and the estimated timing and effect that such obligations are expected to have on the Company s liquidity and cash flow in future periods.

Contractual Obligations[a]	**Total**	**2006**	**2007-2008**	**2009-2010**	**Thereafter**
			(millions)		
Outstanding debt obligations (Note 8)	$ 20,087	$ 1,557	$ 2,427	$ 1,121	$ 14,982
Capital lease obligations (Note 8)	201	83	56	19	43
Operating lease obligations (Note 17)	4,553	549	1,010	839	2,155
Purchase obligations	11,081	4,378	3,531	1,439	1,733
Total contractual obligations and outstanding debt	$ 35,922	$ 6,567	$ 7,024	$ 3,418	$ 18,913

(a) The table does not include the effects of certain put/call or other buy-out

arrangements involving certain of the Company s investees that are optional in nature, which are discussed in more detail in the pages that follow.

The following is a description of the Company s material contractual obligations at December 31, 2005:

Outstanding debt obligations represents the principal amounts due on outstanding debt obligations, current and long-term, as of December 31, 2005. Amounts do not include any fair value adjustments, bond premiums, discounts or interest payments.

Capital lease obligations represents the minimum capital lease payments under noncancelable leases, primarily for network equipment at the AOL segment financed under capital leases.

Operating lease obligations represents the minimum lease rental payments under noncancelable operating leases, primarily for the Company s real estate and operating equipment in various locations around the world.

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Purchase obligations As it is used herein, a purchase obligation represents an agreement to purchase goods or services that is enforceable and legally binding on the Company and that specifies all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. The Company expects to receive consideration (i.e., products or services) for these purchase obligations. The purchase obligation amounts do not represent the entire anticipated purchases in the future, but represent only those items for which the Company is contractually obligated. Additionally, the Company also purchases products and services as needed, with no firm commitment. For this reason, the amounts presented in the table alone will not provide a reliable indicator of the Company s expected future cash outflows. For purposes of identifying and accumulating purchase obligations, the Company has included all material contracts meeting the definition of a purchase obligation (e.g., legally binding for a fixed or minimum amount or quantity). For those contracts involving a fixed or minimum quantity, but variable pricing, the Company has estimated the contractual obligation based on its best estimate of pricing that will be in effect at the time the obligation is incurred. Additionally, the Company has included only the obligation represented by those contracts as they existed at December 31, 2005, and did not assume renewal or replacement of the contract at the end of its term. If a contract includes a penalty for non-renewal, the Company has included that penalty, assuming it will be paid in the period after the contract term expires. If Time Warner can unilaterally terminate an agreement simply by providing a certain number of days notice or by paying a termination fee, the Company has included the amount of the termination fee or the amount that would be paid over the notice period. Contracts that can be unilaterally terminated without incurring a penalty have not been included. The following table summarizes the Company s purchase obligations at December 31, 2005, and the estimated timing and effect that such obligations are expected to have on the Company s liquidity and cash flow in future periods:

Purchase Obligations	**Total**	**2006**	**2007-2008**	**2009-2010**	**Thereafter**
			(millions)		
Network programming obligations[a]	$ 5,319	$ 1,563	$ 1,801	$ 862	$ 1,093
Narrowband and broadband network obligations[b]	453	347	88	3	15
Creative talent and employment agreements[c]	1,866	888	802	158	18
Obligations to purchase paper and to use certain printing facilities for the production of magazines and books	1,248	261	380	247	360
Obligations to certain investee companies[d]	118	118			
Advertising, marketing and sponsorship obligations[e]	625	400	199	25	1
Obligations to purchase information technology licenses and services	311	109	77	64	61
Other, primarily general and administrative obligations[f]	1,141	692	184	80	185
Total purchase obligations	$ 11,081	$ 4,378	$ 3,531	$ 1,439	$ 1,733

(a) The Networks segment enters into contracts to license sports programming to carry on its television networks. The amounts in the

table above represent minimum payment obligations to sports leagues (e.g., NBA, NASCAR and MLB) to air the programming over the contract period. The Networks segment also enters into licensing agreements with certain movie studios to acquire the rights to air movies that the movie studios release theatrically (Studio Movie Deals). The pricing structures in these contracts differ in that certain agreements can require a fixed amount per movie while others will be based on a percentage of the movie s box office receipts (with license fees generally capped at specified amounts), or a combination of both. The amounts included herein represent

obligations for movies that have been released theatrically as of December 31, 2005 and are calculated using the actual or estimated box office performance or fixed amounts, as applicable.

(b) Narrowband and broadband network obligations relate primarily to minimum purchase commitments that AOL has with various narrowband and broadband network providers.

(c) The Company s commitments under creative talent and employment agreements include obligations to executives, actors, producers, authors, sports personnel and other talent under contractual arrangements, including union contracts.

(d)

Obligations to certain investee companies represent obligations to purchase additional interests in a subsidiary of the Publishing segment and fund investees within the Filmed Entertainment segment.

(e) Advertising, marketing and sponsorship obligations include minimum guaranteed royalty and marketing payments to vendors and content providers, primarily of the AOL, Networks and Filmed Entertainment segments.

(f) Other includes obligations to purchase general and administrative items such as legal, security, janitorial, office equipment, support and maintenance services, office supplies, obligations related to the

Company s postretirement and unfunded defined benefit pension plans, purchase obligations for cable converter boxes at the Cable segment, as well as construction commitments primarily for the Publishing and Networks segments.

Most of the Company s other long-term liabilities reflected on the accompanying consolidated balance sheet have been incorporated in the estimated timing of cash payments provided in the summary of contractual obligations, the most significant of which is an approximate $996 million liability for film licensing obligations. However, certain long-term liabilities have been excluded from the summary because there are no cash outflows associated with them (e.g., deferred revenue) or because the cash outflows associated with them are uncertain or do not represent a purchase obligation as it is used herein (e.g., deferred taxes, minority interests, participations and royalties, deferred compensation and other miscellaneous items). Contractual capital commitments are also included in the preceding table; however these commitments represent only a small part of the Company s expected capital spending in 2006 and beyond. Additionally, minimum pension funding requirements have not been presented, as such amounts have

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not been determined beyond 2006. The Company does not have a required minimum pension contribution obligation for its defined benefit pension plans in 2006.

Other Contractual Obligations

In addition to the contractual obligations previously discussed, certain other contractual commitments of the Company entail variable or undeterminable quantities and/or prices and, thus, do not meet the definition of a purchase obligation. As certain of these commitments are significant to its business, the Company has summarized these arrangements below. Given the variability in the terms of these arrangements, significant estimates were involved in the determination of these obligations. Actual amounts, once known, could differ significantly from these estimates.

Other Contractual Commitments	Total	2006	2007-2008	2009-2010	Thereafter
			(millions)		
Cable and network programming, AOL network and DVD manufacturing obligations	$ 16,520	$ 3,897	$ 6,656	$ 3,478	$ 2,489

The Company s other contractual commitments at December 31, 2005 primarily consist of Cable programming arrangements, future film licensing obligations, AOL network obligations and DVD manufacturing obligations. Cable programming arrangements represent contracts that the Company s Cable segment has with cable television networks to provide programming service to its subscribers. Typically, these arrangements provide that the Company purchase cable television programming for a certain number of subscribers provided that the Company is providing cable services to such number of subscribers. There is generally no obligation to purchase these services if the Company is not providing cable services. The obligation included in the above table represents estimates of future cable programming costs based on subscriber levels at December 31, 2005 and current contractual per subscriber rates. Network programming obligations represent studio movie deal commitments to acquire the right to air movies that will be released in the future (i.e., after December 31, 2005). These arrangements do not meet the definition of a purchase obligation since there are neither fixed nor minimum quantities under the arrangement. The amounts included herein have been estimated giving consideration to historical box office performance and studio release trends. AOL network obligations relate to narrowband and broadband modem contracts that are variable in nature. These arrangements do not meet the definition of a purchase obligation since there are neither fixed nor minimum quantities under the arrangement. The amounts included herein have been estimated giving consideration to historical and expected future usage patterns. DVD manufacturing obligations relate to a six-year agreement at the Filmed Entertainment segment with a third-party manufacturer to purchase the Company s DVD requirements. This arrangement does not meet the definition of a purchase obligation since there are neither fixed nor minimum quantities under the arrangement. Amounts were estimated using current annual DVD manufacturing volumes and pricing per manufactured DVD for each year of the agreement.

The Company expects to fund its operating commitments and obligations with cash flow from operations generated in the normal course of business.

Contingent Commitments

The Company also has certain contractual arrangements that would require the Company to make payments or provide funding if certain circumstances occur (contingent commitments). For example, the Company has guaranteed certain lease obligations of joint-venture investees. In this circumstance, the Company would be required to make payments due under the lease to the lessor in the event of default by the joint-venture investee. The Company does not expect that these contingent commitments will result in any material amounts being paid by the Company in the foreseeable future.

The following table summarizes separately the Company s contingent commitments at December 31, 2005. The table identifies when the maximum contingent commitments will expire, but this does not mean that the Company

expects to incur an obligation to make any payments during the applicable time period.

Nature of Contingent Commitments	**Total**	**2006**	**2007-2008**	**2009-2010**	**Thereafter**
			(millions)		
Guarantees	$ 2,071	$ 81	$ 169	$ 174	$ 1,647
Letters of credit and other contingent commitments	366	79	6	75	206
Total contingent commitments	$ 2,437	$ 160	$ 175	$ 249	$ 1,853

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The following is a description of the Company s contingent commitments at December 31, 2005:

Guarantees include guarantees the Company has provided on certain lease and operating commitments entered into by (a) entities formerly owned by the Company as described below, and (b) joint ventures in which the Company is or was a venture partner.

In connection with the Company s former investment in the Six Flags theme parks located in Georgia and Texas (Six Flags Georgia and Six Flags Texas, respectively, and, collectively, the Parks), the Company agreed to guarantee (the Six Flags Guarantee) certain obligations of the partnerships that hold the Parks (the Partnerships), including the following (the Guaranteed Obligations): (a) the obligation to make a minimum amount of annual distributions to the limited partners of the Partnerships; (b) the obligation to make a minimum amount of capital expenditures each year; (c) the requirement that an annual offer to purchase be made in respect of 5% of the limited partnership units of the Partnerships (plus any such units not purchased in any prior year) based on an aggregate price for all limited partnership units at the higher of (i) $250 million in the case of Six Flags Georgia or $374.8 million in the case of Six Flags Texas and (ii) a weighted average multiple of EBITDA for the respective Park over the previous four-year period; (d) ground lease payments; and (e) either (i) the purchase of all of the outstanding limited partnership units upon the earlier of the occurrence of certain specified events and the end of the term of each of the Partnerships in 2027 (Six Flags Georgia) and 2028 (Six Flags Texas) (the End of Term Purchase) or (ii) the obligation to cause each of the Partnerships to have no indebtedness and to meet certain other financial tests as of the end of the term of the Partnership. The aggregate purchase price for the limited partnership units pursuant to the End of Term Purchase is $250 million in the case of Six Flags Georgia and $374.8 million in the case of Six Flags Texas (in each case, subject to a consumer price index based adjustment calculated annually from 1998 in respect of Six Flags Georgia and 1999 in respect of Six Flags Texas). Such aggregate amount will be reduced ratably to reflect limited partnership units previously purchased.

In connection with the 1998 sale of Six Flags Entertainment Corporation to Premier Parks Inc. (Premier), Premier and the Company, among others, entered into a Subordinated Indemnity Agreement pursuant to which Premier agreed to guarantee the performance of the Guaranteed Obligations when due and to indemnify the Company, among others, in the event that the Guaranteed Obligations are not performed and the Six Flags Guarantee is called upon. In the event of a default of Premier s obligations under the Subordinated Indemnity Agreement, the Subordinated Indemnity Agreement and related agreements provide, among other things, that the Company has the right to acquire control of the managing partner of the Parks. Premier s obligations to the Company are further secured by its interest in all limited partnership units that are purchased by Premier.

To date, no payments have been made by the Company pursuant to the Six Flags Guarantee.

Generally, letters of credit and surety bonds support performance and payments for a wide range of global contingent and firm obligations including insurance, litigation appeals, import of finished goods, real estate leases, cable installations and other operational needs. The Cable segment has obtained letters of credit for several of its joint ventures. Should these joint ventures default on their obligations supported by the letters of credit, the Cable segment would be obligated to pay these costs to the extent of the letters of credit.

Except as otherwise discussed above and below, Time Warner does not guarantee the debt of any its investments accounted for using the equity method of accounting.

Selected Investment Information

Cable Joint Ventures

On May 1, 2004, the Company completed the restructuring of two joint ventures that it manages, Kansas City Cable Partners (KCCP), previously a 50-50 joint venture between Comcast and TWE serving approximately 297,000 basic video subscribers as of December 31, 2005, and Texas Cable Partners, L.P. (TCP), previously a 50-50 joint venture between Comcast and the TWE-Advance/Newhouse Partnership (TWE-A/N) serving approximately 1.260 million basic video subscribers as of December 31, 2005. Prior to the restructuring, the Company accounted for its investment in these joint ventures using the equity method. Under the restructuring, KCCP was merged into TCP,

which was renamed Texas and Kansas City Cable Partners, L.P. Following the restructuring, the combined partnership was owned 50% by Comcast and 50% collectively by TWE and TWE-A/N. In February 2005, TWE s interest in the combined partnership was contributed to TWE-A/N in exchange for preferred equity in TWE-A/N. Since the net assets of the combined partnership were owned 50% by TWC Inc. and 50% by Comcast both before and after the restructuring and

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there were no changes in the rights or economic interests of either party, the Company viewed the transaction as a non-substantive reorganization to be accounted for at book value, similar to the transfer of assets under common control. TWC Inc. continues to account for its investment in the restructured joint venture using the equity method. Beginning on June 1, 2006, either TWC Inc. or Comcast can trigger a dissolution of the partnership. If a dissolution is triggered, the non-triggering party has the right to choose and take full ownership of one of two pools of the combined partnership s systems one pool consisting of the Houston systems and the other consisting of the Kansas City, southwest Texas and New Mexico systems with an arrangement to distribute the partnership s debt between the two pools. The party triggering the dissolution would own the remaining pool of systems and any debt associated with that pool.

In conjunction with the Adelphia Acquisition, TWC Inc. and Comcast agreed that if the Adelphia Acquisition and Cable Swaps occur and if Comcast receives the pool of assets consisting of the Kansas City, southwest Texas and New Mexico systems upon distribution of the Texas and Kansas City Cable Partners, L.P. assets as described above, Comcast will have an option, exercisable for 180 days commencing one year after the date of such distribution, to require TWC Inc. or a subsidiary to transfer to Comcast, in exchange for the southwest Texas and New Mexico systems, certain cable systems held by TWE and its subsidiaries.

In 2004, TWE-A/N (which owns the Company s equity stake in Texas and Kansas City Cable Partners, L.P.) agreed to extend its commitment to provide a ratable share (i.e., 50%) of any funding required to maintain certain Texas systems (i.e., Houston and Southwest Texas systems) in compliance with their financial covenants under the bank credit facilities (which facilities are otherwise nonrecourse to the Company, its other subsidiaries and its Kansas City systems). Funding made with respect to this agreement is contributed to the Texas systems in the form of partner subordinated loans. The aggregate amount of subordinated debt provided by TWE-A/N in 2005 and 2004 with respect to its obligations under the funding agreement was $40 million and $33 million, respectively. TWE-A/N s ultimate liability in respect of the funding agreement is dependent on the financial results of the Texas systems.

The existing bank credit facilities of the Texas systems and the Kansas City systems (approximately $548 million in aggregate principal outstanding as of December 31, 2005 for the Texas systems and $400 million in aggregate principal outstanding as of December 31, 2005 for the Kansas City systems) mature at the earlier of June 30, 2007 for the Texas systems and March 31, 2007 for the Kansas City systems or the refinancing thereof pursuant to the dissolution of the partnership.

Court TV Joint Venture

The Company and Liberty Media (Liberty) each have a 50% interest in Courtroom Television Network (Court TV). Beginning January 2006, Liberty may give written notice to Time Warner requiring Time Warner to purchase all of Liberty s interest in Court TV (the Liberty Put). In addition, as of the same date, Time Warner may, by notice to Liberty, require Liberty to sell all of its interest in Court TV to Time Warner (the Time Warner Call). The price to be paid upon exercise of either the Liberty Put or the Time Warner Call will be an amount equal to one-half of the fair market value of Court TV, determined by an appraisal. The consideration is required to be paid in cash if the Liberty Put is exercised. If the Time Warner Call is exercised, the consideration is also payable in cash only if Liberty determines that the transaction cannot be structured as a tax efficient transaction, or if Time Warner determines that a tax efficient transaction may either violate applicable law or cause a breach or default under any other agreement affecting Time Warner. For the year ended December 31, 2005, Court TV s Operating Income was approximately $40 million. As of the date of this filing, Liberty has not given notice to Time Warner nor has Time Warner given notice to Liberty.

Bookspan Joint Venture

The Company and Bertelsmann each have a 50% interest in the Bookspan joint venture, which operates the U.S. book clubs of Book-of-the-Month Club, Inc., and Doubleday Direct, Inc. Under the General Partnership Agreement, in January of each year, either Bertelsmann or the Company may elect to terminate the venture by giving notice during 60-day termination periods. If such an election is made, a confidential bid process will take place, pursuant to

which the highest bidder will purchase the other party s entire venture interest. The Company is unable to predict whether this bid process will occur or the amount that may be paid out or received under it. For the year ended December 31, 2005, the Bookspan joint venture had Operating Income of approximately $42 million.

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Backlog

Backlog represents the amount of future revenue not yet recorded from cash contracts for the licensing of theatrical and television product for pay cable, basic cable, network and syndicated television exhibition. Backlog was approximately $4.5 billion at December 31, 2005 and $3.7 billion at December 31, 2004. Included in these amounts is licensing of film product from the Filmed Entertainment segment to the Networks segment of $774 million and $514 million at December 31, 2005 and 2004, respectively.

Because backlog generally relates to contracts for the licensing of theatrical and television product which have already been produced, the recognition of revenue for such completed product is principally dependent upon the commencement of the availability period for telecast under the terms of the related licensing agreement. Cash licensing fees are collected periodically over the term of the related licensing agreements or, as referenced above and discussed in more detail in Note 8 to the accompanying consolidated financial statements, on an accelerated basis using a $500 million securitization facility. The portion of backlog for which cash has not already been received has significant value as a source of future funding. Of the approximately $4.5 billion of backlog as of December 31, 2005, Time Warner has recorded $335 million of deferred revenue on the accompanying consolidated balance sheet, representing cash received through the utilization of the backlog securitization facility. The backlog excludes filmed entertainment advertising barter contracts, which are also expected to result in the future realization of revenues and cash through the sale of advertising spots received under such contracts.

MARKET RISK MANAGEMENT

Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest rates, foreign currency exchange rates and changes in the market value of financial instruments.

Interest Rate Risk

Time Warner has issued variable-rate debt that, at December 31, 2005, had an outstanding balance of $1.105 billion. Based on Time Warner s variable-rate obligations outstanding at December 31, 2005, each 25 basis point increase or decrease in the level of interest rates would, respectively, increase or decrease Time Warner s annual interest expense and related cash payments by approximately $3 million. Such potential increases or decreases are based on certain simplifying assumptions, including a constant level of variable-rate debt for all maturities and an immediate, across-the-board increase or decrease in the level of interest rates with no other subsequent changes for the remainder of the period. Conversely, since almost all of the Company s cash balance of approximately $4.220 billion is invested in variable-rate interest earning assets, the Company would also earn more (less) interest income due to such an increase (decrease) in interest rates.

Time Warner has entered into fixed-rate debt that, at December 31, 2005, had an outstanding balance of $18.863 billion and a fair value of $20.394 billion. Based on Time Warner s fixed-rate debt obligations outstanding at December 31, 2005, a 25 basis point increase or decrease in the level of interest rates would, respectively, decrease or increase the fair value of the fixed-rate debt by approximately $378 million. Such potential increases or decreases are based on certain simplifying assumptions, including a constant level of fixed-rate debt and an immediate across-the-board increase or decrease in the level of interest rates with no other subsequent changes for the remainder of the period.

From time to time, the Company uses interest rate swaps to hedge the fair value of its fixed-rate obligations. Under the interest rate swap contract, the Company agrees to receive a fixed-rate payment (in most cases equal to the stated coupon rate of the bond being hedged) for a floating-rate payment. The net payment on the swap is exchanged at a specified interval that usually coincides with the bonds underlying coupon payment on the agreed upon notional amount. At December 31, 2005, there were no interest rate swaps outstanding.

The Company monitors its positions with, and the credit quality of, the financial institutions, which are party to any of its financial transactions. Credit risk related to any interest rate swaps outstanding has historically been considered low because the swaps have been entered into with strong, creditworthy counterparties and were limited to the net interest payments receivable, if any, for the remaining life of the swap.

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Foreign Currency Risk

Time Warner uses foreign exchange contracts primarily to hedge the risk that unremitted or future royalties and license fees owed to Time Warner domestic companies for the sale or anticipated sale of U.S. copyrighted products abroad may be adversely affected by changes in foreign currency exchange rates. Similarly, the Company enters into foreign exchange contracts to hedge certain film production costs abroad as well as other transactions, assets and liabilities denominated in a foreign currency. As part of its overall strategy to manage the level of exposure to the risk of foreign currency exchange rate fluctuations, primarily exposure to changes in the value of the British pound and the Euro, Time Warner hedges a portion of its foreign currency exposures anticipated over the calendar year. The hedging period for royalties and license fees covers revenues expected to be recognized during the calendar year; however, there is often a lag between the time that revenue is recognized and the transfer of foreign-denominated cash back into U.S. dollars. To hedge this exposure, Time Warner uses foreign exchange contracts that generally have maturities of three months to eighteen months providing continuing coverage throughout the hedging period. At December 31, 2005, Time Warner had effectively hedged approximately 70% of the estimated net foreign currency exposures that principally relate to anticipated cash flows for royalties and license fees to be remitted to the United States over the ensuing hedging period.

At December 31, 2005, Time Warner had contracts for the sale of $2.981 billion and the purchase of $1.602 billion of foreign currencies at fixed rates, including net contracts for the sale of $380 million of the British pound and $735 million of the Euro. At December 31, 2004, Time Warner had contracts for the sale of $3.375 billion and the purchase of $1.714 billion of foreign currencies at fixed rates, including net contracts for the sale of $496 million of the British pound and $825 million of the Euro.

Based on the foreign exchange contracts outstanding at December 31, 2005, a 10% devaluation of the U.S. dollar as compared to the level of foreign exchange rates for currencies under contract at December 31, 2005 would result in approximately $138 million of net unrealized losses. Conversely, a 10% appreciation of the U.S. dollar would result in approximately $138 million of net unrealized gains. For a hedge of forecasted royalty or license fees denominated in a foreign currency, consistent with the nature of the economic hedge provided by such foreign exchange contracts, such unrealized gains or losses largely would be offset by corresponding decreases or increases, respectively, in the dollar value of future foreign currency royalty and license fee payments that would be received in cash within the hedging period from the sale of U.S. copyrighted products abroad.

Equity Risk

The Company is exposed to market risk as it relates to changes in the market value of its investments. The Company invests in equity instruments of public and private companies for operational and strategic business purposes. These securities are subject to significant fluctuations in fair market value due to volatility of the stock market and the industries in which the companies operate. These securities, which are classified in Investments, including available-for-sale securities on the accompanying consolidated balance sheet, include equity-method investments, investments in private securities, available-for-sale securities, restricted securities and equity derivative instruments. As of December 31, 2005, the Company had $2.548 billion of investments accounted for using the equity method of accounting, $820 million of fair value investments, including $133 million of investments in unrestricted public equity securities held for purposes other than trading, $6 million of equity derivative instruments and $124 million of cost-method investments, primarily relating to private equity securities.

The Company s available-for-sale securities are adjusted to fair value with the gain or loss recognized as an unrealized gain or loss on investment in the accompanying consolidated statement of shareholders equity as a component of accumulated other comprehensive income until the investment is either sold or considered impaired other than on a temporary basis. As of December 31, 2005, the Company had net unrealized gains of $83 million, consisting of gross unrealized gains of $85 million and gross unrealized losses of $2 million. As a result of declines in the value of certain investments, the Company recorded noncash pretax charges of $16 million in 2005, $15 million in 2004 and $212 million in 2003 to reduce the carrying value of certain publicly traded and privately held investments,

restricted securities and investments accounted for using the equity method of accounting that had experienced other-than-temporary declines in value. In addition, the Company holds investments in equity derivative instruments which are recorded at fair value in the accompanying consolidated balance sheet, and the related gains and losses are immediately recognized in income. The Company recognized losses of $1 million and $14 million in 2005 and 2004, respectively, and gains of $8 million in 2003 as a component of other income, net in the accompanying consolidated income statement related to market fluctuations in equity derivative instruments. While Time Warner has recognized all declines that are believed to be other-than-temporary, it is reasonably possible that individual investments in the Company s portfolio may experience an other-than-temporary decline in value in the future

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if the underlying investee company experiences poor operating results or if the U.S. equity markets experience future broad declines in value. See Note 6 to the accompanying consolidated financial statements for additional discussion.

CRITICAL ACCOUNTING POLICIES

The SEC considers an accounting policy to be critical if it is important to the Company s financial condition and results, and if it requires significant judgment and estimates on the part of management in its application. The development and selection of these critical accounting policies have been determined by the management of Time Warner and the related disclosures have been reviewed with the Audit and Finance Committee of the Board of Directors. For a summary of all of the Company s significant accounting policies, see Note 1 to the accompanying consolidated financial statements.

Multiple-Element Transactions

Multiple-element transactions involve situations where judgment must be exercised in determining the fair value of the different elements in a bundled transaction. Specifically, multiple element arrangements can involve:

1. Contemporaneous purchases and sales. The Company sells a product or service (e.g., advertising services) to a customer and at the same time purchases goods or services and/or makes an investment in that customer.
2. Sales of multiple products or services. The Company sells multiple products or services to a counterparty (e.g., Cable sells video, digital phone and high-speed Internet access services to a customer).
3. Purchases of multiple products or services, or the settlement of an outstanding item contemporaneous with the purchase of a product or service. The Company purchases multiple products or services from a counterparty (e.g., the Networks segment licenses a group of films from a counterparty to show over a period of time).

Contemporaneous Purchases and Sales

In the normal course of business, Time Warner enters into transactions in which it purchases a product or service and/or makes an investment in a customer and at the same time negotiates a contract for the sale of advertising, or other product, to the customer. Contemporaneous transactions may also involve circumstances where the Company is purchasing or selling goods and services and settling a Company dispute. For example, the AOL segment may have negotiated for the sale of advertising at the same time it purchased goods or services and/or made an investment in a counterparty. Similarly, when negotiating programming arrangements with cable networks, the Company s Cable segment may negotiate for the sale of advertising to the cable network.

Arrangements, although negotiated contemporaneously, may be documented in one or more contracts. In accounting for such arrangements, the Company looks to the guidance contained in the following authoritative literature:

APB Opinion No. 29, Accounting for Nonmonetary Transactions (APB 29);

FASB Statement 153, Exchanges of Nonmonetary Assets an amendment of APB Opinion No. 29 (FAS 153);

Emerging Issues Task Force (EITF) Issue No. 01-09, Accounting for Consideration Given by a Vendor to a Customer (EITF 01-09); and

EITF Issue No. 02-16, Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor (EITF 02-16).

The Company accounts for each transaction negotiated contemporaneously based on the respective fair values of the goods or services purchased and the goods or services sold. If the Company is unable to determine the fair value of one or more of the elements being purchased, revenue recognition is limited to the total consideration received for the products or services sold less supported payments. For example, if the Company sells advertising to a customer for $10 million in cash and contemporaneously enters into an arrangement to acquire software for $2 million from the same customer, but fair value for the software cannot be reliably determined, the Company would limit the recognized advertising revenue to $8 million and would ascribe no value to the software acquisition. As another example, if the

Company sells advertising to a customer for $10 million in cash and contemporaneously invests $2 million in

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the equity of that same customer at fair value, the Company would recognize advertising revenue of $10 million and would ascribe $2 million to the equity investment. Accordingly, the judgments made in determining fair value in such arrangements impact the amount and period in which revenues, expenses and net income are recognized over the term of the contract.

In determining the fair value of the respective elements, the Company refers to quoted market prices (where available), historical transactions or comparable cash transactions. In addition, the existence of price protection in the form of most favored nation clauses or similar contractual provisions are generally indicative that the stated terms of a transaction are at fair value.

Further, in a contemporaneous purchase and sale transaction, evidence of fair value for one element of a transaction may provide support for the fair value of the other element of a transaction. For example, if the Company sells advertising to a customer and contemporaneously invests in the equity of that same customer, evidence of the fair value of the investment may implicitly support the fair value of the advertising sold, since there are only two elements in the arrangement.

Sales of Multiple Products or Services

The Company s policy for revenue recognition in instances where multiple deliverables are sold contemporaneously to the same counterparty is in accordance with EITF Issue No. 00-21, Revenue Arrangements with Multiple Deliverables, and SEC Staff Accounting Bulletin No. 104, Revenue Recognition. Specifically, if the Company enters into sales contracts for the sale of multiple products or services, then the Company evaluates whether it has objective fair value evidence for each deliverable in the transaction. If the Company has objective fair value evidence for each deliverable of the transaction, then it accounts for each deliverable in the transaction separately, based on the relevant revenue recognition accounting policies. However, if the Company is unable to determine objective fair value for one or more undelivered elements of the transaction, the Company generally recognizes revenue on a straight-line basis over the term of the agreement. For example, the AOL division might enter into an agreement for broadband service that includes AOL providing a modem in connection with the service and the subscriber paying an upfront fee as well as monthly charges. Because AOL is providing both a product and a service, revenue is allocated to the modem and service based on relative fair value.

Purchases of Multiple Products or Services

While no specific accounting guidance exists, the Company s policy for cost recognition in instances where multiple products or services are purchased contemporaneously from the same counterparty is consistent with its policy in instances where the Company sells multiple deliverables to a customer. Specifically, if the Company enters into a contract for the purchase of multiple products or services, the Company evaluates whether it has objective fair value evidence for each product or service being purchased. If the Company has objective fair value evidence for each product or service being purchased, it accounts for each separately, based on the relevant cost recognition accounting policies. However, if the Company is unable to determine objective fair value for one or more of the purchased elements, the Company recognizes the cost of the transaction on a straight-line basis over the term of the agreement. For example, the Networks segment licenses from a film production company the rights to a group of films and episodic series to run as content on its segment. Because the Networks segment is purchasing multiple products that will be aired over varying times and periods, the cost is allocated among the films and episodic series based on the relative fair value of each product being purchased. Each allocated amount is then accounted for in accordance with the Networks segment s accounting policy for that specific type of deliverable.

This policy would also apply in instances in which the Company settles an outstanding disagreement at the same time the Company purchases a product or service from that same counterparty. For example, the Cable segment settles a dispute on an existing programming contract with a programming vendor at the same time that it is renegotiating a new programming contract with the same programming vendor. Because the Cable segment is making payments for both the settlement of an existing programming contract and for carriage under a new programming contract, the amount agreed to be paid is allocated between the settlement of the preexisting programming contract and the carriage

under the new programming contract. The amount allocated to the settlement of the preexisting programming contract would be recognized immediately, whereas the amount allocated to the carriage under the new programming contract would be accounted for prospectively, consistent with the accounting for other similar programming agreements.

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Gross versus Net Revenue Recognition

In the normal course of business, the Company acts as or uses an intermediary or agent in executing transactions with third parties. The accounting issue presented by these arrangements is whether the Company should report revenue based on the gross amount billed to the ultimate customer or on the net amount received from the customer after commissions and other payments to third parties. To the extent revenues are recorded on a gross basis, any commissions or other payments to third parties are recorded as expenses so that the net amount (gross revenues less expenses) is reflected in Operating Income. Accordingly, the impact on Operating Income is the same whether the Company records the revenue on a gross or net basis. For example, if the Company s Filmed Entertainment segment distributes a film to a theater for $15 and remits $10 to the independent production company, representing its share of proceeds, the Company must determine if the Filmed Entertainment segment should record gross revenue from the theater of $15 and $10 of expenses or if it should record as revenue the net amount recognized of $5. In either case, the impact on Operating Income is $5.

Determining whether revenue should be reported as gross or net is based on an assessment of whether the Company is acting as the principal or agent in the transaction. To the extent that the Company is acting as a principal in a transaction, the Company reports revenue on a gross basis. To the extent that the Company is acting as an agent in a transaction, the Company reports revenue on a net basis. The determination of whether the Company is acting as a principal or an agent in a transaction involves judgment and is based on an evaluation of the terms of an arrangement.

In determining whether the Company serves as principal or agent, the Company follows the guidance in EITF 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent (EITF 99-19). Pursuant to such guidance, the Company serves as the principal in transactions in which it has substantial risks and rewards of ownership.

Specifically, the following are examples of arrangements where the Company is an intermediary or uses an intermediary:

The Filmed Entertainment segment distributes films on behalf of independent film producers or together with another party. The Filmed Entertainment segment will typically provide motion picture distribution services for an independent production company in the worldwide theatrical, home video and television markets. The arrangement may cover multiple films produced by the independent film company for which it owns the underlying copyright. In addition, the independent film company will generally retain final approval over the distribution, marketing, advertising and publicity for each film in all media, including the timing and extent of the theatrical releases, the pricing and packaging of home video units and approval of all television licenses. The Filmed Entertainment segment has recorded the revenue generated in these distribution arrangements on a gross basis when it is the merchant of record for the licensing arrangements, is the licensor/contracting party, provides the film materials to licensees, handles the billing and collection of all amounts due under such arrangements and bears the risk of loss related to distribution advances for print and advertising costs and/or the video product inventory. If the Filmed Entertainment segment does not bear the risk of loss as described in the previous sentence, the arrangements are accounted for on a net basis.

In order to share the risks (and consequently the rewards) of distributing certain films, the Filmed Entertainment segment (and in some cases the Networks segment) sometimes enters into what are referred to as co-financing arrangements whereby certain parties to a contractual agreement would be responsible for a particular distribution channel. For example, Warner Bros. may produce a film along with a third party. In accordance with the terms of the contract, Warner Bros. might agree to control the domestic distribution of the film while the other party controls the international distribution of that film. While these arrangements do not occur regularly, Warner Bros., after considering the factors noted in the preceding paragraph, would record revenue on a gross basis for the channels for which it serves as principal (in this example, the domestic distribution).

The Publishing segment utilizes subscription agents to generate magazine subscribers. As a way to generate magazine subscribers, the Publishing segment uses subscription agents whereby the agent secures subscribers and, in exchange, receives a percentage of the subscription revenue generated. The Publishing

segment has recorded subscription revenue generated by the agent, net of the fees paid to the agent. This is primarily because the subscription agent has the primary contact with the customer, performs all of the billing and collection activities, and passes the proceeds from the subscription to the Publishing segment after deducting the agent s commission.

The AOL segment sells advertising on behalf of third parties. AOL often will sell advertising on a third-party website (outside of the AOL service). Generally, AOL records the revenue generated from such sales on a gross basis (records as

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revenue the proceeds received from the advertiser, with an expense equal to the amount paid to the third-party owner of the website). This is primarily because AOL was responsible for identifying and contracting with third-party advertisers, establishing the selling price of the inventory, serving the advertisements at AOL s cost and expense, performing all billing and collection activities and bearing sole liability for fulfillment of the advertising. Similarly, AOL records gross revenue from Advertising.com transactions where Advertising.com purchases advertising inventory from third parties at a fixed price and resells the inventory.

The Cable segment bills for reimbursement of taxes paid to franchising authorities. In the monthly bill to customers, there is a line item identifying the reimbursement of taxes paid by the cable company to the franchising authorities. The Cable segment includes in its revenue amounts received from customers that are passed on to the franchising authorities by the Cable company. This is because the Cable segment is considered to be the primary obligor with respect to the customer purchasing the service and assumes the credit risk (i.e., it would still be required to remit the tax if the customer did not pay).

Impairment of Goodwill and Intangible Assets

Goodwill and Indefinite-Lived Intangible Assets

Goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is to identify a potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. The estimates of fair value of a reporting unit, generally the Company s operating segments, are determined using various valuation techniques, with the primary technique being a discounted cash flow analysis. A discounted cash flow analysis requires one to make various judgmental assumptions, including assumptions about future cash flows, growth rates and discount rates. The assumptions about future cash flows and growth rates are based on the Company s operating segments budget and business plans, and varying perpetual growth rate assumptions for periods beyond the long-term business plan period. Discount rate assumptions are based on an assessment of the risk inherent in the future cash flows of the respective reporting units. In estimating the fair values of its reporting units, the Company also uses research analyst estimates, as well as comparable market analyses. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not deemed impaired and the second step of the impairment test is not performed. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit s goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit s goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit.

The impairment test for other intangible assets not subject to amortization consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. The estimates of fair value of intangible assets not subject to amortization are determined using various discounted cash flow valuation methodologies. The most common among these is a relief from royalty methodology, which is used in estimating the fair value of the Company s brands and trademarks, and income methodologies, which are used to value cable franchises. The income methodology used to value the cable franchises entails identifying the discrete cash flows related to such franchises and discounting them back to the valuation date. Market and income-based methodologies are used to value sports franchises. Significant assumptions inherent in the methodologies employed include estimates of royalty rates and discount rates. Discount rate assumptions are based on an assessment of the risk inherent in the respective intangible assets. Assumptions about royalty rates are based on the rates at which similar brands and trademarks are being licensed in the marketplace.

The Company s 2005 annual impairment analysis, which was performed during the fourth quarter, did not result in an impairment charge. For certain reporting units, the 2005 estimated fair values were within 10% of respective book values. Applying a hypothetical 10% decrease to the fair values of each reporting unit would result in a greater book value than fair value for the following reporting units: Warner Bros. (approximately $390 million), Publishing (approximately $260 million) and The WB Network (approximately $20 million). A hypothetical 10% decrease to the fair values of indefinite-lived intangible assets would result in a greater book value than fair value for Cable franchises in the amount of approximately $150 million. Intangible assets not subject to amortization are tested for impairment annually, or more frequently if events or circumstances indicate that the asset might be impaired.

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Finite-Lived Intangible Assets

In determining whether finite-lived intangible assets (e.g., customer lists, film libraries, etc.) are impaired, the accounting rules do not provide for an annual impairment test. Instead they require that a triggering event occur before testing an asset for impairment. Such triggering events include the significant disposal of a portion of such assets or the occurrence of an adverse change in the market involving the business employing the related asset. Once a triggering event has occurred, the impairment test employed is based on whether the intent is to hold the asset for continued use or to hold the asset for sale. If the intent is to hold the asset for continued use, the impairment test first requires a comparison of undiscounted future cash flows against the carrying value of the asset as an initial test. If the carrying value of such asset exceeds the undiscounted cash flow, the asset would be deemed to be impaired. Impairment would then be measured as the difference between the fair value of the asset and its carrying value. Fair value is generally determined by discounting the future cash flows associated with that asset. If the intent is to hold the asset for sale and certain other criteria are met (e.g., can be disposed of currently, appropriate levels of authority have approved the sale, actively pursuing buyer), the impairment test involves comparing the asset s carrying value to its fair value. To the extent the carrying value is greater than the asset s fair value, an impairment loss is recognized for the difference.

Significant judgments in this area involve determining whether a triggering event has occurred and the determination of the cash flows for the assets involved and the discount rate to be applied in determining fair value. There was no impairment of finite-lived intangible assets in 2005.

Pension Plans

Time Warner and certain of its subsidiaries have defined benefit pension plans covering a majority of domestic employees and, to a lesser extent, international employees. Pension benefits are based on formulas that reflect the employees years of service and compensation during their employment period and participation in the plans. The Company recognized domestic pension expense of $157 million in 2005, $156 million in 2004 and $202 million in 2003. The pension expense recognized by the Company is determined using certain assumptions, including the discount rate, the expected long-term rate of return on plan assets and the rate of compensation increases. See Notes 1 and 13 to the accompanying consolidated financial statements for additional discussion. The determination of assumptions for domestic pension plans is discussed in more detail below.

The Company used a discount rate of 6% to compute 2005 pension expense. The discount rate was determined by reference to the Moody s Aa Corporate Bond Index, adjusted for coupon frequency and duration of obligation. A decrease in the discount rate of 25 basis points, from 6% to 5.75%, while holding all other assumptions constant, would have resulted in an increase in the Company s domestic pension expense of approximately $22 million in 2005.

The Company s expected long-term rate of return on plan assets used to compute 2005 pension expense was 8%. In developing the expected long-term rate of return, the Company considered the pension portfolio s past average rate of earnings, portfolio composition and discussions with portfolio managers. The expected long-term rate of return is based on an asset allocation assumption of 75% equities and 25% fixed-income securities, which approximated the actual allocation as of December 31, 2005. A decrease in the expected long-term rate of return of 25 basis points, from 8.00% to 7.75%, while holding all other assumptions constant, would have resulted in an increase in the Company s domestic pension expense of approximately $7 million in 2005.

The Company used an estimated rate of future compensation increases of 4.5% to compute 2005 pension expense. An increase in the rate of 25 basis points while holding all other assumptions constant would have resulted in an increase in the Company s domestic pension expense of approximately $3 million in 2005.

Filmed Entertainment Revenues and Costs

The Company accounts for film and television production costs, as well as related revenues (film accounting), in accordance with the guidance in Statement of Position 00-2, Accounting by Producers or Distributors of Films (SOP 00-2). See Note 1 to the accompanying consolidated financial statements for additional discussion. An aspect of film accounting that requires the exercise of judgment relates to the process of estimating the total revenues to be received

throughout a film s life cycle. Such estimate of a film s ultimate revenue is important for two reasons. First, for completed films and while a film is being produced and the related costs are being capitalized, it is necessary for management to estimate the ultimate revenues, less additional costs to be incurred, including exploitation costs, in order to determine whether the carrying value of a film is impaired and thus requires an immediate write-off of unrecoverable film costs. Second, the amount of capitalized film costs recognized as cost of revenues for a given film as it is exhibited in various markets, throughout its life cycle, is based on the proportion of the film s revenues recognized for such period to the film s

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TIME WARNER INC.
MANAGEMENT S DISCUSSION AND ANALYSIS
OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION (Continued)

estimated ultimate total revenues. Similarly, the recognition of participations and residuals is based on the proportion of the film s revenues recognized for such period to the film s estimated ultimate total revenues.

Prior to release, management bases its estimates of ultimate revenue for each film on the historical performance of similar films, incorporating factors such as the star power of the lead actors and actresses, the genre of the film, prerelease market research (including test market screenings), the expected number of theaters in which the film will be released and the expected home video or DVD release date, if any. Management updates such estimates based on information available on the progress of the film production and, upon release, the actual results of each film. For example, prior to a film s release, the Company often will test market the film to the film s targeted demographic. If the film is not received favorably, the Company may (1) reduce the film s estimated ultimate revenue, (2) revise the film, which could cause the production costs to exceed budget or (3) a combination of both. Similarly, a film that results in lower-than-expected theatrical revenues in its initial weeks of release would have its theatrical, home video and television distribution ultimate revenue adjusted downward. A failure to adjust for a downward change in ultimate revenue estimates could result in the understatement of amortized film costs for the period. Since the amount of capitalized film cost to be amortized for a given film is fixed, the estimate of ultimate revenues impacts only the timing of film cost amortization.

Sales Returns and Uncollectible Accounts

Another area of judgment affecting reported revenue and net income is management s estimate of product sales that will be returned and the amount of receivables that will ultimately be collected. In estimating product sales that will be returned, management analyzes actual and historical returns trends, current economic conditions and changes in customer demand and acceptance of Time Warner s products. Based on this information, management reserves a percentage of any product sales that provide the customer with the right of return. The provision for such sales returns is reflected as a reduction of the related sale. See Note 1 to the accompanying consolidated financial statements for additional discussion.

The Company s products subject to return include home video product at the Filmed Entertainment and Networks segments and magazines, books and direct sales merchandise at the Publishing segment. At December 31, 2005, total reserves for returns were approximately $993 million, $13 million and $574 million at the Filmed Entertainment, Networks and Publishing segments, respectively. See Note 1 to the accompanying consolidated financial statements for additional discussion.

Similarly, management evaluates accounts receivable to determine if they will ultimately be collected. In performing this evaluation, significant judgments and estimates are involved, including an analysis of specific risks on a customer-by-customer basis for larger accounts, and an analysis of receivables aging that determines the percentage that has historically been uncollected by aged category. Using this information, management reserves an amount that is believed to be uncollectible. Based on management s analysis of sales returns and uncollectible accounts, reserves totaling $2.225 billion and $2.109 billion have been established at December 31, 2005 and 2004, respectively. Total gross accounts receivable were $8.636 billion and $7.621 billion at December 31, 2005 and 2004, respectively.

CAUTION CONCERNING FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, particularly statements anticipating future growth in revenues, Operating Income before Depreciation and Amortization and cash from operations. Words such as anticipates, estimates, expects, projects, intends, plans, believes and words and terms of similar substance used in connection with any discussion of future operating or financial performance identify forward-looking statements. These forward-looking statements are based on management s current expectations and beliefs about future events. As with any projection or forecast, they are inherently susceptible to uncertainty and changes in circumstances, and the Company is under no obligation to, and expressly disclaims any obligation to, update or alter its forward-looking statements whether as a result of such changes, new information, subsequent events or otherwise.

Various factors could adversely affect the operations, business or financial results of Time Warner or its business segments in the future and cause Time Warner s actual results to differ materially from those contained in the forward-looking statements, including those factors discussed in detail in Item 1A, Risk Factors of the 2005 Form 10-K and in Time Warner s other filings made from time to time with the SEC after the date of this report. In addition, Time Warner operates in highly competitive, consumer and technology-driven and rapidly changing media, entertainment, interactive services and cable businesses. These businesses are affected by government regulation, economic, strategic, political and social conditions, consumer response to new and existing products and services, technological developments and, particularly in view of new technologies, the continued ability to protect intellectual

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TIME WARNER INC.
MANAGEMENT S DISCUSSION AND ANALYSIS
OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION (Continued)

property rights. Time Warner s actual results could differ materially from management s expectations because of changes in such factors.

Further, for Time Warner generally, lower than expected valuations associated with the cash flows and revenues at Time Warner s segments may result in Time Warner s inability to realize the value of recorded intangibles and goodwill at those segments. In addition, achieving the Company s financial objectives, including growth in operations, maintaining financial ratios and a strong balance sheet, could be adversely affected by the factors discussed in detail in Item 1A, Risk Factors of the 2005 Form 10-K, as well as:

decreased liquidity in the capital markets, including any reduction in the ability to access either the capital markets for debt securities or bank financings;

the failure to meet earnings expectations;

significant acquisitions such as the Adelphia Acquisition or other transactions such as the proposed redemption of Comcast s interests in TWC Inc. and TWE;

economic slowdowns;

the impact of terrorist acts and hostilities; and

changes in the Company s plans, strategies and intentions.

For Time Warner s AOL business, actual results could differ materially from management s expectations due to the factors discussed in detail in Item 1A, Risk Factors of the 2005 Form 10-K, as well as:

the ability to provide adequate server, network and system capacity;

the risk of unanticipated increased costs for network services;

the ability to maintain or enter into new content, electronic commerce or marketing arrangements and the risk that the cost of such arrangements may increase; and

the risks from changes in U.S. and international regulatory environments affecting interactive services.

For Time Warner s cable business, actual results could differ materially from management s expectations due to the factors discussed in detail in Item 1A, Risk Factors of the 2005 Form 10-K, as well as:

increases in government regulation of video services, including regulation that limits cable operators ability to raise rates or that dictates set-top box or other equipment features, functionalities or specifications;

government regulation that dictates the manner in which it operates its cable systems or determines what to offer, such as the imposition of forced access rules or common carrier type requirements;

increased difficulty in obtaining franchise renewals;

unanticipated funding obligations relating to its cable joint ventures;

a future decision by the FCC or Congress to require cable operators to contribute to the federal Universal Service Fund based on the provision of cable modem service, which could raise the price of cable modem service and impair TWC Inc. s competitive position; and

the award of franchises or similar grants of rights through state or federal legislation that would allow competitors of cable providers to offer video service on terms substantially more favorable than those afforded existing cable operators (e.g., without the need to obtain local franchise approval or to comply with local franchising regulations as cable operators currently must).

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TIME WARNER INC.
CONSOLIDATED BALANCE SHEET
December 31,
(restated, millions)

	2005	2004
ASSETS		
Current assets		
Cash and equivalents	$ 4,220	$ 6,139
Restricted cash		150
Receivables, less allowances of $2.225 and $2.109 billion	6,411	5,512
Inventories	1,806	1,737
Prepaid expenses and other current assets	1,026	920
Total current assets	13,463	14,458
Noncurrent inventories and film costs	4,916	4,415
Investments, including available-for-sale securities	3,493	4,677
Property, plant and equipment, net	13,659	13,070
Intangible assets subject to amortization, net	3,522	3,892
Intangible assets not subject to amortization	39,813	39,656
Goodwill	40,458	39,709
Other assets	3,152	3,272
Total assets	$ 122,476	$ 123,149
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 1,380	$ 1,339
Participations payable	2,426	2,452
Royalties and programming costs payable	1,095	1,038
Deferred revenue	1,473	1,653
Debt due within one year	92	1,672
Other current liabilities	6,100	6,468
Current liabilities of discontinued operations	42	51
Total current liabilities	12,608	14,673
Long-term debt	20,238	20,703
Deferred income taxes	15,077	14,870
Deferred revenue	681	749
Mandatorily convertible preferred stock		1,500
Other liabilities	5,420	4,404
Noncurrent liabilities of discontinued operations	7	38
Minority interests	5,766	5,493
Commitments and contingencies (Note 17)		
Shareholders equity		
Series LMCN-V common stock, $0.01 par value, 87.2 and 105.7 million shares outstanding	1	1
Time Warner common stock, $0.01 par value, 4.498 and 4.483 billion shares outstanding	45	45
Paid-in-capital	155,927	156,252

Accumulated other comprehensive income (loss), net	(64)	106
Accumulated deficit	(93,230)	(95,685)
Total shareholders equity	62,679	60,719
Total liabilities and shareholders equity	$ 122,476	$ 123,149

See accompanying notes.

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TIME WARNER INC.
CONSOLIDATED STATEMENT OF OPERATIONS
Years Ended December 31,
(restated, millions, except per share amounts)

	2005	**2004**	**2003**
Revenues:			
Subscription	$ 22,222	$ 21,605	$ 20,448
Advertising	7,612	6,947	6,113
Content	12,615	12,350	11,446
Other	1,203	1,179	1,489
Total revenues[(a)]	43,652	42,081	39,496
Costs of revenues[(a)]	(25,046)	(24,402)	(23,373)
Selling, general and administrative[(a)]	(10,478)	(10,261)	(9,730)
Amortization of intangible assets	(597)	(626)	(640)
Amounts related to securities litigation and government investigations	(2,865)	(536)	(56)
Merger-related and restructuring costs	(117)	(50)	(109)
Asset impairments	(24)	(10)	(318)
Gains on disposal of assets, net	23	21	14
Operating income	4,548	6,217	5,284
Interest expense, net[(a)]	(1,266)	(1,533)	(1,734)
Other income, net	1,125	522	1,213
Minority interest expense, net	(289)	(250)	(218)
Income before income taxes, discontinued operations and cumulative effect of accounting change	4,118	4,956	4,545
Income tax provision	(1,197)	(1,717)	(1,381)
Income before discontinued operations and cumulative effect of accounting change	2,921	3,239	3,164
Discontinued operations, net of tax		121	(495)
Income before cumulative effect of accounting change	2,921	3,360	2,669
Cumulative effect of accounting change, net of tax		34	(12)
Net income	$ 2,921	$ 3,394	$ 2,657
Basic income per common share before discontinued operations and cumulative effect of accounting change	$ 0.63	$ 0.71	$ 0.70
Discontinued operations		0.03	(0.11)
Cumulative effect of accounting change			
Basic net income per common share	$ 0.63	$ 0.74	$ 0.59
Average basic common shares	4,648.2	4,560.2	4,506.0

Diluted income per common share before discontinued operations and cumulative effect of accounting change	$ 0.62	$ 0.69	$ 0.68
Discontinued operations		0.03	(0.11)
Cumulative effect of accounting change			
Diluted net income per common share	$ 0.62	$ 0.72	$ 0.57
Average diluted common shares	4,710.0	4,694.7	4,623.7
Cash dividends declared per share of common stock	$ 0.10	$	$

[a] Includes the following income (expenses) resulting from transactions with related companies:

Revenues	$ 283	$ 282	$ 415
Costs of revenues	(206)	(158)	(132)
Selling, general and administrative	36	32	23
Interest income, net	35	25	19

See accompanying notes.

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TIME WARNER INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
Years Ended December 31,
(restated, millions)

	2005	2004	2003
OPERATIONS			
Net income[a]	$ 2,921	$ 3,394	$ 2,657
Adjustments for noncash and nonoperating items:			
Cumulative effect of accounting change, net of tax		(34)	12
Depreciation and amortization	3,268	3,196	3,127
Amortization of film costs	3,513	3,547	2,959
Asset impairments	25	10	318
Gain on investments and other assets, net	(1,086)	(432)	(600)
Equity in (income) losses of investee companies, net of cash distributions	(15)	19	152
Amounts related to securities litigation and government investigations	111	300	
Changes in operating assets and liabilities, net of acquisitions:			
Receivables	(552)	(853)	(310)
Inventories	(3,910)	(3,841)	(3,707)
Accounts payable and other liabilities	(598)	(36)	(120)
Other balance sheet changes	1,298	1,345	1,261
Adjustments relating to discontinued operations	(10)	2	845
Cash provided by operations[b][c]	4,965	6,617	6,594
INVESTING ACTIVITIES			
Investments and acquisitions, net of cash acquired	(680)	(877)	(570)
Investments and acquisitions from discontinued operations			(52)
Capital expenditures and product development costs from continuing operations	(3,246)	(3,024)	(2,761)
Capital expenditures from discontinued operations			(126)
Investment proceeds from available-for-sale securities	991	532	1,079
Investment proceeds from discontinued operations			1,056
Other investment proceeds	439	2,866	1,451
Cash provided (used) by investing activities	(2,496)	(503)	77
FINANCING ACTIVITIES			
Borrowings	6	1,320	2,371
Debt repayments	(1,995)	(4,523)	(7,109)
Redemption of redeemable preferred securities of subsidiary			(813)
Proceeds from exercise of stock options	307	353	372
Principal payments on capital leases	(118)	(190)	(171)
Repurchases of common stock	(2,141)		
Dividends paid	(466)		
Other	19	25	(11)

Cash used by financing activities	(4,388)	(3,015)	(5,361)
INCREASE (DECREASE) IN CASH AND EQUIVALENTS	(1,919)	3,099	1,310
CASH AND EQUIVALENTS AT BEGINNING OF PERIOD	6,139	3,040	1,730
CASH AND EQUIVALENTS AT END OF PERIOD	$ 4,220	$ 6,139	$ 3,040

(a) Includes net income (loss) from discontinued operations of $121 million in 2004 and $(495) million in 2003.

(b) 2005 reflects $2.754 billion in payments related to securities litigation and the government investigations. 2004 reflects $236 million in payments related to securities litigation and the government investigations.

(c) 2005 includes an approximate $36 million use of cash related to changing the fiscal year end of certain international operations from November 30 to December 31.

See accompanying notes.

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TIME WARNER INC.
CONSOLIDATED STATEMENT OF SHAREHOLDER S EQUITY
Years Ended December 31,
(restated, millions)

	Common Stock	Paid-In Capital	Retained Earnings (Accumulated Deficit)	Total
BALANCE AT DECEMBER 31, 2002[a]	$ 45	$ 155,134	$ (102,288)	$ 52,891
Net income			2,657	2,657
Foreign currency translation adjustments			(77)	(77)
Unrealized loss on securities, net of $34 million tax benefit[b]			(50)	(50)
Realized and unrealized losses on derivative financial instruments, net of $9 million tax benefit			(6)	(6)
Reversal of unfunded accumulated benefit obligation, net of $180 million income tax provision			270	270
Comprehensive income			2,794	2,794
Shares issued pursuant to stock options, restricted stock and benefit plans, including $23 million income tax benefit	1	445		446
BALANCE AT DECEMBER 31, 2003	46	155,579	(99,494)	56,131
Net income			3,394	3,394
Foreign currency translation adjustments			(66)	(66)
Unrealized gain on securities, net of $388 million tax provision[c]			582	582
Realized and unrealized losses on derivative financial instruments, net of $0.6 million tax provision			1	1
Reversal of unfunded accumulated benefit obligation, net of $3 million income tax provision			4	4
Comprehensive income			3,915	3,915
Shares issued pursuant to stock options, restricted stock and benefit plans, including $244 million income tax benefit		673		673
BALANCE AT DECEMBER 31, 2004	46	156,252	(95,579)	60,719
Net income			2,921	2,921
Foreign currency translation adjustments[d]			430	430
Change in unrealized gain on securities, net of $402 million tax benefit[e]			(603)	(603)
			22	22

Realized and unrealized losses on derivative financial instruments, net of $14.8 million tax provision				
Reversal of unfunded accumulated benefit obligation, net of $11 million income tax provision			(19)	(19)
Comprehensive income			2,751	2,751
Conversion of mandatorily convertible preferred stock	1	1,499		1,500
Cash dividends ($0.10 per common share)			(466)	(466)
Common stock repurchases	(1)	(2,249)		(2,250)
Shares issued pursuant to stock options, restricted stock and benefit plans, including $37 million income tax benefit		425		425
BALANCE AT DECEMBER 31, 2005	$ 46	$ 155,927	$ (93,294)	$ 62,679

(a) Accumulated deficit at December 31, 2002 reflects a cumulative adjustment in connection with the restatement that increased the deficit by $100 million (Note 1).

(b) Includes a $218 million pretax reduction (tax effect of $87 million) related to realized gains on the sale of securities in 2003 and an increase of $11 million pretax (tax effect $4 million) related to impairment charges on investments that had experienced other-than-temporary declines. These changes are included in the 2003 net income.

(c) Includes a $268 million pretax

reduction (tax effect of $107 million) related to realized gains on the sale of securities in 2004 and an increase of $4 million pretax (tax effect $2 million) related to impairment charges on investments that had experienced other-than-temporary declines. These changes are included in the 2004 net income.

(d) Includes an adjustment of $439 million for foreign currency translation related to goodwill and intangible assets, including amounts that relate to prior periods (Note 2).

(e) Includes a $959 million pretax reduction (tax effect of $384 million) related to realized gains on the sale of securities in 2005, primarily Google, and an increase of $3 million pretax (tax effect $1 million) related to impairment charges on investments that had experienced other-than-temporary declines. These changes are included in the 2005 net income.

See accompanying notes.

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TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Restatement of Prior Financial Information, Description of Business and Basis of Presentation

Restatement of Prior Financial Information

As previously disclosed by Time Warner Inc. (Time Warner or the Company), the Securities and Exchange Commission (SEC) had been conducting an investigation into certain accounting and disclosure practices of the Company. On March 21, 2005, the Company announced that the SEC had approved the Company s proposed settlement, which resolved the SEC s investigation of the Company. Under the terms of the settlement with the SEC, the Company agreed, without admitting or denying the SEC s allegations, to be enjoined from future violations of certain provisions of the securities laws and to comply with the cease-and-desist order issued by the SEC to AOL LLC (formerly America Online, Inc., AOL), a subsidiary of the Company, in May 2000. The Company also agreed to appoint an independent examiner, who was to either be or hire a certified public accountant. The independent examiner was to review whether the Company s historical accounting for transactions (as well as any subsequent amendments) with 17 counterparties identified by the SEC staff, principally involving online advertising revenues and including three cable programming affiliation agreements with related online advertising elements, was appropriate, and provide a report to the Company s Audit and Finance Committee of its conclusions, originally within 180 days of being engaged. The transactions that were to be reviewed were entered into (or amended) between June 1, 2000 and December 31, 2001, including subsequent amendments thereto, and involved online advertising and related transactions for which the majority of the revenue was recognized before January 1, 2002.

The independent examiner began his review in June 2005 and, after several extensions of time, recently completed that review, in which he concluded that certain of the transactions under review with 15 counterparties, including three cable programming affiliation agreements with advertising elements, were accounted for improperly because the historical accounting did not reflect the substance of the arrangements. Under the terms of its SEC settlement, the Company is required to restate any transactions that the independent examiner determined were accounted for improperly. Accordingly, on August 15, 2006, the Company determined it would restate its consolidated financial results for each of the years ended December 31, 2000 through December 31, 2005 and for the six months ended June 30, 2006. The financial statements presented herein reflect the impact of the adjustments being made in the Company s financial results.

The transactions being restated are principally transactions in which (i) AOL secured online advertising commitments from counterparties (and subsequently delivered on such commitments) at the same time that the Company entered into commitments with those same counterparties to purchase products or services or to make an investment in such counterparties and (ii) in the case of three counterparties, Time Warner Cable, a subsidiary of the Company, entered into cable programming affiliation agreements at the same time it committed to deliver (and did subsequently deliver) network and online advertising services to those same counterparties. Total advertising revenue recognized by the Company under these transactions was $584 million ($24 million in 2000, $378 million in 2001, $107 million in 2002, $67 million in 2003 and $8 million in 2004). Included in the $584 million is $37 million related to operations that have been subsequently classified as discontinued operations and $12 million of amounts that were reclassified to another revenue category (content or other) in connection with the restatement. In addition to reversing the recognition of revenue, based on the independent examiner s conclusions and as described more fully below, the Company has recorded corresponding reductions in the cost of the products or services that were acquired or investments that were made contemporaneously with the execution of the advertising agreements. In addition, the independent examiner concluded that approximately $119 million in marketing expenses were not recognized in the appropriate accounting period.

Included in the $584 million of restated advertising revenues is $310 million of advertising revenues in which the advertising arrangements were secured by AOL contemporaneously with the purchase of products or services or making an investment. In restating these transactions, the Company has reduced the cost of the related products, services or investment, which has had the effect of increasing earnings during certain of the periods. The remaining balance of the $584 million (or $274 million) consists of advertising arrangements that were secured

contemporaneously with cable programming affiliation agreements. In restating these advertising arrangements, the Company is reducing cable programming costs over the life of the related cable programming affiliation arrangements (which range from 10 to 12 years), which has the effect of increasing earnings during certain of the periods restated and in future periods.

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TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In addition to the revenue impact, the net effect of restating these transactions is that the Company s net income has been reduced by $1 million in 2000 and $161 million in 2001 and has been increased by $62 million in 2002, $18 million in 2003, $30 million in 2004 and $16 million in 2005. Included in the 2002 incremental net income of $62 million is a $42 million decrease in the aggregate goodwill impairment charge recognized by the Company during 2002.

Details of the impact of the restatement on the accompanying consolidated statement of operations are as follows:

	Years Ended December 31,		
	2005	2004	2003
	(in millions, except per share amounts)		
Advertising Revenues decrease	$	$ (8)	$ (67)
Cost of Revenues decrease	29	47	49
Selling, general and administrative decrease		13	48
Operating Income increase	29	52	30
Other income, net increase	1	1	3
Minority interest expense increase	(4)	(4)	(4)
Income before income taxes, discontinued operations and cumulative effect of accounting change increase	26	49	29
Income tax provision increase	(10)	(19)	(11)
Net income increase	$ 16	$ 30	$ 18
Basic income per common share before discontinued operations and cumulative effect of accounting change increase	$ 0.01	$ 0.01	$ 0.00
Diluted income per common share before discontinued operations and cumulative effect of accounting change increase	$ 0.00	$ 0.01	$ 0.00
Basic net income per common share increase	$ 0.01	$ 0.00	$ 0.00
Diluted net income per common share increase	$ 0.00	$ 0.00	$ 0.00

At December 31, 2004 and 2005, the impact of the restatement on Total Assets is a decrease of $9 million and an increase of $1 million, respectively, and the impact of the restatement on Total Liabilities is an increase of $43 million and $37 million, respectively. In addition, the impact of the restatement on the Accumulated Deficit at December 31, 2002 is an increase in the deficit of $100 million. While the restatement results in changes in the classification of cash flows, it has not impacted total cash flow during the periods. Certain of the footnotes that follow have also been restated to reflect the changes described above.

In June 2006, certain debt securities of one of the Company s subsidiaries, Time Warner Companies, Inc., that were guaranteed by the Company and certain subsidiaries of the Company were delisted from the New York Stock Exchange and deregistered under Section 12(b) of the Securities Exchange Act of 1934. As a result, the Company is no longer required to include the condensed consolidating financial statements required under Rule 3-10 of Registration S-X, and such supplementary data has not been restated or included herein.

Description of Business

Time Warner Inc. (Time Warner or the Company) is a leading media and entertainment company, whose businesses include interactive services, cable systems, filmed entertainment, television networks and publishing. Time Warner classifies its business interests into five reportable segments: *AOL:* consisting principally of interactive

services; *Cable:* consisting principally of interests in cable systems that provide video, high-speed data and Digital Phone services; *Filmed Entertainment:* consisting principally of feature film, television and home video production and distribution; *Networks:* consisting principally of cable television and broadcast networks; and *Publishing:* consisting principally of magazine publishing and, subject to a pending sale, book publishing. Financial information for Time Warner s various reportable segments is presented in Note 16.

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TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Pending Transactions

Adelphia/Comcast

Refer to Note 5 for further details.

Sale of Time Warner Book Group

On February 6, 2006, the Company announced an agreement to sell Time Warner Book Group Inc. (TWBG) to Hachette Livre SA, a wholly-owned subsidiary of Lagardère SCA, for approximately $538 million in cash, not including working capital adjustments. This transaction is expected to close in the first half of 2006 and the Company expects to record a pretax gain of approximately $180 million to $220 million. In 2005, TWBG had revenues of $571 million and Operating Income of $74 million.

Sale of Canal Satellite Digital

On February 7, 2006, Warner Bros. Entertainment Inc. (Warner Bros.)entered into an agreement for the sale of its equity investment interest in Canal Satellite Digital (CSD), a Spanish satellite pay television operator, together with its interest in Cinemania, the Spanish library movie channel, for approximately $90 million in cash and stock. This transaction is expected to close in the second quarter of 2006 and the Company expects to record a pretax equity investment gain of approximately $40 million.

Sale of Turner South

On February 23, 2006, the Company announced an agreement to sell the Turner South network (Turner South), a subsidiary of Turner, to Fox Cable Networks, Inc. (Fox) for approximately $375 million in cash. This transaction is expected to close in the second or third quarter of 2006 and the Company expects to record a pretax gain of approximately $110 million to $130 million. In 2005, Turner South had revenues of $49 million and an Operating Loss of $7 million.

The WB Network

On January 24, 2006, Warner Bros. and CBS Corp. (CBS) announced an agreement in principle to form a new fully-distributed national broadcast network, to be called The CW. At the same time, Warner Bros. and CBS are preparing to cease the standalone operations of The WB Network and UPN, respectively, at the end of the 2005/2006 television season (September 2006). Warner Bros. and CBS will each own 50% of the new network and will have joint and equal control. In addition, Warner Bros. has reached an agreement in principle with Tribune Corp. (Tribune), currently a subordinated 22.25% limited partner in The WB Network, under which Tribune will surrender its ownership interest in The WB Network and will be relieved of funding obligations. In addition, Tribune will become one of the principal affiliate groups for the new network.

Upon the closing of this transaction, the Company will account for its investment in The CW under the equity method of accounting. The Company anticipates that prior to the closing of this transaction the Company is expected to incur restructuring charges ranging from $15 million to $20 million related to employee terminations. In addition, the Company may incur costs in terminating certain programming arrangements that will not be contributed to the new network or utilized in another manner.

TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

AOL-Google Alliance

During December 2005, the Company announced that America Online, Inc. (AOL) is expanding its current strategic alliance with Google Inc. (Google) to enhance its global online advertising partnership and make more of AOL s content available to Google users. Under the alliance, Google and AOL will continue to provide search technology to AOL s network of Internet properties worldwide. Other key aspects of the alliance include:

Creating an AOL Marketplace through white labeling of Google s advertising technology, which enables AOL to sell search advertising directly to advertisers on AOL-owned properties;

Expanding display advertising available for AOL to sell throughout the Google network;

Making AOL content more accessible to Google Web crawlers;

Collaborating in video search and showcasing AOL s premium video service within Google Video;

Enabling Google Talk and AIM instant messaging users to communicate with each other, provided certain conditions are met; and

Providing AOL marketing credits for promotion of AOL s content on Google s Internet properties.

In addition, Google will invest $1 billion for a 5% equity interest in a limited liability company that will own all of the outstanding equity interests in AOL. The Company expects these transactions with Google to close during the first quarter of 2006.

Amounts Related to Securities Litigation

In July 2005, the Company reached an agreement in principle for the settlement of the securities class action lawsuits included in the matters consolidated under the caption *In re: AOL Time Warner Inc. Securities & ERISA Litigation* described in Note 17 herein. The settlement is reflected in a written agreement between the lead plaintiff and the Company. On September 30, 2005, the court issued an order granting preliminary approval of the settlement and certified the settlement class. The court held a final approval hearing on February 22, 2006, and the parties are now awaiting the court s ruling. At this time, there can be no assurance that the settlement of the securities class action litigation will receive final court approval. In connection with reaching the agreement in principle on the securities class action, the Company established a reserve of $2.4 billion during the second quarter of 2005. Ernst & Young LLP also has agreed to a settlement in this litigation matter and will pay $100 million. Pursuant to the settlement, in October 2005, Time Warner paid $2.4 billion into a settlement fund (the MSBI Settlement Fund) for the members of the class represented in the action. In addition, the $150 million previously paid by Time Warner into a fund in connection with the settlement of the investigation by the U.S. Department of Justice (DOJ) was transferred to the MSBI Settlement Fund, and Time Warner is using its best efforts to have the $300 million it previously paid in connection with the settlement of its Securities and Exchange Commission (SEC) investigation, or at least a substantial portion thereof, transferred to the MSBI Settlement Fund.

In addition to the $2.4 billion reserve established in connection with the agreement in principle regarding the settlement of the MSBI consolidated securities class action, during the second quarter of 2005, the Company established an additional reserve totaling $600 million in connection with the other related securities litigation matters described in Note 17 herein that are pending against the Company. This $600 million amount continues to represent the Company s current best estimate of the amounts to be paid in resolving these matters, including the remaining individual shareholder suits (including suits brought by individual shareholders who decided to opt-out of the settlement in the primary securities class action), the derivative actions and the actions alleging violations of The Employee Retirement Income Security Act (ERISA). Of this amount, subsequent to December 31, 2005, the Company has paid, or has agreed to pay, approximately $335 million, before providing for any remaining potential insurance recoveries, to settle certain of these claims.

The Company reached an agreement with the carriers on its directors and officers insurance policies in connection with the securities and derivative action matters described above (other than the actions alleging violations of ERISA). As a result of this agreement, in the fourth quarter, the Company recorded a recovery of approximately $185 million (bringing the total 2005 recoveries to $206 million), which is expected to be collected in the first quarter of 2006 and is reflected as a reduction to Amounts related to securities litigation and government investigations in the accompanying consolidated statement of operations for the year ended December 31, 2005.

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TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Government Investigations

As previously disclosed by the Company, the SEC and the DOJ had been conducting investigations into accounting and disclosure practices of the Company. Those investigations focused on advertising transactions, principally involving the Company s AOL segment, the methods used by the AOL segment to report its subscriber numbers and the accounting related to the Company s interest in AOL Europe prior to January 2002. During 2004, the Company established $510 million in legal reserves related to the government investigations, the components of which are discussed in more detail in the following paragraphs.

The Company and its subsidiary, AOL, entered into a settlement with the DOJ in December 2004 that provided for a deferred prosecution arrangement for a two-year period. As part of the settlement with the DOJ, in December 2004, the Company paid a penalty of $60 million and established a $150 million fund, which the Company could use to settle related securities litigation. The fund was reflected as restricted cash on the Company s accompanying consolidated balance sheet at December 31, 2004. During October 2005, the $150 million was transferred by the Company into the MSBI Settlement Fund described above under the heading Amounts Related to Securities Litigation.

In addition, on March 21, 2005, the Company announced that the SEC had approved the Company s proposed settlement, which resolved the SEC s investigation of the Company.

Under the terms of the settlement with the SEC, the Company agreed, without admitting or denying the SEC s allegations, to be enjoined from future violations of certain provisions of the securities laws and to comply with the cease-and-desist order issued by the SEC to AOL in May 2000. The settlement also required the Company to:

- Pay a $300 million penalty, which will be used for a Fair Fund, as authorized under the Sarbanes-Oxley Act;
- Adjust its historical accounting for Advertising revenues in certain transactions with Bertelsmann, A.G. (Bertelsmann) that were improperly or prematurely recognized, primarily in the second half of 2000, during 2001 and during 2002; as well as adjust its historical accounting for transactions involving three other AOL customers where there were Advertising revenues recognized in the second half of 2000 and during 2001;
- Adjust its historical accounting for its investment in and consolidation of AOL Europe; and
- Agree to the appointment of an independent examiner, who will either be or hire a certified public accountant. The independent examiner will review whether the Company s historical accounting for transactions with 17 counterparties identified by the SEC staff, principally involving online advertising revenues and including three cable programming affiliation agreements with related advertising elements, was in conformity with GAAP, and provide a report to the Company s audit and finance committee of its conclusions, originally within 180 days of being engaged. The transactions that would be reviewed were entered into between June 1, 2000 and December 31, 2001, including subsequent amendments thereto, and involved online advertising and related transactions for which revenue was principally recognized before January 1, 2002.

The Company paid the $300 million penalty in March 2005; however, it is unable to deduct the penalty for income tax purposes, be reimbursed or indemnified for such payment through insurance or any other source, or use such payment to setoff or reduce any award of compensatory damages to plaintiffs in related securities litigation pending against the Company. As described above, in connection with the pending settlement of the consolidated securities class action, the Company is using its best efforts to have the $300 million, or a substantial portion thereof, transferred to the MSBI Settlement Fund. The historical accounting adjustments were reflected in the restatement of the Company s financial results for each of the years ended December 31, 2000 through December 31, 2003, which were included in the Company s Annual Report on Form 10-K for the year ended December 31, 2004 (the 2004 Form 10-K).

The independent examiner recently completed his review and, as a result of the conclusions, the Company s consolidated financial results have been restated as reflected herein. For more information on the restatement, see

Restatement of Prior Financial Information above.

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TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Basis of Presentation

Basis of Consolidation

The consolidated financial statements include 100% of the assets, liabilities, revenues, expenses and cash flows of Time Warner and all entities in which Time Warner has a controlling voting interest (subsidiaries) and variable interest entities (VIE) required to be consolidated in accordance with U.S. generally accepted accounting principles (GAAP). Intercompany accounts and transactions between consolidated companies have been eliminated in consolidation.

The financial position and operating results of substantially all foreign operations are consolidated using the local currency as the functional currency. Local currency assets and liabilities are translated at the rates of exchange on the balance sheet date, and local currency revenues and expenses are translated at average rates of exchange during the period. Resulting translation gains or losses are included in the accompanying consolidated statement of shareholders equity as a component of Accumulated other comprehensive income, net.

The effects of any changes in the Company s ownership interests resulting from the issuance of equity capital by consolidated subsidiaries or equity investees to unaffiliated parties are accounted for as capital transactions pursuant to the SEC s Staff Accounting Bulletin No. 51, Accounting for Sales of Stock by a Subsidiary.

Discontinued Operations

The Company disposed of its entire Music segment effective March 1, 2004. Accordingly, the Company has presented the financial condition and results of operations of the Music segment as discontinued operations for all periods presented.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and footnotes thereto. Actual results could differ from those estimates.

Significant estimates inherent in the preparation of the accompanying consolidated financial statements include reserves established for securities litigation matters, accounting for asset impairments, allowances for doubtful accounts, depreciation and amortization, film ultimate revenues, home video and magazine returns, business combinations, pensions and other postretirement benefits, income taxes, contingencies and certain programming arrangements.

Recently Issued Accounting Guidance

Accounting for Rental Costs

In October 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) 13-1, Accounting for Rental Costs Incurred during a Construction Period (FSP 13-1). FSP 13-1 requires rental costs associated with ground or building operating leases that are incurred during a construction period be recognized as rental expense and included in income from continuing operations. FSP 13-1 is effective for fiscal periods beginning after December 15, 2005. The provisions of FSP 13-1 are not expected to have a material impact on the Company s consolidated financial statements.

Conditional Asset Retirement Obligations

In March 2005, the FASB issued FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations an Interpretation of FASB Statement No. 143 (FIN 47). FIN 47 clarifies the timing of liability recognition for legal obligations associated with the retirement of a tangible long-lived asset when the timing and/or method of settlement are conditional on a future event. The Company adopted the provisions of FIN 47 during 2005. The application of FIN 47 did not have a material impact on the Company s consolidated financial statements.

Stock-Based Compensation

In December 2004, the FASB issued FASB Statement 123 (Revised 2004), Share-Based Payment (FAS 123R). FAS 123R requires all companies to measure compensation costs for all share-based payments (including employee stock options) at fair value

TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and recognize such costs in the statement of operations. The Company will adopt FAS 123R beginning January 1, 2006 and elect the modified retrospective method of transition. This method of transition requires that the financial statements of all prior periods be adjusted on a basis consistent with the pro forma disclosures required for those periods by FASB Statement No. 123, Accounting for Stock-Based Compensation, the predecessor to FAS 123R. Through December 31, 2005, the Company has accounted for stock-based compensation using the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). In accordance with APB 25 and related interpretations, compensation expense for stock options is generally recognized in income based on the excess, if any, of the quoted market price of the stock at the grant date of the award or other measurement date over the amount an employee must pay to acquire the stock. The compensation costs related to stock options recognized by the Company pursuant to APB 25 were minimal. As a result, the application of the provisions of FAS 123R will have a significant impact on reported net income and earnings per share. See Stock-Based Compensation for the pro forma impact if compensation costs for the Company s stock option plans had been determined based on the fair value method set forth in FAS 123.

Use of Residual Method in Fair Value Determinations

In September 2004, the Emerging Issue Task Force (EITF) issued Topic No. D-108, Use of the Residual Method to Value Acquired Assets Other than Goodwill (Topic D-108). Topic D-108 requires the direct value method, rather than the residual value method, be used to value intangible assets other than goodwill for such assets acquired in business combinations completed after September 29, 2004. Under the residual value method, the fair value of the intangible asset is determined to be the difference between the enterprise value and the fair value of all other separately identifiable assets; whereas, under the direct value method all intangible assets are valued separately and directly. Topic D-108 also requires that registrants who have applied the residual method to the valuation of intangible assets for purposes of impairment testing shall perform an impairment test using the direct value method on all intangible assets. Previously, the Company had used a residual value methodology to value cable franchise and sports franchise intangible assets. Pursuant to the provisions of Topic D-108, the income methodology used to value the cable franchises entails identifying the discrete cash flows related to such franchises and discounting them back to the valuation date. Market and income-based methodologies are used to value sports franchises. The provisions of Topic D-108 did not affect the consolidated financial statements.

Consolidation of Variable Interest Entities

Pursuant to the provisions of FASB Interpretation No. 46, Consolidation of Variable Interest Entities an Interpretation of ARB No. 51, (as revised, FIN 46R), the Company began consolidating the operations of America Online Latin America, Inc. (AOLA) as of March 31, 2004. AOLA is a publicly traded entity whose significant shareholders include the Company, AOL, the Cisneros Group (a private investment company) and Banco Itau (a leading Brazilian bank). AOLA provides online services principally to customers in Brazil, Mexico, Puerto Rico and Argentina. During 2005, AOLA filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code and has announced that it intends to liquidate, sell or wind up its operations. For the year ended December 31, 2005, the Company recorded a $24 million noncash goodwill impairment charge related to the wind down of AOLA s operations. The Company has no obligation to provide additional funding for AOLA s operations, and the creditors of AOLA have no recourse to the Company.

In accordance with the transition provisions of FIN 46R, the assets and liabilities of AOLA were recorded in the Company s consolidated balance sheet as of March 31, 2004, in the amounts at which they would have been carried if FIN 46R had been effective when the Company first met the conditions to be considered the primary beneficiary of AOLA. Upon consolidating the balance sheet of AOLA, the Company recorded incremental assets of approximately $85 million and liabilities of $29 million, with the difference of $56 million recognized as the pretax cumulative effect of an accounting change ($34 million on an after-tax basis). Prior periods have not been restated. The Company consolidated the operating results of AOLA s operations commencing April 1, 2004. In order to provide the time necessary to consolidate and evaluate the AOLA financial information, the AOLA financial statements are consolidated by the Company on a one-quarter time lag. For the year ended December 31, 2005 and 2004, the

Company recognized revenues of $50 million and $40 million, respectively, and an Operating Loss of $11 million and $20 million, respectively, associated with AOLA.

At December 31, 2005, the Company had two entities deemed to be VIEs for which the Company is not considered the primary beneficiary. At December 31, 2005, these entities had total assets of $35 million and total liabilities of $30 million. In addition, in 2005 these entities had total revenues of $159 million and a net loss of $85 million.

TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Summary of Significant Accounting Policies

Cash and Equivalents

Cash equivalents consist of commercial paper and other investments that are readily convertible into cash and have original maturities of three months or less. Cash equivalents are carried at cost, which approximates fair value.

Restricted Cash

In 2004, as part of the Company s settlement with the DOJ, the Company established a $150 million fund to be used to settle any related shareholder or securities litigation. The fund was reflected as Restricted cash on the Company s accompanying consolidated balance sheet at December 31, 2004. During October 2005, the $150 million was transferred by the Company into the MSBI Settlement Fund for the members of the class covered by the consolidated securities class action as described in Note 17.

Investments

Investments in companies in which Time Warner has significant influence, but less than a controlling voting interest, are accounted for using the equity method. This is generally presumed to exist when Time Warner owns between 20% and 50% of the investee. However, in certain circumstances, Time Warner s ownership percentage exceeds 50% but the Company accounts for the investment using the equity method because the minority shareholders hold certain rights that allow them to participate in certain operations of the business.

Under the equity method, only Time Warner s investment in and amounts due to and from the equity investee are included in the consolidated balance sheet; only Time Warner s share of the investee s earnings (losses) is included in the consolidated operating results; and only the dividends, cash distributions, loans or other cash received from the investee, additional cash investments, loan repayments or other cash paid to the investee are included in the consolidated cash flows. In circumstances in which the Company s ownership in an investee is in the form of a preferred security or otherwise senior security, Time Warner s share in the investee s income or loss is determined by applying the equity method of accounting using the hypothetical- liquidation-at-book-value method. Under the hypothetical-liquidation-at-book-value method, the investor s share of earnings or losses is determined based on changes in the investor s claim in the book value of the investee. Additionally, the carrying value of investments accounted for using the equity method of accounting is adjusted downward to reflect any other-than-temporary declines in value (see Asset Impairments below).

Investments in companies in which Time Warner does not have a controlling interest or is unable to exert significant influence are accounted for at market value if the investments are publicly traded and any resale restrictions are less than one year (available-for-sale investments). If there are resale restrictions greater than one year or if the investment is not publicly traded then the investment is accounted for at cost. Unrealized gains and losses on investments accounted for at market value are reported, net-of-tax, in the accompanying consolidated statement of shareholders equity as a component of Accumulated other comprehensive income, net until the investment is sold or considered impaired (see Asset Impairments below), at which time the realized gain or loss is included in Other income, net. Dividends and other distributions of earnings from both at-market-value investments and investments accounted for at cost are included in Other income, net when declared.

Accounts Receivable Securitization Facilities

Time Warner has certain accounts receivable securitization facilities that provide for the accelerated receipt of cash on available accounts receivable. These securitization transactions are accounted for as sales in accordance with FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement No. 125 (FAS 140), because the Company has relinquished control of the receivables. For further information, see Note 8.

Derivative Instruments

The Company accounts for derivative instruments in accordance with FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133), FASB Statement No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities an amendment of FASB Statement No. 133 (FAS 138), and FASB Statement No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities (FAS

149). These pronouncements require that all derivative instruments be recognized on the balance sheet at fair value. In addition, these pronouncements provide that for derivative instruments that qualify for hedge accounting, changes in the fair value will either be offset against the change in fair value of the hedged assets,

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TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

liabilities or firm commitments through earnings or recognized in shareholders equity as a component of accumulated other comprehensive income, net until the hedged item is recognized in earnings, depending on whether the derivative is being used to hedge changes in fair value or cash flows. The ineffective portion of a derivative s change in fair value will be immediately recognized in earnings. The Company uses derivative instruments principally to manage the risk associated with movements in foreign currency exchange rates, the risk that changes in interest rates will affect the fair value or cash flows of its debt obligations and equity price risk in the Company s investment holdings. See Note 15 for additional information regarding derivative instruments held by the Company and risk management strategies.

Financial Instruments

Based on the level of interest rates prevailing at December 31, 2005, the fair value of Time Warner s fixed-rate debt exceeded its carrying value by $1.531 billion (Note 8). Additionally, certain differences exist between the carrying value and fair value of the Company s other financial instruments; however, these differences are not significant at December 31, 2005. The fair value of financial instruments is generally determined by reference to market values resulting from trading on a national securities exchange or in an over-the-counter market. In cases where quoted market prices are not available, fair value is based on estimates using present value or other valuation techniques.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Additions to property, plant and equipment generally include material, labor and overhead. Depreciation, which includes amortization of capital leases, is provided generally on the straight-line method over useful lives ranging up to 40 years for buildings and related improvements and up to 16 years for furniture, fixtures and other equipment. For cable television plant upgrades and cable converters and modems, depreciation is provided generally over useful lives of 16 and 3-4 years, respectively. Time Warner evaluates the depreciation periods of property, plant and equipment to determine whether events or circumstances warrant revised estimates of useful lives. Property, plant and equipment, including capital leases, consists of:

	December 31,	
	2005	2004
	(restated, millions)	
Land and buildings	$ 3,292	$ 3,203
Cable television equipment	11,415	10,168
Furniture, fixtures and other equipment	7,461	6,631
	22,168	20,002
Less accumulated depreciation	(8,509)	(6,932)
Total	$ 13,659	$ 13,070

Capitalized Software Costs

Time Warner capitalizes certain costs incurred for the development of internal use software. These costs, which include the costs associated with coding, software configuration, upgrades and enhancements, are included in Property, plant and equipment in the accompanying consolidated balance sheet.

AOL s subscription services are comprised of various features, which contribute to the overall functionality of the services. AOL capitalizes costs incurred for the production of computer software that generates the functionality within its products. Capitalized costs typically include direct labor and related overhead for software produced by AOL, as well as the cost of software purchased from third parties. Costs incurred for a product prior to the determination that the product is technologically feasible (research and development costs), as well as maintenance costs for established products, are expensed as incurred. Once technological feasibility has been established, such costs are capitalized until the software has completed testing and is mass-marketed. Amortization is provided on a product-by-product basis using the greater of the straight-line method or the current year revenue as a percentage of

total revenue estimates for the related software product, not to exceed five years, commencing the month after the date of the product release. Included in costs of revenues are research and development costs totaling $123 million in 2005, $134 million in 2004 and $139 million in 2003. The total net book value of capitalized software costs was $189 million and $237 million as of December 31, 2005 and December 31, 2004, respectively. Such amounts are included in Other assets in the accompanying consolidated balance sheet. Amortization of capitalized software costs was $165 million in 2005, $210 million in 2004 and $194 million in 2003.

TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Intangible Assets

As a creator and distributor of branded information and copyrighted entertainment products, Time Warner has a significant number of intangible assets, including cable television and sports franchises, film and television libraries and other copyrighted products, trademarks and customer subscriber lists. In accordance with GAAP, Time Warner does not recognize the fair value of internally generated intangible assets. Costs incurred to create and produce copyrighted product, such as feature films and television series, generally are either expensed as incurred or capitalized as tangible assets, as in the case of cash advances and inventoriable product costs. However, accounting recognition is not given to any increase in asset value that may be associated with the collection of the underlying copyrighted material. Additionally, costs incurred to create or extend brands, such as magazine titles and new television networks, generally result in losses over an extended development period and are recognized as a reduction of income as incurred, while any corresponding brand value created is not recognized as an intangible asset in the consolidated balance sheet. However, intangible assets acquired in business combinations accounted for under the purchase method of accounting are recorded at fair value on the Company s consolidated balance sheet.

Asset Impairments

Investments

The Company s investments consist of fair-value investments, including available-for-sale investments, investments accounted for using the cost method of accounting and investments accounted for using the equity method of accounting. The Company regularly reviews its investment securities for impairment based on criteria that include the extent to which carrying value exceeds its related market value, the financial condition of the investee, and the intent and ability to retain the investment for a sufficient period of time to allow for recovery in the market value of the investments. For more information, see Note 6.

Long-Lived Assets

Long-lived assets are tested for impairment whenever events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Determining the extent of an impairment, if any, typically requires various estimates and assumptions including cash flows directly attributable to the asset, the useful life of the asset and residual value, if any. When necessary, we use internal cash flow estimates, quoted market prices and appraisals, as appropriate, to determine fair value.

Goodwill and Indefinite-Lived Intangible Assets

Goodwill and other indefinite-lived intangible assets, primarily certain franchise assets, trademarks and brand names, are tested annually as of December 31 and whenever events or circumstances make it more likely than not that an impairment may have occurred, such as a significant adverse change in the business climate or a decision to sell or dispose of the unit. Estimating fair value is performed by utilizing various valuation techniques, with the primary technique being a discounted cash flow. The use of a discounted cash flow model often involves the use of significant estimates and assumptions. For more information, see Note 2.

Accounting for Pension Plans

Time Warner and certain of its subsidiaries have defined benefit pension plans covering a majority of domestic employees and, to a lesser extent, international employees. Pension benefits are based on formulas that reflect the employees years of service and compensation during their employment period and participation in the plans. The pension expense recognized by the Company is determined using certain assumptions, including the expected long-term rate of return on plan assets, the discount rate used to determine the present value of future pension benefits and the rate of compensation increases. The determination of these assumptions is discussed in more detail in Note 13.

Revenues and Costs

AOL

Subscription revenues are recognized over the period that services are provided. Advertising and Other revenues are recognized as the services are performed or when the goods are delivered. AOL generates Advertising revenues by directly selling advertising or through transaction-based arrangements. Advertising revenues related to advertising sold by AOL is generally categorized into two types of contracts: standard and nonstandard. The revenues derived

from standard advertising contracts, in which AOL provides a

TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

minimum number of impressions for a fixed fee, are recognized as the impressions are delivered. The revenues derived from nonstandard advertising contracts, which provide carriage, advisory services, premier placements and exclusivities, navigation benefits, brand affiliation and other benefits, are recognized on a straight-line basis over the term of the contract, provided that AOL is meeting its obligations under the contract (e.g., delivery of impressions). In cases where refund arrangements exist, upon the expiration of the condition related to the refund, revenue directly related to the refundable fee is recognized on a straight-line basis over the remaining term of the agreement. Transaction-based arrangements generally involve either arrangements in which AOL performs advertising and promotion through prominent display of a customer s content or search results on one of AOL s services, or arrangements in which AOL s Advertising.com, Inc. (Advertising.com) subsidiary purchases and resells advertising on a third-party website. As compensation for display of a partner s content or search results, AOL is paid a share of the partner s advertising revenues. For performance-based advertising, AOL is paid an agreed to fee based on customer specified results, such as registrations or sales leads. Advertising revenues related to these transaction-based arrangements is recognized when the amount is determinable (i.e., generally when performance reporting is received from the partner). Deferred revenue consists primarily of prepaid advertising fees and monthly and annual prepaid subscription fees billed in advance.

For promotional programs in which consumers are typically offered a subscription to AOL s subscription services at no charge as a result of purchasing a product from the commerce partner, AOL records Subscription revenues, based on net amounts received from the commerce partner, if any, on a straight-line basis over the term of the service contract with the subscriber.

The accounting rules for advertising barter transactions require that historical cash advertising of a similar nature exist in order to support the recognition of advertising barter revenues. The criteria used by the accounting rules used to determine if a barter and cash transaction are considered similar include circulation, exposure or saturation within an intended market, timing, prominence, demographics and duration. In addition, when a cash transaction has been used to support an equivalent quantity and dollar amount of barter revenues, the same cash transaction cannot serve as evidence of fair value for any other barter transaction. While not required by the accounting rules, AOL management adopted a more conservative policy by establishing an additional size criterion to the determination of similar. Pursuant to such criterion, beginning in the second quarter of 2003, an individual cash advertising transaction of comparable average value or higher value must exist in order for revenue to be recognized on an intercompany advertising barter transaction. Said differently, no intercompany advertising barter revenue is recognized if a cash advertising transaction of comparable average value or higher value has not been entered into in the past six months, even if all of the other accounting criteria have been satisfied.

Cable

Subscriber fees (for video programming, high-speed data and Digital Phone) are recorded as revenue in the period that the service is provided, and Advertising revenues, including advertising purchased by programming vendors, are recognized in the period that the advertisements are exhibited. Video programming costs are recognized as the services are provided based on TWC Inc. s contractual agreements with programming vendors. However, circumstances may arise for which management is required to estimate the programming costs due to the expiration of a programming contract. During periods in which a programming contract has expired and TWC Inc. continues to carry the programming vendor, management must utilize its best judgment to record the appropriate amount of programming expense. When the programming contract terms are finalized, an adjustment to programming expense is recorded, if necessary, to reflect the terms of the new contract. Management must also make estimates in the recognition of programming expense related to other items, such as the accounting for free periods, most favored nation clauses and service interruptions.

Launch fees received by the Company from programming vendors are recognized as a reduction of expense on a straight-line basis over the life of the related programming arrangement. Fees received from programming vendors representing the reimbursement of marketing costs specifically incurred by TWC Inc. in promoting the programming service are recognized as a reduction in marketing expense as the marketing services are provided.

Publishing

Magazine Subscription and Advertising revenues are recognized at the magazine cover date. The unearned portion of magazine subscriptions is deferred until the magazine cover date. Upon cover date, a proportionate share of the gross subscription price is included in revenues, net of any commissions paid to subscription agents. Also included in Subscription revenues are revenues generated from single-copy sales of magazines through retail outlets such as newsstands, supermarkets, convenience stores and drugstores, which may or may not result in future subscription sales.

TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Certain products, such as books and other merchandise, are sold to customers with the right to return unsold items. Revenues from such sales are recognized when the products are shipped, based on gross sales less a provision for future estimated returns based on historical experience.

Inventories of books and other merchandise are stated at the lower of cost or estimated realizable value. Cost is determined using primarily the first-in, first-out method, or alternatively the average cost method. Returned goods included in inventory are valued at estimated realizable value, but not in excess of cost. See Note 7 for additional discussion of inventory.

Networks

The Networks segment recognizes Subscription revenues as services are provided based on the per subscriber negotiated contractual programming rate for each affiliate and the estimated number of subscribers at the respective affiliate.

In the normal course of business, the Networks segment enters into long-term license agreements to acquire programming rights. An asset and liability related to these rights are created (on a discounted basis) when (i) the cost of each program is reasonably determined, (ii) the program material has been accepted in accordance with the terms, and (iii) the program is available for its first showing or telecast. As discussed below, there are slight variations in the accounting depending on whether the network is advertising supported (e.g., TNT, TBS, The WB Television Network (The WB Network) or not advertising supported (e.g., HBO).

For advertising-supported networks, the Company s general policy is to amortize the programming costs on a straight-line basis (or per play basis if greater) over the licensing period. There are, however, exceptions to this general rule. For example, because of the significance of the rights fees paid for sports programming licensing arrangements (e.g., NBA and MLB), programming costs are amortized using an income-forecast model, in which total revenue generated under the sports programming is estimated and the costs associated with this programming are amortized as revenue is earned, based on the relationship that the programming costs bear to total estimated revenues, which approximates the pattern with which the network will utilize and benefit from providing the sports programming. In addition, based on historical advertising sales, the Company believes that, for certain types of programming, the initial airing has more value than subsequent airings. In these circumstances, the Company will use an accelerated method of amortization. Additionally, if the Company is licensing the right to air a movie multiple times over a certain period and the movie is being shown to the public for the first time on a Company network (a Premiere Movie), a portion of the licensing cost is amortized on the initial airing of the movie, with the remaining cost amortized on a straight-line basis (or per play basis, if greater) over the remaining licensing period. The determination of the amount of amortization to accelerate in the first showing versus subsequent showings has been determined based on a study of historical advertising sales for similar programming.

For a premium cable network that is not advertising supported (e.g., HBO), programming costs are generally amortized on a straight-line basis in the year that the related shows are exhibited. When the Company has the right to exhibit feature theatrical programming in multiple windows over a number of years, the Company uses historical audience performance as its basis for determining the amount of a film s programming amortization attributable to each window.

The Company records programming arrangements (e.g., film inventory, sports rights, etc.) at the lower of unamortized cost or estimated net realizable value. For broadcast television networks (e.g., The WB Network) whose primary source of revenue is advertising, the Company estimates the net realizable value of unamortized cost based on the estimated advertising that can be sold during the season in which the package of programming is aired. For cable networks (e.g., TBS, TNT, etc.), that earn both Advertising and Subscription revenues, the Company evaluates the net realizable value of unamortized cost based on the package of programming provided to the subscribers by the network. Specifically, in determining whether the programming arrangements for a particular network are impaired, the Company determines the net realizable value for all of the network s programming arrangements based on a projection of the network s estimated combined subscription revenues and advertising revenues. Similarly, given the premise that customers subscribe to a premium service because of the overall quality of its programming, the

Company performs its evaluation of the net realizable value of unamortized programming costs based on the package of programming provided to the subscribers by the network. Specifically, the Company determines the net realizable value for all of its premium service programming arrangements based on projections of estimated subscription revenues.

Filmed Entertainment

Feature films are produced or acquired for initial exhibition in theaters, followed by distribution in the pay-per-view, home video, pay cable, basic cable, broadcast network and syndicated television markets. Generally, distribution to the theatrical, home video, pay cable and broadcast network markets is completed principally within three years of initial release. Thereafter, feature films are

TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

distributed to the basic cable and syndicated television markets. Theatrical revenues are recognized as the films are exhibited. Revenues from home video sales are recognized at the later of the delivery date or the date that video units are made widely available-for-sale or rental by retailers based on gross sales less a provision for estimated future returns. Revenues from the distribution of theatrical product to cable, broadcast network and syndicated television markets are recognized when the films are available to telecast.

Television films and series are initially produced for broadcast networks, cable networks or first-run television syndication and may be subsequently licensed to foreign or domestic cable and syndicated television markets, as well as sold on home video. Revenues from the distribution of television product are recognized when the films or series are available to telecast, except for barter agreements where the recognition of revenue is deferred until the related advertisements are exhibited. Similar to theatrical home video sales, revenue from home video sales of television films and series is recognized at the later of the delivery date or the date that video units are made widely available-for-sale or rental by retailers less a provision for estimated returns.

License agreements for the telecast of theatrical and television product in the cable, broadcast network and syndicated television markets are routinely entered into well in advance of the available date for telecast, which is generally determined by the telecast privileges granted under previous license agreements. Accordingly, there are significant contractual rights to receive cash and barter under these licensing agreements. For cash contracts, the related revenues (which are discounted based on when cash will be collected) will not be recognized until such product is available for telecast under the contractual terms of the related license agreement. For barter contracts, the related revenues will not be recognized until the product is available for telecast and the advertising spots received under such contracts are either used or sold to third parties. All of these contractual rights for which revenue is not yet recognizable are referred to as backlog.

Inventories of theatrical and television product consist of videocassettes, DVDs and compact video discs and are stated at the lower of cost or net realizable value. Returned goods included in inventory are valued at estimated realizable value, but not in excess of cost.

Film costs include the unamortized cost of completed theatrical films and television episodes, theatrical films and television series in production and film rights acquired for the home video market. Film costs principally consist of direct production costs, production overhead, development and pre-production costs, and are stated at the lower of cost, less accumulated amortization, or fair value. The amount of capitalized film costs recognized as cost of revenues for a given film as it is exhibited in various markets, throughout its life cycle, is determined using the film forecast method. Under this method, the amount of capitalized costs recognized as expense is based on the proportion of the film s revenues recognized for such period to the film s estimated remaining ultimate revenues. Similarly, the recognition of expenses for participations and residuals is recognized based on the proportion of the film s revenues recognized for such period to the film s estimated remaining ultimate revenues. These estimates are revised periodically and losses, if any, are provided in full. See Note 7 for additional details of film costs.

From time to time, the Company enters into arrangements with third parties to jointly finance theatrical production. These arrangements, which are referred to as co-financing arrangements, take various forms; however, in most cases, the form of the arrangements is the sale of a copyright interest in a film to a joint venture investor. The Filmed Entertainment segment records the amounts received for the sale of the copyright interest as a reduction of the cost of the film, as such investors assume full risk for that portion of the film asset acquired in these transactions.

A portion of the costs of acquiring Historic TW Inc. (Historic TW) in 2001 and of acquiring the remaining Time Warner Entertainment Company, L.P. (TWE) content assets in 2003 were allocated to theatrical and television product, including purchased program rights and product that had been exhibited at least once in all markets (Library). Library product is amortized in amortization expense using the film-forecast method. See Note 2 for additional details of Library.

Barter Transactions

Time Warner enters into transactions that either exchange advertising for advertising (Advertising Barter) or advertising for other products and services (Non-advertising Barter). Advertising Barter transactions are recorded at

the lesser of estimated fair value of the advertising received or given in accordance with the provisions of EITF Issue No. 99-17, Accounting for Advertising Barter Transactions. Revenue from barter transactions is recognized when advertising is provided, and services received are charged to expense when used. Revenues for Non-advertising Barter transactions are recognized at the estimated fair value when the product is available for telecast and the advertising spots received under such contracts are either used or sold to third parties. Revenue from barter transactions is not material to the Company s consolidated statement of operations for any of the periods presented herein.

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TIME WARNER INC.
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Multiple-Element Transactions

Multiple-element transactions within Time Warner fall broadly into three categories:

1. Contemporaneous purchases and sales. The Company sells a product or service (e.g., advertising services) to a customer and at the same time purchases goods or services and/or makes an investment in that customer.

2. Sales of multiple products or services. The Company sells multiple products or services to a counterparty (e.g., Cable sells video, digital phone and high-speed Internet access services to a customer).

3. Purchases of multiple products or services, or the settlement of an outstanding item contemporaneous with the purchase of a product or service. The Company purchases multiple products or services from a counterparty (e.g., the Networks segment licenses a group of films from a counterparty to show over a period of time).

Contemporaneous Purchases and Sales

In the normal course of business, Time Warner enters into transactions in which it purchases a product or service and/or makes an investment in a customer and at the same time negotiates a contract for the sale of advertising, or other product, to the customer. Contemporaneous transactions may also involve circumstances where the Company is purchasing or selling goods and services and settling a Company dispute. For example, the AOL segment may have negotiated for the sale of advertising at the same time it purchased goods or services and/or made an investment in a counterparty. Similarly, when negotiating programming arrangements with cable networks, the Company s Cable segment may negotiate for the sale of advertising to the cable network.

Arrangements, although negotiated contemporaneously, may be documented in one or more contracts. In accounting for such arrangements, the Company looks to the guidance contained in the following authoritative literature:

APB Opinion No. 29, Accounting for Nonmonetary Transactions (APB 29);

FASB Statement 153, Exchanges of Nonmonetary Assets an amendment of APB Opinion No. 29 (FAS 153);

Emerging Issues Task Force (EITF) Issue No. 01-09, Accounting for Consideration Given by a Vendor to a Customer (EITF 01-09); and

EITF Issue No. 02-16, Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor (EITF 02-16).

The Company accounts for each transaction negotiated contemporaneously based on the respective fair values of the goods or services purchased and the goods or services sold. If the Company is unable to determine the fair value of one or more of the elements being purchased, revenue recognition is limited to the total consideration received for the products or services sold less supported payments. For example, if the Company sells advertising to a customer for $10 million in cash and contemporaneously enters into an arrangement to acquire software for $2 million from the same customer, but fair value for the software cannot be reliably determined, the Company would limit the recognized advertising revenue to $8 million and would ascribe no value to the software acquisition. As another example, if the Company sells advertising to a customer for $10 million in cash and contemporaneously invests $2 million in the equity of that same customer at fair value, the Company would recognize advertising revenue of $10 million and would ascribe $2 million to the equity investment. Accordingly, the judgments made in determining fair value in such arrangements impact the amount and period in which revenues, expenses and net income are recognized over the term of the contract.

In determining the fair value of the respective elements, the Company refers to quoted market prices (where available), historical transactions or comparable cash transactions. In addition, the existence of price protection in the form of most favored nation clauses or similar contractual provisions are generally indicative that the stated terms of a transaction are at fair value.

Further, in a contemporaneous purchase and sale transaction, evidence of fair value for one element of a transaction may provide support for the fair value of the other element of a transaction. For example, if the Company sells advertising to a customer and contemporaneously invests in the equity of that same customer, evidence of the fair value of the investment may implicitly support the fair value of the advertising sold, since there are only two elements in the arrangement.

TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Sales of Multiple Products or Services

The Company s policy for revenue recognition in instances where multiple deliverables are sold contemporaneously to the same counterparty is in accordance with EITF Issue No. 00-21, Revenue Arrangements with Multiple Deliverables, and SEC Staff Accounting Bulletin No. 104, Revenue Recognition. Specifically, if the Company enters into sales contracts for the sale of multiple products or services, then the Company evaluates whether it has objective fair value evidence for each deliverable in the transaction. If the Company has objective fair value evidence for each deliverable of the transaction, then it accounts for each deliverable in the transaction separately, based on the relevant revenue recognition accounting policies. However, if the Company is unable to determine objective fair value for one or more undelivered elements of the transaction, the Company generally recognizes revenue on a straight-line basis over the term of the agreement. For example, the AOL division might enter into an agreement for broadband service that includes AOL providing a modem in connection with the service and the subscriber paying an upfront fee as well as monthly charges. Because AOL is providing both a product and a service, revenue is allocated to the modem and service based on relative fair value.

Purchases of Multiple Products or Services

The Company s policy for cost recognition in instances where multiple products or services are purchased contemporaneously from the same counterparty is consistent with its policy in instances where the Company sells multiple deliverables to a customer. Specifically, if the Company enters into a contract for the purchase of multiple products or services, the Company evaluates whether it has objective fair value evidence for each product or service being purchased. If the Company has objective fair value evidence for each product or service being purchased, it accounts for each separately, based on the relevant cost recognition accounting policies. However, if the Company is unable to determine objective fair value for one or more of the purchased elements, the Company generally recognizes the cost of the transaction on a straight-line basis over the term of the agreement. For example, the Networks segment licenses from a film production company the rights to a group of films and episodic series to run as content on its segment. Because the Networks segment is purchasing multiple products that will be aired over varying times and periods, the cost is allocated among the films and episodic series based on the relative fair value of each product being purchased. Each allocated amount is then accounted for in accordance with the Networks segment s accounting policy for that specific type of deliverable.

This policy would also apply in instances where the Company settles an outstanding disagreement at the same time the Company purchases a product or service from that same counterparty. For example, the Cable segment settles a dispute on an existing programming contract with a programming vendor at the same time that it is renegotiating a new programming contract with the same programming vendor. Because the Cable segment is making payments for both the settlement of an existing programming contract and for carriage under a new programming contract, the amount agreed to be paid is allocated between the settlement of the preexisting programming contract and the carriage under the new programming contract. The amount allocated to the settlement of the preexisting programming contract would be recognized immediately, whereas the amount allocated to the carriage under the new programming contract would be accounted for prospectively, consistent with the accounting for other similar programming agreements.

Gross versus Net Revenue Recognition

In the normal course of business, the Company acts as or uses an intermediary or agent in executing transactions with third parties. Pursuant to EITF No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, such transactions are recorded on a gross or net basis depending on whether the Company is acting as the principal in a transaction or acting as an agent in the transaction. The Company serves as the principal in transactions in which it has substantial risks and rewards of ownership and, accordingly, records revenue on a gross basis. For those transactions in which the Company does not have substantial risks and rewards of ownership, the Company is considered an agent in the transaction and, accordingly, records revenue on a net basis. To the extent that revenues are recorded on a gross basis, any commissions or other payments to third parties are recorded as expenses so that the net amount (gross revenues less expenses) is reflected in Operating Income. Accordingly, the impact on Operating Income is the same whether the Company records revenue on a gross or net basis.

Advertising Costs

Time Warner expenses advertising costs as they are incurred, which is when the advertising is exhibited or aired. Advertising expense to third-parties was $5.171 billion in 2005, $4.942 billion in 2004 and $4.517 billion in 2003. In addition, the Company had advertising costs of $129 million at December 31, 2005 and $145 million at December 31, 2004 recorded in Prepaid and other current assets on its consolidated balance sheet, which primarily related to prepaid advertising.

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TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Income Taxes

Income taxes are provided using the asset and liability method prescribed by FASB Statement No. 109, Accounting for Income Taxes. Under this method, income taxes (i.e., deferred tax assets, deferred tax liabilities, taxes currently payable/refunds receivable and tax expense) are recorded based on amounts refundable or payable in the current year and include the results of any difference between GAAP and tax reporting. Deferred income taxes reflect the tax effect of net operating loss, capital loss and general business credit carryforwards and the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial statement and income tax purposes, as determined under enacted tax laws and rates. Valuation allowances are established when management determines that it is more likely than not that some portion or all of the deferred tax asset will not be realized. The financial effect of changes in tax laws or rates is accounted for in the period of enactment. The subsequent realization of net operating loss and general business credit carryforwards acquired in acquisitions accounted for using the purchase method of accounting is recorded as a reduction of goodwill. Investment tax credits earned are offset against the cost of inventory or property acquired or produced. Research and development credits are recorded based on the amount of benefit the Company believes is probable of being earned. The majority of such research and development benefits were recorded to shareholders equity as they resulted from stock option deductions for which such amounts are recorded as an increase to additional paid-in-capital.

Comprehensive Income (Loss)

Comprehensive income (loss) is reported on the accompanying consolidated statement of shareholders equity as a component of retained earnings (accumulated deficit) and consists of net income (loss) and other gains and losses affecting shareholders equity that, under GAAP, are excluded from net income (loss). For Time Warner, such items consist primarily of unrealized gains and losses on marketable equity investments, gains and losses on certain derivative financial instruments, foreign currency translation gains (losses) and unfunded accumulated benefit obligations.

The following summary sets forth the components of other comprehensive income (loss), net of tax, accumulated in shareholders equity (in millions):

	Foreign Currency Translation Gains (Losses)[a]	Net Unrealized Gains (Losses) on Securities	Net Derivative Financial Instrument Gains (Losses)	Net Unfunded Accumulated Benefit Obligation	Net Accumulated Other Comprehensive Income (Loss)
Balance at December 31, 2002	$ (328)	$ 122	$ (27)	$ (319)	$ (552)
2003 activity	(77)	(50)	(6)	270	137
Balance at December 31, 2003	(405)	72	(33)	(49)	(415)
2004 activity	(66)	582	1	4	521
Balance at December 31, 2004	(471)	654	(32)	(45)	106
2005 activity	430	(603)	22	(19)	(170)
Balance at December 31, 2005	$ (41)	$ 51	$ (10)	$ (64)	$ (64)

(a)

2005 includes an adjustment of $439 million for foreign currency translation related to goodwill and intangible assets, including amounts that relate to prior periods (Note 2).

Stock-Based Compensation

The Company follows FAS 123, and FASB Statement No. 148, Accounting for Stock-Based Compensation, Transition and Disclosure. The provisions of FAS 123 allow companies either to expense the estimated fair value of stock options or to continue to follow the intrinsic value method set forth in APB 25, but disclose the pro forma effect on net income (loss) had the fair value of the options been expensed. Time Warner has elected to continue to apply APB 25 in accounting for its stock option incentive plans.

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TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company uses the attribution method under FASB Interpretation No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option Award Plans, in recognizing any compensation cost for its stock option incentive plans under APB 25 and in the FAS 123 pro forma disclosure below. Had compensation cost for Time Warner s stock option plans been determined based on the fair value method set forth in FAS 123 (or FAS 123R, which will be adopted on January 1, 2006), Time Warner s net income and basic and diluted net income per common share would have been changed to the pro forma amounts indicated below:

	Years Ended December 31,		
	2005	2004	2003
	(restated, millions, except per share amounts)		
Net income, as reported	$ 2,921	$ 3,394	$ 2,657
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(184)	(298)	(548)
Pro forma net income	$ 2,737	$ 3,096	$ 2,109
Basic net income per share:			
As reported	$ 0.63	$ 0.74	$ 0.59
Pro forma	$ 0.59	$ 0.68	$ 0.47
Diluted net income per share:			
As reported	$ 0.62	$ 0.72	$ 0.57
Pro forma	$ 0.58	$ 0.66	$ 0.46

For purposes of applying FAS 123 for the 2005 period, the Company has refined certain of its valuation approaches and inputs and believes such refinements are consistent with valuation techniques required under FAS 123R. As guidance and interpretations in the area of equity-based compensation evolve, the Company will continually assess its methodologies and processes in this area to ensure compliance with FAS 123R. Before the first quarter of 2005, the Company estimated the expected term of an option by computing the average period of time such options would remain outstanding from the grant date to the exercise date. The historical expected term was previously computed by segregating the employee base into two groups (senior executives and all other employees). Beginning in the first quarter of 2005, the Company began to use historical exercise patterns of previously granted options in relation to stock price movements to derive an employee behavioral pattern used to forecast expected exercise dates. In evaluating expected employee exercise behavior and related expected exercise dates, the Company separated employees into four groups based on the number of options they were granted. The weighted average expected term assumption used for 2005 was 4.79 years from the date of grant as compared to 3.60 years from the date of grant for 2004 and 3.11 years from the date of grant in 2003. In addition, historically during 2004, the volatility assumption was calculated using an average of historic and implied volatilities. Expected volatility in 2003 was based on historic volatilities. Beginning in the first quarter of 2005, the Company determined the volatility assumption using implied volatilities based primarily on traded Time Warner options. The weighted average volatility assumption used for 2005 was 24.5% as compared to a weighted average volatility assumption of 34.9% for 2004 and 53.9% for 2003. Had the Company used the methodologies employed in 2004 to estimate stock option valuation assumptions, the weighted average fair value of an option granted in 2005 would have increased by approximately 1%.

Historically, the Company recognized pro forma stock-based compensation expense related to retirement-age-eligible employees over the award s contractual vesting period. During the first quarter of 2005, based on recent accounting interpretations, the Company recorded a pro forma charge related to the accelerated amortization of the fair value of options granted in prior periods to certain retirement-age-eligible employees with no subsequent substantive service requirement (e.g., no substantive non-compete agreement). As a result, pro forma stock-based compensation expense for the year ended December 31, 2005 reflects approximately $20 million, net of tax, related to the accelerated amortization of the fair value of options granted in prior years to certain retirement-age-eligible employees with no subsequent substantive service requirement. In May 2005, the staff of the SEC announced that companies that previously followed the contractual vesting period approach must continue following that approach prior to adopting FAS 123R and apply the recent accounting interpretation to new grants that have retirement eligibility provisions only upon adoption of FAS 123R. As a result, pro forma stock-based compensation expense related to awards granted subsequent to March 31, 2005 has been determined using the contractual vesting period. For the year ended December 31, 2005, the impact of applying the contractual vesting period approach as compared to the approach noted in the recent accounting interpretations is not significant.

TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Income Per Common Share

Basic income per common share is computed by dividing the net income applicable to common shares after preferred dividend requirements, if any, by the weighted average of common shares outstanding during the period. Weighted-average common shares include shares of Time Warner s common stock and Series LMCN-V common stock. Diluted income per common share adjusts basic income per common share for the effects of convertible securities, stock options, restricted stock and other potentially dilutive financial instruments, only in the periods in which such effect is dilutive.

Set forth below is a reconciliation of basic and diluted income per common share before discontinued operations and cumulative effect of accounting change:

	Years Ended December 31,		
	2005	2004	2003
	(restated, millions, except per share amounts)		
Income before discontinued operations and cumulative effect of accounting change basic and diluted	$ 2,921	$ 3,239	$ 3,164
Average number of common shares outstanding basic	4,648.2	4,560.2	4,506.0
Dilutive effect of stock options and restricted stock	41.4	57.4	55.2
Dilutive effect of mandatorily convertible preferred stock	20.4	77.1	62.5
Average number of common shares outstanding diluted	4,710.0	4,694.7	4,623.7
Income per common share before discontinued operations and cumulative effect of accounting change:			
Basic	$ 0.63	$ 0.71	$ 0.70
Diluted	$ 0.62	$ 0.69	$ 0.68

Reclassifications

Certain reclassifications have been made to the prior years financial information to conform to the 2005 presentation.

2. GOODWILL AND INTANGIBLE ASSETS

As a creator and distributor of branded information and copyrighted entertainment products, Time Warner has a significant number of intangible assets, including cable television and sports franchises, film and television libraries and other copyrighted products, trademarks and customer lists. FAS 142 requires that goodwill and intangible assets deemed to have an indefinite useful life be reviewed for impairment at least annually.

Goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is to identify a potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. The estimates of fair value of a reporting unit, generally the Company s operating segments, are determined using various valuation techniques, with the primary technique being a discounted cash flow analysis. A discounted cash flow analysis requires one to make various judgmental assumptions, including assumptions about future cash flows, growth rates and discount rates. The assumptions about future cash flows and growth rates are based on the Company s operating segments budget and business plans, and varying perpetual growth rate assumptions for periods beyond the long-term business plan period. Discount rate assumptions are based on an assessment of the risk inherent in the future cash flows of the respective reporting units. In estimating the fair values of its reporting units, the Company also uses research analyst estimates, as well as comparable market analyses. If the fair value of a reporting

unit exceeds its carrying amount, goodwill of the reporting unit is not deemed impaired and the second step of the impairment test is not performed. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit s goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit s goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit.

TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The impairment test for other intangible assets not subject to amortization consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. The estimates of fair value of intangible assets not subject to amortization are determined using various discounted cash flow valuation methodologies. The most common among these is a relief from royalty methodology, which is used in estimating the fair value of the Company s brands and trademarks, and income methodologies, which are used to value cable franchises. The income methodology used to value the cable franchises entails identifying the discrete cash flows related to such franchises and discounting them back to the valuation date. Market and income-based methodologies are used to value sports franchises. Significant assumptions inherent in the methodologies employed include estimates of royalty rates and discount rates. Discount rate assumptions are based on an assessment of the risk inherent in the respective intangible assets. Assumptions about royalty rates are based on the rates at which similar brands and trademarks are being licensed in the marketplace.

During 2003, the Company recorded impairment losses of $318 million to reduce the carrying value of certain intangible assets of the Turner winter sports teams and certain goodwill and intangible assets of TWBG, which were recorded at the time of the merger of AOL and Historic TW (the AOL-Historic TW Merger). In addition, in December 2003, the Company recognized an impairment charge of approximately $1.1 billion to reduce the carrying value of the Music segment s intangible assets, which is included in discontinued operations. These impairment charges were computed based on information received during the negotiations for sale of these businesses. The Company determined during its annual impairment reviews for goodwill, which occur in the fourth quarter, that no additional impairments existed at December 31, 2005, 2004 or 2003.

The impairment charges were noncash in nature and did not affect the Company s liquidity or result in non-compliance with respect to any debt covenants.

A summary of changes in the Company s goodwill during the years ended December 31, 2005 and 2004 by reportable segment is as follows (millions):

	December 31, 2004 (restated)	Acquisitions & Adjustments[a]	Impairment[b]	Translation Adjustments[c]	December 31, 2005 (restated)
AOL	$ 3,069	$ (14)	$ (24)	$ 113	$ 3,144
Cable	1,921	(15)			1,906
Filmed Entertainment	5,218	38			5,256
Networks[d]	20,626	128			20,754
Publishing[e]	8,875	256		267	9,398
Total	$ 39,709	$ 393	$ (24)	$ 380	$ 40,458

	December 31, 2003 (restated)	Acquisitions & Adjustments[a]	December 31, 2004 (restated)
AOL[f]	$ 2,826	$ 243	$ 3,069
Cable	1,909	12	1,921
Filmed Entertainment	5,245	(27)	5,218
Networks[d]	20,742	(116)	20,626
Publishing[e]	8,779	96	8,875

Total	$ 39,501	$ 208	$ 39,709

(a) Includes changes in estimates in deferred tax assets and liabilities acquired in purchase business combinations, with the net impact of increasing goodwill by approximately $207 million in 2005 and decreasing goodwill by approximately $219 million in 2004. The adjustments affected multiple segments.

(b) Relates to the $24 million impairment charge of AOLA goodwill in the first quarter of 2005.

(c) Includes an adjustment related to periods prior to January 1, 2005. This adjustment had no impact on consolidated net income or cash flows in the current or any prior period. In addition, the adjustment is not

considered material to the consolidated assets or equity of the current or any prior period.

(d) 2005 primarily includes $174 million related to changes in valuation of net deferred tax liabilities related to historical purchase business combinations offset by a $39 million reduction, net of tax, related to reversals of purchase accounting reserves as well as the adjustments discussed in (a) above. 2004 primarily includes $31 million related to the purchase of the remaining interest in Warner Channel Latin America and $29 million related to the consolidation of Cartoon Network Japan, offset by $25 million related to the sale of the winter sports teams assets as well as the adjustments

discussed in (a) above.

(e) 2005 includes $111 million at the Publishing segment related to the preliminary purchase price allocation for the acquisition of the remaining ownership interest in Essence Communications Partners (Essence) and $75 million related to the preliminary purchase price allocation for the acquisition of Grupo Editorial Expansión as well as the adjustments discussed in (a) above. 2004 primarily includes $94 million related to the purchase of an additional interest in Synapse Group, Inc as well as the adjustments discussed in (a) above.

(f) 2004 primarily includes $269 million related to the purchase of Advertising.com and $24 million related to the

consolidation of AOLA, which was subsequently impaired as discussed in (b) above, as well as the adjustments discussed in (a) above.

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TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company s intangible assets and related accumulated amortization consisted of the following (millions):

	As of December 31, 2005			As of December 31, 2004		
	Gross	Accumulated Amortization[a]	Net	Gross	Accumulated Amortization[a]	Net
Intangible assets subject to amortization:						
Film library	$ 3,967	$ (1,064)	$ 2,903	$ 3,967	$ (830)	$ 3,137
Customer lists and other intangible assets[b]	2,569	(1,950)	619	2,316	(1,561)	755
Total	$ 6,536	$ (3,014)	$ 3,522	$ 6,283	$ (2,391)	$ 3,892
Intangible assets not subject to amortization:						