

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

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

**Form 10-Q/A  
Amendment No. 1**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
for the quarterly period ended March 31, 2006 or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
for the transition period from \_\_\_\_\_ to \_\_\_\_\_  
**Commission file number 001-15062**

**TIME WARNER INC.**  
*(Exact name of Registrant as specified in its charter)*

**Delaware**  
*(State or other jurisdiction of incorporation or organization)*

**13-4099534**  
*(I.R.S. Employer Identification No.)*

**One Time Warner Center  
New York, NY 10019-8016**  
*(Address of Principal Executive Offices) (Zip Code)*  
**(212) 484-8000**  
*(Registrant's Telephone Number, Including Area Code)*

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

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

<b>Description of Class</b>	<b>Shares Outstanding as of April 28, 2006</b>
Common Stock \$.01 par value	4,189,470,241
Series LMCN-V Common Stock \$.01 par value	92,645,036

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**EX-31.1 SECTION 302 CERTIFICATION OF THE PEO**

**EX-31.2 SECTION 302 CERTIFICATION OF THE PFO**

**EX-32 SECTION 906 CERTIFICATION OF THE PEO AND PFO**

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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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The net effect of restating these transactions is that the Company's net income has been increased by \$8 million and \$4 million for the three months ended March 31, 2006 and 2005, respectively.

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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 Quarterly Report on Form 10-Q for the quarter ended March 31, 2006 (the March 2006 Form 10-Q) was filed with the SEC. The Company therefore recommends that this Quarterly Report on Form 10-Q/A be read in conjunction with the Company's reports filed subsequent to the filing date of the March 2006 Form 10-Q.

**Amended Items**

The Company hereby amends the following items, financial statements, exhibits or other portions of the March 2006 Form 10-Q as set forth herein.

**PART I  
FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

The financial information of the Company is amended to read in its entirety as set forth at pages 35 through 67 herein and is incorporated herein by reference.

At the time the Company filed the March 2006 Form 10-Q, 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 March 2006 Form 10-Q 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 Quarterly Report on Form 10-Q-A.

**Item 2. 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 Financial Condition and Results of Operations is amended to read in its entirety as set forth at pages 4 through 34 herein and is incorporated herein by reference.

**PART II  
OTHER INFORMATION**

**Item 6. 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:

- 31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, with respect to the Company's Quarterly Report on Form 10-Q/A for the quarter ended March 31, 2006.
- 31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, with respect to the Company's Quarterly Report on Form 10-Q/A for the quarter ended March 31, 2006.
- 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 Company's Quarterly Report on Form 10-Q/A for the quarter ended March 31, 2006.

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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**TIME WARNER INC.  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION**

**INTRODUCTION**

Management's discussion and analysis of results of operations and financial condition ( MD&A ) is 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 months ended March 31, 2006. 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 financial condition as of March 31, 2006 and cash flows for the three months ended March 31, 2006.

*Caution concerning forward-looking statements.* This section provides a description of the use of forward-looking information appearing in this report, including in MD&A and the consolidated financial statements. Such information is based on management's current expectations about future events, which are inherently susceptible to uncertainty and changes in circumstances. Refer to the Company's 2005 Form 10-K for a discussion of the risk factors for the Company and to Item 1A of this report for an update to such risk factors.

**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 ( GAAP ). 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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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 *Harry Potter* series, *The Lord of the Rings* trilogy and *Wedding Crashers*, as well as television programs, including *ER*, *Two and a Half Men*, *Cold Case* and *Without a Trace*. During the three months ended March 31, 2006, the Company generated revenues of \$10.455 billion (up 1% from \$10.363 billion in 2005), Operating Income before Depreciation and Amortization of \$2.693 billion (up 8% from \$2.485 billion in 2005), Operating Income of \$1.879 billion (up 11% from \$1.689 billion in 2005), Net Income of \$1.463 billion (up 59% from \$919 million in 2005) and Cash Provided by Operations of \$2.330 billion (up 27% from \$1.832 billion in 2005).

**Time Warner Businesses**

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

**AOL.** On April 3, 2006, in connection with an investment by Google Inc. ( Google ) as more fully described below, America Online, Inc. converted to a Delaware limited liability company and changed its name to AOL LLC (together with its subsidiaries, AOL ). AOL operates a leading network of web brands and the largest Internet access subscription service in the United States, with 24.5 million total AOL brand subscribers in the U.S. and Europe at March 31, 2006. AOL reported total revenues of \$1.981 billion (19% of the Company's overall revenues), \$444 million in Operating Income before Depreciation and Amortization and \$277 million in Operating Income for the three months ended March 31, 2006. 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.

The Access business unit offers Internet access and on-line subscription services, primarily dial-up telephone Internet access and the AOL service. The AOL service, offered under a variety of different terms and price plans, generates the substantial majority of AOL's revenues. Over the past several years, the 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 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's network of Internet services and websites through sales of branded advertising and performance-based advertising, including paid-search, as well as from increased utilization and optimization of AOL's advertising inventory.

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

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**OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION (Continued)**

advertising and digital services. AOL Europe has experienced declines in subscribers as consumers have shifted from traditional dial-up plans to highly competitive broadband plans offered by AOL and others, which have lower margins, and this trend is expected to continue.

**Cable.** Time Warner's cable business, Time Warner Cable Inc. and its subsidiaries (TWC), is the second-largest cable operator in the U.S. (in terms of basic cable subscribers). At March 31, 2006, TWC managed approximately 11.039 million basic cable subscribers (including approximately 1.577 million subscribers of unconsolidated investees), in highly clustered and technologically upgraded systems in 27 states. TWC delivered revenues of \$2.580 billion (25% of the Company's overall revenues), \$937 million of Operating Income before Depreciation and Amortization and \$506 million in Operating Income for the three months ended March 31, 2006. As part of the strategy to expand TWC's cable footprint and improve the clustering of its cable systems, TWC, 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). Refer to Recent Developments for further details.

TWC principally offers three products—video, high-speed data and voice. Video is TWC's largest product in terms of revenues generated; however, the potential growth of its customer base within TWC's existing footprint for video cable service is limited, as the customer base has matured and industry-wide competition has increased. Nevertheless, TWC is continuing to increase its video revenues through rate increases, subscriber growth 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's footprint. TWC's digital video subscribers provide a broad base of potential customers for these advanced services. Video programming costs represent a major component of TWC's expenses and are expected to continue to increase, reflecting an expansion of service offerings and contractual rate increases.

High-speed data service has been one of TWC's fastest-growing products over the past several years and is a key driver of its results. TWC 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.

TWC's voice product, Digital Phone, was available to over 88% of TWC's homes passed, and approximately 1.4 million subscribers (including 176,000 subscribers of unconsolidated investees) received the service as of March 31, 2006. 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 intends to offer additional plans with a variety of local and long-distance options. Digital Phone enables TWC 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 expects strong growth in Digital Phone subscribers and revenues for the foreseeable future.

In addition to the subscription services, TWC 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 \$2.779 billion (25% of the Company's overall revenues), \$457 million in Operating Income before Depreciation and Amortization and \$368 million in Operating Income for the three months ended March 31, 2006.

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*).

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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 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 \$2.351 billion (21% of the Company's overall revenues), \$857 million in Operating Income before Depreciation and Amortization and \$788 million in Operating Income for the three months ended March 31, 2006.

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 over four consecutive years, more prime-time viewers watched advertising-supported cable TV networks than the national broadcast networks. For the first quarter of 2006, TNT ranked second among advertising-supported cable networks in prime-time delivery of its key demographics, adults 18-49 and adults 25-54, and first in total day delivery of adults 25-54. TBS ranked second 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. 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, leading to strong ratings and Advertising and Subscription revenue growth, as well as strong brands 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 Recent Developments, on January 24, 2006, Warner Bros. and CBS Corp. ( CBS ) announced an agreement 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 and a number of direct-marketing and direct-selling businesses. The segment generated revenues of \$1.126 billion (10% of the Company's overall revenues), \$116 million in Operating Income before Depreciation and Amortization and \$71 million in Operating Income for the three months ended March 31, 2006.

Time Inc. publishes over 145 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 subscriptions 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



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Media (the U.K.'s largest magazine company, IPC) and the magazine subscription marketer Synapse Group, Inc. In addition, Time Inc. continues to invest in developing digital content, including the launch of Officepirates.com, the redesign of CNNmoney.com and the acquisition of Golf.com. 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.

***Recent Developments***

***AOL-Google Alliance***

During December 2005, the Company announced that AOL is expanding its current strategic alliance with Google to enhance its global online advertising partnership and make more of AOL's content available to Google users. In addition, Google agreed to invest \$1 billion to acquire a 5% equity interest in a limited liability company that owns all of the outstanding equity interests in AOL. On March 24, 2006, the Company and Google signed definitive agreements governing the investment and the commercial arrangements. Under the alliance, Google will continue to provide search technology to AOL's network of Internet properties worldwide and provide AOL with an improved share in revenues generated through search conducted on the AOL network. 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;

Providing AOL \$300 million of marketing credits for promotion of AOL's content on Google-owned Internet properties as well as \$100 million of AOL/Google co-sponsored promotion of AOL properties;

Collaborating in video search and promoting the AOL Video destination within Google Video; and

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

AOL and Google also agreed to collaborate in the future to expand on the alliance, including the possible sale by AOL of display advertising on the Google network.

On April 13, 2006, the Company completed its issuance of a 5% equity interest in AOL to Google for \$1 billion in cash. In accordance with Staff Accounting Bulletin No. 51, *Accounting for the Sales of Stock of a Subsidiary*, Time Warner will recognize a gain of approximately \$800 million, which will be reflected in shareholders' equity, as an adjustment to paid-in capital in the second quarter of 2006.

***The WB Network***

On January 24, 2006, Warner Bros. and CBS announced an agreement 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 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 it will incur restructuring charges ranging from \$25 million to \$30 million related to employee terminations and contractual settlements. In addition, The WB Network may incur up to \$100 million in terminating certain programming arrangements (primarily licensed movie rights), most of which are not expected to be contributed to the new network and may not be sold or utilized in another manner. Included in these costs are approximately \$70 million associated with intercompany programming arrangements with Warner Bros. and New Line. Any costs incurred by The WB Network on such

intercompany programming would be largely offset by amounts recognized by Warner Bros. and New Line, with the impact of all intercompany transactions being eliminated in consolidation. Excluding the impact



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of these intercompany transactions, the anticipated exit costs to the Company of programming arrangements and employee and other contractual arrangements range from approximately \$55 million to \$60 million.

*Adelphia Acquisition Agreement*

On April 20, 2005, a subsidiary of TWC, 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 (the Adelphia Acquisition ).

At the same time that Comcast and TW NY entered into the Adelphia Acquisition agreements, Comcast, TWC and/or their respective affiliates entered into agreements providing for the redemption of Comcast's interests in TWC and Time Warner Entertainment Company, L.P. ( TWE ) (the TWC Redemption Agreement and the TWE Redemption Agreement, respectively, and, collectively, the TWC and TWE Redemption Agreements ). Specifically, Comcast's 17.9% interest in TWC will be redeemed in exchange for 100% of the capital stock of a subsidiary of TWC 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 100% of the equity 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, Comcast and their respective subsidiaries will also swap certain cable systems to enhance their respective geographic clusters of subscribers (the Cable Swaps ).

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

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 certain local franchise approvals, as well as completion of the bankruptcy process. The parties expect to close the Adelphia Acquisition on or before July 31, 2006.

The closing of the Adelphia Acquisition is not dependent on the closing of the Cable Swaps or the transactions contemplated by the TWC 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 stock at TWC's discretion.

Pursuant to registration rights granted to Comcast and certain of its affiliates in conjunction with the restructuring of TWE in 2003, TWC has an obligation to file a shelf registration statement with the Securities and Exchange Commission ( SEC ) by June 1, 2006 covering all the shares of TWC Class A Common Stock held by Comcast and its affiliates if the transactions contemplated by the TWC Redemption Agreement have not occurred as of such date.

*Common Stock Repurchase Program*

Time Warner's Board of Directors has authorized a common stock repurchase program that allows the Company 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



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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, as defined, of approximately 3-to-1, and expects it will have purchased 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 May 2, 2006, the Company repurchased approximately 460 million shares of common stock for approximately \$8.0 billion pursuant to trading programs under Rule 10b5-1 of the Securities Exchange Act of 1934, as amended.

*Sale of Time Warner Book Group*

On March 31, 2006, the Company sold Time Warner Book Group ( TWBG ) to Hachette Livre SA ( Hachette ), a wholly-owned subsidiary of Lagardère SCA ( Lagardère ) for \$532 million in cash resulting in a pretax gain of approximately \$206 million, after taking into account selling costs and estimated working capital adjustments. As a result of the sale, TWBG has been reflected as discontinued operations for all periods presented (Note 4).

*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 closed on May 1, 2006. The results of Turner South have been reflected as discontinued operations for all periods presented. The Company expects to record a pretax gain ranging from approximately \$120 million to \$140 million (after taking into account selling costs) in the second quarter of 2006. Since the Company has sufficient tax attribute carryforwards to offset the gain, there will not be any tax expense recognized on the sale of Turner South (Note 4).

*Time Warner Telecom*

As of December 31, 2005, wholly-owned subsidiaries of the Company owned a total of 50.4 million shares of Class B common stock of Time Warner Telecom Inc. ( TWT ), a publicly traded telecommunications company. The Company accounts for this investment using the equity method of accounting and, as a result of the Company's share in losses of TWT and impairment losses recognized in previous years, the carrying value of the investment is zero. In the first quarter of 2006, the Company's subsidiaries participated as selling shareholders in a TWT secondary offering, converted approximately 17 million shares of Class B common stock into Class A common stock of TWT and sold the Class A common stock for approximately \$239 million, net of underwriter commissions. This sale resulted in a pretax gain of approximately \$239 million, which is included as a component of Other income, net, in the accompanying consolidated statement of operations for the three months ended March 31, 2006. The Company does not consider its remaining investment in TWT to be strategic and, therefore, additional sales or other dispositions may occur in the future, subject to customary restrictions on transfer agreed to in connection with the offering and as provided in a stockholders agreement among the holders of the Class B common stock of TWT.

*Amounts Related to Securities Litigation*

As previously disclosed, 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 13 to the accompanying consolidated financial statements (the MSBI consolidated securities class action ). 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 SEC investigation, or at least a substantial portion thereof, transferred to the MSBI Settlement Fund. The court issued an order dated April 6, 2006 granting final approval of the settlement.



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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 (including suits brought by individual shareholders) described in Note 13 to the accompanying consolidated financial statements that are pending against the Company. As of May 1, 2006, the Company has reached agreements to resolve the actions alleging violations of the Employee Retirement Income Security Act ( ERISA ) and the derivative actions, both of which are subject to preliminary and final court approval, as well as some of the individual suits. Of the \$600 million reserve, through May 1, 2006, the Company has paid, or has agreed to pay, approximately \$358 million, after considering probable insurance recoveries, to settle certain of these claims. The Company has been successful in reaching settlements with respect to certain of the securities actions brought by individual shareholders. The Company also has engaged in, or expects to engage in, mediation in an attempt to resolve the additional cases brought by shareholders who elected to opt out of the settlement in the consolidated securities action. Such mediation efforts have not been fruitful to date in certain of these matters, in which trials are possible and for which plaintiffs have claimed several billion dollars in aggregated damages. The Company intends to defend these lawsuits vigorously. It is possible that the ultimate amount paid to resolve all unsettled litigation in these matters could be greater than the remaining reserve (Note 13).

The Company recognizes insurance recoveries when it becomes probable that such amounts will be received. Amounts recognized in the first quarter of 2006 and 2005 totaled \$50 million and \$6 million, respectively. In 2005, 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 was collected in the first quarter of 2006.

*Government Investigations*

As previously disclosed by the Company, the DOJ and the SEC have resolved their investigations into the accounting and disclosure practices of the Company, the former through a deferred prosecution agreement entered into in December 2004 for a two-year period, and the latter through a settlement agreement that was approved by the SEC in March 2005. These resolutions are described in more detail in Management's Discussion and Analysis Other Recent Developments Government Investigations in the Company's Annual Report on Form 10-K for the year ended December 31, 2005 (the 2005 Form 10-K ). The historical accounting adjustments related thereto were reflected in the restatement of the Company's financial results for each of the years ended December 31, 2000 through December 31, 2003, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004 (the 2004 Form 10-K ).

With respect to the \$300 million that was placed into an SEC Fair Fund as a condition of the SEC settlement, the Company has used its best efforts to have the \$300 million, or a substantial portion thereof, transferred to the MSBI Settlement Fund and distributed in connection with the eventual distribution of proceeds pursuant to the settlement of the MSBI consolidated securities class action. However, the SEC, as yet, has not made any determination as to how to distribute those funds.

Under the terms of the Company's settlement with the SEC, the Company agreed to the appointment of an independent examiner to review whether the Company's historical accounting for transactions with 17 counterparties, which were identified by the SEC staff, was in conformity with GAAP. The transactions subject to review were entered into between June 1, 2000 and December 31, 2001 (but including subsequent amendments thereto), and principally involve online advertising revenues, as well as three cable programming affiliation agreements with related advertising elements. Revenue related to the 17 transactions principally was recognized prior to January 1, 2002. The independent examiner has been engaged in his review, and, under the terms of the SEC settlement, is required to provide a report to the Company's audit and finance committee of his conclusions. 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.

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**RESULTS OF OPERATIONS**

**Recently Adopted Accounting Principle**

*Stock-Based Compensation*

The Company has adopted the provisions of Financial Accounting Standards Board ( FASB ) Statement No. 123 (revised 2004), Share-Based Payment ( FAS 123R ), as of January 1, 2006. The provisions of FAS 123R require a Company to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost is recognized in the statement of operations over the period during which an employee is required to provide service in exchange for the award. FAS 123R also amends FASB Statement No. 95, Statement of Cash Flows, to require that excess tax benefits, as defined, realized from the exercise of stock options be reported as a financing cash inflow rather than as a reduction of taxes paid in cash flow from operations.

Prior to the adoption of FAS 123R, the Company had followed the provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation ( FAS 123 ), which allowed the Company to follow the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and disclose the pro forma effects on net income (loss) had the fair value of the equity awards been expensed. In connection with adopting FAS 123R, the Company elected to adopt the modified retrospective application method provided by FAS 123R and, accordingly, financial statement amounts for all prior periods presented herein reflect results as if the fair value method of expensing had been applied from the original effective date of FAS 123 (Refer to Note 1 for discussion of impact).

Prior to the adoption of FAS 123R, the Company recognized stock-based compensation expense for awards with graded vesting by treating each vesting tranche as a separate award and recognizing compensation expense ratably for each tranche. For equity awards granted subsequent to the adoption of FAS 123R, the Company treats such awards as a single award and recognizes stock-based compensation expense on a straight-line basis (net of estimated forfeitures) over the employee service period. Stock-based compensation expense is recorded in costs of revenues or selling, general and administrative expense depending on the employee's job function.

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Additionally, when recording compensation cost for equity awards, FAS 123R requires companies to estimate the number of equity awards granted that are expected to be forfeited. Prior to the adoption of FAS 123R, the Company recognized forfeitures when they occurred, rather than using an estimate at the grant date and subsequently adjusting the estimated forfeitures to reflect actual forfeitures. Accordingly, a pretax cumulative effect adjustment totaling \$40 million (\$25 million, net of tax) has been recorded in the first quarter of 2006 to adjust for awards granted prior to January 1, 2006 that are not expected to vest. Total impact of the adoption of FAS 123R and total equity-based compensation expense recognized for the three months ended March 31, 2006 and 2005 is as follows:

	<b>Stock Option Expense<sup>(a)</sup></b>		<b>Total Equity-Based Compensation<sup>(a)(b)</sup></b>	
	<b>Three Months Ended</b>		<b>Three Months Ended</b>	
	<b>3/31/06</b>	<b>3/31/05</b>	<b>3/31/06</b>	<b>3/31/05</b>
	<b>(millions)</b>		<b>(millions)</b>	
AOL	\$ 13	\$ 10	\$ 14	\$ 11
Cable	12	26	14	26
Filmed Entertainment Networks	19	27	31	29
Publishing	13	27	15	28
Corporate	11	20	13	20
	12	17	21	20
<b>Total</b>	<b>\$ 80</b>	<b>\$ 127</b>	<b>\$ 108</b>	<b>\$ 134</b>

(a) The amount expensed in the first quarter of each year is not consistent with the amounts expected to be incurred during the remaining quarters of the year as the first quarter includes the expensing of 100% of the equity awards granted to retirement eligible employees as part of a broad-based



grant.

- (b) Total equity-based compensation includes expense recognized related to stock options, restricted stock and restricted stock units.

**Change in Accounting Principle for Recognizing Programming Inventory Costs at HBO**

Effective January 1, 2006, the Company changed its methodology for recognizing programming inventory costs (for both theatrical and original programming) at its HBO division. Previously, the Company recognized HBO's programming costs on a straight-line basis in the calendar year in which the related programming first aired on the HBO and Cinemax pay television services. Now the Company recognizes programming costs on a straight-line basis over the license periods or estimated period of use of the related shows, beginning with the month of initial exhibition. The Company concluded that this change in accounting for programming inventory costs was preferable after giving consideration to the cumulative impact that marketplace and technological changes have had in broadening the variety of viewing options and period over which consumers are now experiencing HBO's programming.

Since this change involves a revision to an inventory costing principle, the change is reflected retrospectively to all prior periods presented, including the impact that such a change has on retained earnings for the earliest year presented (Refer to Note 1 for discussion of impact).

**Discontinued Operations**

As previously noted under Recent Developments, the Company has reflected the operations of TWBG and Turner South as discontinued operations for all periods presented.

**Reclassifications**

Certain reclassifications have been made to the prior year's financial information to conform to the March 31, 2006 presentation.

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***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:

	<b>Three Months Ended</b>	
	<b>3/31/06</b>	<b>3/31/05</b>
	<b>(millions)</b>	
Amounts related to securities litigation and government investigations	\$ (29)	\$ (6)
Merger and restructuring costs	(30)	(12)
Asset impairments		(24)
Gain on disposal of assets, net	22	10
 Impact on Operating Income	 (37)	 (32)
Investment gains, net	295	23
Gain on WMG option		80
 Impact on Other income, net	 295	 103
 Pretax impact	 258	 71
Income tax impact	(93)	(35)
 After-tax impact	 \$ 165	 \$ 36

***Amounts Related to Securities Litigation and Government Investigations***

For the three months ended March 31, 2006 and 2005, the Company recognized legal and other professional fees related to the SEC and DOJ investigations into certain of the Company's historical accounting and disclosure practices and the defense of various shareholder lawsuits, as well as legal reserves, totaling \$79 million and \$12 million, respectively. In addition, for the three months ended March 31, 2006 and 2005, the Company recognized insurance recoveries of \$50 million and \$6 million, respectively.

***Merger and Restructuring Costs***

During the three months ended March 31, 2006, the Company incurred restructuring costs, primarily related to various employee terminations of approximately \$23 million, including \$12 million at the Publishing segment, \$6 million at the Cable segment and \$5 million at the Corporate segment. The Company also expensed \$2 million at the Filmed Entertainment segment and \$1 million at the AOL segment as a result of changes in estimates of previously established restructuring accruals. In addition, during the three months ended March 31, 2006, the Cable segment expensed approximately \$4 million of non-capitalizable merger-related costs associated with the Adelphia Acquisition.

During the three months ended March 31, 2005, the Company incurred restructuring costs at the Cable segment primarily related to various employee terminations and exit activities of \$17 million. In addition, there were changes in estimates of previously established restructuring accruals at the AOL segment, which included \$3 million of additional restructuring costs and the reversal of \$8 million of restructuring costs that were no longer required (Note 11).

***Asset Impairments***

During the three months ended March 31, 2005, the Company recorded a \$24 million noncash impairment charge related to goodwill associated with America Online Latin America, Inc. ( AOLA ).

*Gains on Disposal of Assets, Net*

For the three months ended March 31, 2006, the Company recorded a gain of approximately \$20 million at the Corporate segment related to the sale of two aircraft and a \$2 million gain at the AOL segment from the resolution of a previously contingent gain related to the 2004 sale of Netscape Security Solutions ( NSS ).

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For the three months ended March 31, 2005, the Company recorded a \$2 million gain at the AOL segment from the resolution of a previously contingent gain related to the 2004 sale of NSS 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., which was previously fully reserved due to concerns about recoverability.

*Investment Gains, Net*

For the three months ended March 31, 2006, the Company recognized net gains of \$295 million primarily related to the sale of investments, including a \$239 million gain on the sale of a portion of the Company's investment in TWT and a \$51 million gain on the sale of the Company's investment in Canal Satellite Digital. Investment gains, net also include \$7 million of gains to reflect market fluctuations in equity derivative instruments.

For the three months ended March 31, 2005, the Company recognized net gains of \$23 million primarily related to the sale of investments. Investment gains, net included \$3 million of writedowns to reduce the carrying value of certain investments that experienced other-than-temporary declines in market value, partially offset by \$1 million of gains to reflect market fluctuations in equity derivative instruments.

*Gain on WMG Option*

For the three months ended March 31, 2005, the Company recorded an \$80 million gain reflecting a fair value adjustment related to the Company's option in Warner Music Group ( WMG ).

**Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2005***Consolidated Results*

**Revenues.** The components of revenues are as follows:

	<b>Three Months Ended</b>		
	<b>3/31/06</b>	<b>3/31/05 (recast) (millions)</b>	<b>% Change</b>
Subscription	\$ 5,667	\$ 5,485	3%
Advertising	1,761	1,645	7%
Content	2,756	2,976	(7%)
Other	271	257	5%
Total revenues	\$ 10,455	\$ 10,363	1%

The increase in Subscription revenues is 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 services, advanced digital video services and Digital Phone) and video rate increases. The increase at the Networks segment was due primarily to higher subscription rates 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 and the unfavorable impact of foreign currency exchange rates at AOL Europe.

The increase in Advertising revenues was primarily due to growth at the AOL and Networks segments. The increase at the AOL segment was due to revenues from growth in traditional advertising, paid-search advertising and sales of advertising run on third-party websites generated by Advertising.com. The increase at the Networks segment was primarily driven by higher CPMs (advertising cost per one thousand viewers) and sellouts at Turner's domestic entertainment networks, partly offset by a decline at The WB Network as a result of lower ratings.

The decrease in Content revenues was principally due to decreases at the Filmed Entertainment and Networks segments. The decrease at the Filmed Entertainment segment was driven by declines in both theatrical and television

product revenues. The decrease at the Networks segment was due primarily to the absence of HBO's licensing revenue from *Everybody Loves Raymond*, which ended its broadcast network run in 2005, and, to a lesser extent, a decline in ancillary sales of HBO's original programming.

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

**Costs of Revenues.** For the three months ended March 31, 2006 and 2005, costs of revenues totaled \$5.806 billion and \$5.907 billion, respectively, and as a percentage of revenues were 56% and 57%, respectively. The improvement in costs of revenues as a percentage of revenues related primarily to improved margins at the Filmed Entertainment, Networks and Publishing segments, partially offset by a decline in margins at the AOL and Cable segments. The segment variations are discussed in detail in Business Segment Results.

**Selling, General and Administrative Expenses.** For the three months ended March 31, 2006 and 2005, selling, general and administrative expenses remained essentially flat (\$2.600 billion in 2006 and \$2.587 billion in 2005). The segment variations are discussed in detail in Business Segment Results.

**Amounts Related to Securities Litigation and Government Investigations.** As previously discussed in Recent Developments, in the results for the three months ended March 31, 2006 and 2005, the Company recognized legal and other professional fees related to the SEC and DOJ investigations into certain of the Company's historical accounting and disclosure practices and the defense of various shareholder lawsuits, as well as legal reserves, totaling \$79 million and \$12 million, respectively. In addition, for the three months ended March 31, 2006 and 2005, the Company recognized insurance recoveries of \$50 million and \$6 million, 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:

	Three Months Ended		
	3/31/06	3/31/05 (recast)	% Change
	(restated, millions)		
Operating Income before Depreciation and Amortization	\$ 2,693	\$ 2,485	8%
Depreciation	(681)	(648)	5%
Amortization	(133)	(148)	(10%)
Operating Income	1,879	1,689	11%
Interest expense, net	(299)	(346)	(14%)
Other income, net	318	112	184%
Minority interest expense, net	(79)	(55)	44%
Income before income taxes, discontinued operations and cumulative effect of accounting change	1,819	1,400	30%
Income tax provision	(613)	(488)	26%
Income before discontinued operations and cumulative effect of accounting change	1,206	912	32%
Discontinued operations, net of tax	232	7	NM
Cumulative effect of accounting change, net of tax	25		NM
Net income	\$ 1,463	\$ 919	59%

**Operating Income before Depreciation and Amortization.** Time Warner's Operating Income before Depreciation and Amortization increased 8% to \$2.693 billion for the three months ended March 31, 2006 from \$2.485 billion for

the three months ended March 31, 2005, principally as a result of growth at the Cable, Filmed Entertainment and Networks segments, offset by a decline at the AOL and Publishing segments.

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

**Depreciation Expense.** Depreciation expense increased to \$681 million for the three months ended March 31, 2006 from \$648 million for the three months ended March 31, 2005. The increase in depreciation expense primarily related to an increase at the Cable segment reflecting continued higher spending on customer premise equipment that is depreciated over a shorter useful life compared to the mix of assets previously purchased.

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**Amortization Expense.** Amortization expense decreased to \$133 million for the three months ended March 31, 2006 from \$148 million for the three months ended March 31, 2005. The decrease in amortization expense primarily relates to the Publishing segment as a result of certain short-lived intangibles, such as customer lists, becoming fully amortized in the latter part of 2005. This increase at the Publishing segment was partially offset by amortization from certain indefinite-lived trade name intangibles being assigned a finite life beginning in the first quarter of 2006.

**Operating Income.** Time Warner's Operating Income increased to \$1.879 billion for the three months ended March 31, 2006 from \$1.689 billion for the three months ended March 31, 2005, reflecting the changes in Operating Income before Depreciation and Amortization and the decline in amortization expense, offset partially by the increase in depreciation expense as discussed above.

**Interest Expense, Net.** Interest expense, net, decreased to \$299 million for the three months ended March 31, 2006 from \$346 million for the three months ended March 31, 2005 due primarily to higher interest income on cash investments and lower average interest rates on borrowings.

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

	<b>Three Months Ended</b>	
	<b>3/31/06</b>	<b>3/31/05</b>
		<b>(restated)</b>
	<b>(millions)</b>	
Investment gains, net	\$ 295	\$ 23
Gain on WMG option		80
Income from equity investees	22	12
Other	1	(3)
Other income, net	\$ 318	\$ 112

The changes in investment gains, net, and the net gain on the WMG option are discussed in detail under Significant Transactions and Other Items Affecting Comparability. Excluding the impact of these items, Other income, net, increased principally from an increase in income from equity method investees, primarily related to the Texas and Kansas City Cable Partners, L.P., a joint venture between TWC and Comcast.

**Minority Interest Expense, Net.** Time Warner had \$79 million of minority interest expense for the three months ended March 31, 2006 compared to \$55 million for the three months ended March 31, 2005. The increase relates primarily to larger profits recorded by TWC, in which Comcast has a minority interest.

**Income Tax Provision.** Income tax expense was \$613 million for the three months ended March 31, 2006 compared to \$488 million for the three months ended March 31, 2005. The Company's effective tax rate was 34% and 35% for the three months ended March 31, 2006 and 2005, respectively. The decrease in the effective tax rate results primarily from \$93 million of tax attribute carryforwards recognized during the period compared to \$51 million for the same period in the prior year.

**Income before Discontinued Operations and Cumulative Effect of Accounting Change.** Income before discontinued operations and cumulative effect of accounting change was \$1.206 billion for the three months ended March 31, 2006 compared to \$912 million for the three months ended March 31, 2005. Basic and diluted net income per share before discontinued operations and cumulative effect of accounting change were both \$0.27 in 2006, compared to \$0.20 and \$0.19 in 2005, respectively. Excluding the items previously discussed under Significant Transactions and Other Items Affecting Comparability totaling \$165 million and \$36 million of net income for the three months ended March 31, 2006 and 2005, respectively, Income before discontinued operations and cumulative effect of accounting change improved by \$165 million primarily due to higher Operating Income, higher other income, net, lower interest expense, net, and the income tax provision as discussed above.



***Discontinued Operations.*** The three months ended March 31, 2006 and 2005 results include the impact of the treatment of TWBG and Turner South as discontinued operations. Included in the results for the three months ended March 31, 2006 is a pretax gain of \$206 million and a tax benefit of \$22 million related to the sale of TWBG. The

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tax benefit resulted primarily from the release of a valuation allowance associated with tax attribute carryforwards offsetting the tax gain on the transaction.

**Cumulative Effect of Accounting Change, net of tax.** The Company recorded a \$40 million pretax benefit (\$25 million, net of tax), as the cumulative effect of a change in accounting principle upon the adoption of FAS 123R to recognize the effect of estimating the number of awards granted prior to January 1, 2006 that are not ultimately expected to vest.

**Net Income and Net Income Per Common Share.** Net income was \$1.463 billion for the three months ended March 31, 2006 compared to \$919 million for the three months ended March 31, 2005. Basic and diluted net income per common share were \$0.33 and \$0.32, respectively, in 2006, compared to \$0.20 and \$0.19 in 2005, respectively.

**Business Segment Results**

**AOL.** Revenues, Operating Income before Depreciation and Amortization and Operating Income of the AOL segment for the three months ended March 31, 2006 and 2005 are as follows:

	<b>3/31/06</b>	<b>3/31/05</b>	<b>% Change</b>
		<b>(recast)</b>	
		<b>(restated, millions)</b>	
Revenues:			
Subscription	\$ 1,538	\$ 1,774	(13%)
Advertising	392	311	26%
Other	51	48	6%
Total revenues	1,981	2,133	(7%)
Costs of revenues <sup>(a)</sup>	(946)	(982)	(4%)
Selling, general and administrative <sup>(a)</sup>	(592)	(626)	(5%)
Gain on disposal of consolidated businesses	2	2	
Asset impairments		(24)	NM
Restructuring costs	(1)	5	(120%)
Operating Income before Depreciation and Amortization	444	508	(13%)
Depreciation	(127)	(145)	(12%)
Amortization	(40)	(47)	(15%)
Operating Income	\$ 277	\$ 316	(12%)

<sup>(a)</sup> 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 \$1.313 billion in 2005 to \$1.109 billion in 2006) and a decline in Subscription revenues at AOL Europe (from \$449 million in 2005 to \$407 million in 2006). AOL's domestic Subscription revenues declined due primarily to a decrease in the number of domestic AOL brand subscribers and related revenues. The decrease in AOL Europe's Subscription revenues was driven by the unfavorable impact of foreign currency exchange rates (\$41 million). AOL

Europe's dial-up Subscription revenues declined, however this decline was almost entirely offset by an increase in broadband and telephony revenues.

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The number of AOL brand domestic and European subscribers is as follows at March 31, 2006, December 31, 2005 and March 31, 2005 (millions):

	<b>March 31, 2006</b>	<b>December 31, 2005</b>	<b>March 31, 2005</b>
Subscriber category:			
AOL brand domestic <sup>(a)</sup>			
\$15 and over	12.8	13.7	16.8
Under \$15	5.8	5.8	4.9
Total AOL brand domestic	18.6	19.5	21.7
AOL Europe	5.9	6.0	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.

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:

	<b>Three Months Ended</b>	
	<b>3/31/06</b>	<b>3/31/05</b>
Subscriber category:		
AOL brand domestic		
\$15 and over	\$20.88	\$20.52
Under \$15	12.78	13.11
Total AOL brand domestic	18.43	18.91
AOL Europe	22.46	23.11

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 March 31, 2006 and December 31, 2005 and 14% at March 31, 2005. AOL has recently entered into agreements with certain high-speed Internet access providers to offer the AOL service along with high-speed Internet access. The price plan for the AOL service portion of these offers is less than \$15 and, therefore, subscribers to these plans are included in the under \$15 category price plans. In addition, late in the first quarter of 2006 and continuing into the second quarter, AOL implemented price increases on certain AOL brand service price plans, including increasing the price of the \$23.90 plan to \$25.90. The price increases are expected to have an incremental short-term 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, resulting in a further decline in Subscription revenues and AOL brand domestic ARPU during the remainder of 2006.

The largest component of the AOL brand domestic \$15 and over price plans is the \$25.90 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 generally includes a limited number of 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, market and implement price plans, service offerings and payment methods as well as other strategies 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 period, subscribers migrated from the premium-priced unlimited dial-up plans, including the \$25.90 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.

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Year-over-year 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 impacts of the recent price plan increases and the new agreements with high-speed Internet access providers. The growth in subscribers on plans below \$15 per month is expected to come primarily from subscribers who are currently on the \$25.90 price plan.

Within the \$15 and over per month category, the increase in ARPU over the prior year was primarily due to an increase in the percentage of revenue generating customers, partially offset by a shift in the mix to lower-priced subscriber price plans. Premium subscription services revenues included in ARPU were \$20 million for both the three months ended March 31, 2006 and 2005.

Within the under \$15 per month category, the decrease in ARPU over the prior year was primarily due to a decrease in revenues generated by members on limited plans who exceeded their free time, partially offset by an increase in the percentage of revenue generating customers. Premium subscription services revenues included in ARPU for the three months ended March 31, 2006 and 2005 were \$9 million and \$6 million, respectively.

The decline in total AOL brand domestic ARPU was due primarily to the shift in AOL's membership base to lower-priced subscriber plans. AOL brand domestic members on price plans under \$15 was 31% of total AOL brand domestic membership as of March 31, 2006 as compared to 22% as of March 31, 2005.

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 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 decreased primarily due to the negative effect of changes in foreign currency exchange rates. In addition, although bundled broadband subscribers continue to grow as a percentage of total subscribers at AOL Europe, broadband price reductions in France, Germany and the U.K. due to competition have offset the impact of this migration on ARPU.

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 due to increased revenues from growth in traditional advertising, paid-search advertising and sales of advertising run on third-party websites generated by Advertising.com. Paid-search revenues and revenues generated by Advertising.com increased \$27 million and \$16 million, respectively, for the three months ended March 31, 2006 as compared to the three months ended March 31, 2005. AOL expects Advertising revenues to continue to increase during the remainder of 2006 as compared to the similar periods in 2005 due to expected growth in paid-search and traditional online advertising and contributions from Advertising.com's performance-based advertising.

Costs of revenues decreased 4% and, as a percentage of revenues, increased to 48% in 2006 from 46% in 2005. The decrease in cost of revenues related primarily to lower network-related expenses. Network-related expenses decreased 11% to \$318 million in 2006 from \$359 million in 2005. 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. 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, resulting in lower margins.

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The decrease in selling, general and administrative expenses primarily related to an \$18 million benefit related to employee incentive compensation, including the reversal of previously established accruals that are no longer required and lower current year accruals, other cost savings initiatives and a decrease in third-party marketing costs. The three months ended March 31, 2006 also includes an approximate \$14 million benefit related to the favorable resolution of certain tax matters.

As previously discussed under Significant Transactions and Other Items Affecting Comparability, the results for the three months ended March 31, 2006 include a \$2 million gain from the resolution of a previously contingent gain related to the 2004 sale of NSS and a \$1 million restructuring charge, primarily related to changes in estimates of previously established restructuring accruals. The results for the three months ended March 31, 2005 include a \$24 million noncash goodwill impairment charge related to AOL, changes in estimates of previously established restructuring accruals, which include the reversal of \$8 million of restructuring charges that were no longer required, partially offset by \$3 million of additional restructuring charges and a \$2 million gain from the resolution of a previously contingent gain related to the 2004 sale of NSS.

The decreases in Operating Income before Depreciation and Amortization and Operating Income are due primarily to lower Subscription revenues, partially offset by higher Advertising revenues and lower costs of revenues and selling, general and administrative expenses and the absence of the \$24 million noncash goodwill impairment charge. Operating Income before Depreciation and Amortization included a \$27 million decline at AOL Europe for the first quarter of 2006, as compared to the similar period in 2005, reflecting a decline in revenues and higher costs. Operating Income also improved due to lower depreciation expense reflecting a decline in network assets as the result of membership declines.

In response to the changing dynamics of its business, AOL is undertaking efforts to realign its resources more efficiently and expects to incur restructuring charges ranging from \$15 million to \$20 million related to a second quarter 2006 restructuring action. The restructuring costs relate to a reduction in headcount, lease termination costs and an impairment of certain long-lived assets. As AOL continues to analyze its resource needs, further restructuring charges may be incurred during 2006.

As noted above, the Company expects a continued decline in AOL's domestic and European subscribers, ARPU and related revenues. As a result of the decline in revenues, which are not expected to be offset by cost decreases, the Company anticipates Operating Income before Depreciation and Amortization and Operating Income will continue to decline during the second quarter of 2006 as compared to the comparable 2005 period.

**Cable.** Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Cable segment for the three months ended March 31, 2006 and 2005 are as follows:

	<b>Three Months Ended</b>		
	<b>3/31/06</b>	<b>3/31/05</b>	<b>% Change</b>
	<b>(recast)</b>		
	<b>(restated, millions)</b>		
Revenues:			
Subscription	\$ 2,463	\$ 2,127	16%
Advertising	117	119	(2%)
Total revenues	2,580	2,246	15%
Costs of revenues <sup>(a)</sup>	(1,170)	(1,001)	17%
Selling, general and administrative <sup>(a)</sup>	(463)	(427)	8%
Merger-related and restructuring costs	(10)	(17)	(41%)
Operating Income before Depreciation and Amortization	937	801	17%

Depreciation	(411)	(376)	9%
Amortization	(20)	(20)	
Operating Income	\$ 506	\$ 405	25%

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



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The components of Subscription revenues are as follows:

	<b>Three Months Ended</b>		
	<b>3/31/06</b>	<b>3/31/05</b> (millions)	<b>% Change</b>
Subscription revenues:			
Video services	\$ 1,711	\$ 1,602	7%
High-speed data	612	493	24%
Digital Phone	140	32	338%
<b>Total Subscription revenues</b>	<b>\$ 2,463</b>	<b>\$ 2,127</b>	<b>16%</b>

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

TWC 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's Road Runner Internet service or any of the other Internet services offered by TWC. Digital Phone subscribers include all subscribers who receive telephony service. At March 31, 2006, as compared to March 31, 2005, basic cable subscribers increased 1.2% (129,000) and totaled 11.039 million (including 1.577 million subscribers of unconsolidated investees, which are managed by TWC), digital video subscribers increased by 15% to 5.642 million (including 789,000 subscribers of unconsolidated investees, which are managed by TWC), residential high-speed data subscribers increased by 25% to 5.168 million (including 731,000 subscribers of unconsolidated investees, which are managed by TWC) and commercial high-speed data subscribers increased by 19% to 216,000 (including 27,000 subscribers of unconsolidated investees, which are managed by TWC). Additionally, Digital Phone subscribers increased by 998,000 to 1.370 million (including 176,000 subscribers of unconsolidated investees, which are managed by TWC).

Costs of revenues increased 17% and, as a percentage of revenues, were 45% for both 2006 and 2005. The increase in costs of revenues is primarily related to increases in video programming costs, telephony service costs and employee costs. For the three months ended March 31, 2006, video programming costs increased 10% to \$553 million due primarily to contractual rate increases and the ongoing deployment of new digital video services, partially offset by an \$11 million benefit reflecting an adjustment in the amortization of certain launch support payments. Video programming costs for the remainder of 2006 are expected to increase at a rate similar to the 12% rate experienced during the first quarter, excluding the \$11 million benefit. This increase reflects the continued expansion of service offerings and contractual rate increases. Telephony service costs increased approximately \$47 million due to the growth in Digital Phone subscribers. Employee costs increased primarily due to salary increases and higher headcount resulting from the roll-out of advanced services. These increases in costs of revenues were partially offset by an \$18 million benefit (with an additional \$5 million benefit recorded in selling, general and administrative expenses) in the first quarter of 2006 due to changes in estimates related to certain medical benefit accruals.

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 a decrease in equity-based compensation expense. The first quarter of 2005 also included a \$9 million reserve related to legal matters.

As previously discussed under Significant Transactions and Other Items Affecting Comparability, during the three months ended March 31, 2006, the Cable segment expensed approximately \$4 million of non-capitalizable

merger-related costs associated with the Adelphia Acquisition and the Cable Swaps. Such costs are expected to increase between now and the closing date and continue thereafter. Closing of these transactions is expected to occur on or before July 31, 2006. In addition, the results for the three months ended March 31, 2006 include approximately \$6 million of restructuring costs, primarily associated with a reduction in headcount associated with efforts to reorganize the Company's operations in a more efficient manner. The results for the three months ended March 31, 2005 included \$17 million of restructuring costs, primarily associated with the early retirement of certain senior

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executives. These charges are part of TWC's broader plans to simplify its organizational structure and enhance its customer focus. TWC is in the process of executing these initiatives and expects to incur additional costs as these plans are implemented throughout 2006.

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

Operating Income increased due primarily to the increase in Operating Income before Depreciation and Amortization described above, partially offset by an increase in depreciation expense. Depreciation expense increased \$35 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.

**Filmed Entertainment.** Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Filmed Entertainment segment for the three months ended March 31, 2006 and 2005 are as follows:

	<b>Three Months Ended</b>		<b>%</b>
	<b>3/31/06</b>	<b>3/31/05</b>	<b>Change</b>
		<b>(recast)</b>	
		<b>(millions)</b>	
Revenues:			
Advertising	\$	\$ 3	NM
Content	2,709	2,951	(8%)
Other	70	60	17%
Total revenues	2,779	3,014	(8%)
Costs of revenues <sup>(a)</sup>	(1,944)	(2,227)	(13%)
Selling, general and administrative <sup>(a)</sup>	(376)	(404)	(7%)
Restructuring costs	(2)		NM
Operating Income before Depreciation and Amortization	457	383	19%
Depreciation	(34)	(30)	13%
Amortization	(55)	(52)	6%
Operating Income	\$ 368	\$ 301	22%

<sup>(a)</sup> Costs of revenues and selling, general and administrative expenses exclude depreciation.

Content revenues decreased during the three months ended March 31, 2006 as a result of declines 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:

	<b>Three Months Ended</b>		
	<b>3/31/06</b>	<b>3/31/05</b>	<b>% Change</b>
	<b>(millions)</b>		
Theatrical product:			
Theatrical film	\$ 361	\$ 465	(22%)
Television licensing	332	433	(23%)
Home video	966	957	1%
 Total theatrical product	 1,659	 1,855	 (11%)
Television product:			
Television licensing	755	747	1%
Home video	178	244	(27%)
 Total television product	 933	 991	 (6%)
 Consumer product and other	 117	 105	 11%
 Total Content revenues	 \$ 2,709	 \$ 2,951	 (8%)

The decline in theatrical film revenues was due primarily to difficult comparisons to the first quarter of 2005, which included the release of *Constantine* and carryover from *Ocean's Twelve* and *Million Dollar Baby*, compared to the carryover success from *Harry Potter and the Goblet of Fire* and the releases of *V For Vendetta* and *Final*

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*Destination 3* in the first quarter of 2006. The decrease in theatrical product revenues from television licensing primarily related to the timing and quantity of various international availabilities, including a greater number of significant titles in 2005. Home video sales of theatrical product were essentially flat reflecting the worldwide release of *Harry Potter and the Goblet of Fire* and the domestic release of *Wedding Crashers* in the first quarter of 2006, partially offset by the international success of *Harry Potter and the Prisoner of Azkaban* and the domestic release of *Troy* in the first quarter of 2005.

The decline in home video sales of television product reflects difficult comparisons to the prior year, which included revenue from the releases of *Friends: The Complete Ninth Season* and *Seinfeld Seasons 1-3* and higher catalog revenue.

The decrease in costs of revenues resulted primarily from lower film costs (\$1.132 billion in 2006 compared to \$1.373 billion in 2005) and lower advertising and print costs resulting from the quantity and mix of films released. Included in film costs are theatrical valuation adjustments, which increased to \$69 million in 2006 from \$38 million in 2005. Costs of revenues as a percentage of revenues decreased to 70% in 2006 from 74% in 2005, due to the quantity and mix of product released.

Selling, general and administrative expenses decreased primarily due to lower distribution fees and the impact of cost saving initiatives.

As previously discussed in Significant Transactions and Other Items Affecting Comparability, the results for the three months ended March 31, 2006 include \$2 million of restructuring charges as a result of changes in estimates of previously established restructuring accruals.

Operating Income before Depreciation and Amortization and Operating Income increased as a result of lower costs of revenues and selling, general and administrative expenses, partially offset by the decline in revenues as discussed above. Operating Income before Depreciation and Amortization and Operating Income also included a benefit of \$42 million from the sale of certain international film rights in the first quarter of 2006.

The Company anticipates that the rate of growth in Operating Income before Depreciation and Amortization experienced in the first quarter of 2006 will not continue during the remainder of 2006. The first quarter of 2006 benefited from the sale of certain international film rights, as discussed above, and higher contributions from the consumer products business.

**Networks.** Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Networks segment for the three months ended March 31, 2006 and 2005 are as follows:

	<b>3/31/06</b>	<b>Three Months Ended 3/31/05 (recast) (millions)</b>	<b>% Change</b>
Revenues:			
Subscription	\$ 1,442	\$ 1,334	8%
Advertising	702	681	3%
Content	195	253	(23%)
Other	12	7	71%
Total revenues	2,351	2,275	3%
Costs of revenues <sup>(a)</sup>	(1,057)	(1,055)	
Selling, general and administrative <sup>(a)</sup>	(437)	(426)	3%
Operating Income before Depreciation and Amortization	857	794	8%
Depreciation	(66)	(55)	20%

Amortization	(3)	(4)	(25%)
Operating Income	\$ 788	\$ 735	7%

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

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The increase in Subscription revenues was due primarily to higher subscription rates and, to a lesser extent, an increase in the number of subscribers at Turner and HBO.

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

The decrease in Content revenues was primarily due to the absence of HBO's licensing revenues from *Everybody Loves Raymond*, which ended its broadcast network run in 2005, and, to a lesser extent, a decline in ancillary sales of HBO's original programming.

Costs of revenues increased slightly; however, as a percentage of revenues, it decreased from 46% in 2005 to 45% in 2006. The slight increase in costs of revenues was primarily attributable to an increase in programming costs, offset by lower distribution costs resulting from the decline in Content revenues and lower equity-based compensation expense. Programming costs increased to \$754 million in 2006 from \$717 million in 2005. The increase in programming expenses is primarily due to increased amortization related to fewer expected airings of certain shows due to the anticipated shutdown of The WB Network, higher acquired theatrical costs at HBO and an increase in sports programming costs, particularly NBA related, at Turner.

The increase in selling, general and administrative expenses reflects higher marketing and promotional expenses.

Operating Income before Depreciation and Amortization and Operating Income increased during 2006 primarily due to an increase in revenues, partially offset by higher selling, general and administrative expenses, as described above.

On January 24, 2006, Warner Bros. and CBS announced an agreement 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).

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 it will incur restructuring charges ranging from \$25 million to \$30 million related to employee terminations and contractual settlements. In addition, The WB Network may incur up to \$100 million in terminating certain programming arrangements (primarily licensed movie rights), most of which are not expected to be contributed to the new network and may not be sold or utilized in another manner. Included in these costs are approximately \$70 million associated with intercompany programming arrangements with Warner Bros. and New Line. Any costs incurred by The WB Network on such intercompany programming would be largely offset by amounts recognized by Warner Bros. and New Line, with the impact of all intercompany transactions being eliminated in consolidation. Excluding the impact of these intercompany transactions, the anticipated exit costs to the Company of programming arrangements and employee and other contractual arrangements range from approximately \$55 million to \$60 million.

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**Publishing.** Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Publishing segment for the three months ended March 31, 2006 and 2005 are as follows:

	Three Months Ended		
	3/31/06	3/31/05 (recast) (millions)	% Change
Revenues:			
Subscription	\$ 372	\$ 381	(2%)
Advertising	583	571	2%
Content	20	20	
Other	151	157	(4%)
Total revenues	1,126	1,129	
Costs of revenues <sup>(a)</sup>	(474)	(487)	(3%)
Selling, general and administrative <sup>(a)</sup>	(524)	(510)	3%
Gain on sale of assets		8	NM
Restructuring costs	(12)		NM
Operating Income before Depreciation and Amortization	116	140	(17%)
Depreciation	(30)	(33)	(9%)
Amortization	(15)	(25)	(40%)
Operating Income	\$ 71	\$ 82	(13%)

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

The decline in Subscription revenues primarily resulted from unfavorable effects of foreign currency exchange rates at IPC.

Advertising revenues increased slightly due primarily to growth in online Advertising revenues. Magazine Advertising revenues remained essentially flat as contributions from the acquisitions of Essence Communication Partners ( Essence ) and Grupo Editorial Expansión ( GEE ) and contributions from recent magazine launches were offset by lower Advertising revenues at IPC and certain magazines, including *People*, *Parenting* and *Time*.

Other revenues decreased primarily due to declines at Southern Living At Home, partially offset by growth at Synapse, a subscription marketing business.

Costs of revenues decreased 3% and, as a percentage of revenues, were 42% and 43% in 2006 and 2005, respectively. Costs of revenues for the magazine publishing business include manufacturing (paper, printing and distribution) and editorial-related costs, which together decreased 1% to \$422 million primarily due to print cost savings.



Selling, general and administrative expenses increased 3% primarily due to an increase in advertising and marketing costs, primarily related to the inclusion of Essence and GEE.

As previously discussed in Significant Transactions and Other Items Affecting Comparability, the results for the three months ended March 31, 2006 include \$12 million of restructuring costs, primarily associated with continuing efforts to streamline operations. In April 2006, Time Inc. further reduced headcount, which will result in additional restructuring charges ranging from \$18 million to \$22 million. The results for the three months ended March 31, 2005 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.

Operating Income before Depreciation and Amortization decreased primarily due to an increase in selling, general and administrative expenses, \$12 million of restructuring charges in 2006 and the absence of the prior year gain related to the collection of a loan, partially offset by lower costs of revenues. Also included in Operating Income before Depreciation and Amortization are \$8 million of lower start-up losses on magazine launches.

Operating Income decreased primarily due to the changes in Operating Income before Depreciation and Amortization discussed above, partially offset by the decline in amortization expense as a result of certain short-

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lived intangibles, such as customer lists, becoming fully amortized in the latter part of 2005. This increase was partially offset by amortization from certain indefinite-lived trade name intangibles being assigned a finite life beginning in the first quarter of 2006.

As discussed in more detail in Recent Developments, on March 31, 2006, the Company sold TWBG to Hachette for \$532 million in cash resulting in a pretax gain of approximately \$206 million, after taking into account selling costs and estimated working capital adjustments. As a result of the sale, TWBG has been reflected as discontinued operations for all periods presented.

**Corporate.** Operating Loss before Depreciation and Amortization and Operating Loss of the Corporate segment for the three months ended March 31, 2006 and 2005 are as follows:

	<b>Three Months Ended</b>		
	<b>3/31/06</b>	<b>3/31/05</b>	<b>% Change</b>
		<b>(recast)</b>	
		<b>(millions)</b>	
Amounts related to securities litigation and government investigations	\$ (29)	\$ (6)	NM
Selling, general and administrative <sup>(a)</sup>	(112)	(113)	(1%)
Gain on sale of assets	20		NM
Restructuring costs	(5)		NM
Operating Loss before Depreciation and Amortization	(126)	(119)	6%
Depreciation	(13)	(9)	44%
Operating Loss	\$ (139)	\$ (128)	9%

<sup>(a)</sup> Selling, general and administrative expenses exclude depreciation.

As previously discussed, the Company recognized legal and other professional fees related to the SEC and DOJ investigations into certain of the Company's historical accounting and disclosure practices and the defense of various shareholder lawsuits, as well as legal reserves, totaling \$79 million and \$12 million, respectively. In addition, for the three months ended March 31, 2006 and 2005, the Company recognized insurance recoveries of \$50 million and \$6 million, respectively. Legal and other professional fees are expected to continue to be incurred in future periods (Note 1).

As previously discussed under Significant Transactions and Other Items Affecting Comparability, the three months ended March 31, 2006 results include approximately \$5 million of restructuring costs and a gain of approximately \$20 million on the sale of two aircraft.

Excluding the items discussed above, Operating Loss before Depreciation and Amortization and Operating Loss remained essentially flat for the three months ended March 31, 2006, due primarily to higher professional fees and financial advisory services costs, offset by lower transactional costs.

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**FINANCIAL CONDITION AND LIQUIDITY*****Current Financial Condition***

At March 31, 2006, Time Warner had \$20.115 billion of debt, \$2.295 billion of cash and equivalents (net debt of \$17.820 billion, defined as total debt less cash and equivalents) and \$62.463 billion of shareholders' equity, compared to \$20.330 billion of debt, \$4.220 billion of cash and equivalents (net debt of \$16.110 billion) and \$65.105 billion of shareholders' equity at December 31, 2005.

The following table shows the significant items contributing to the increase in net debt from December 31, 2005 to March 31, 2006 (millions):

Net debt at December 31, 2005	\$ 16,110
Cash provided by operations	(2,330)
Capital expenditures and product development costs	781
Dividends paid to common shareholders <sup>(a)</sup>	225
Common stock repurchases	3,936
Proceeds from the sale of Time Warner Book Group	(532)
Proceeds from the sale of Time Warner Telecom	(239)
All other, net	(131)
 Net debt at March 31, 2006 <sup>(b)</sup>	 \$ 17,820

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

(b) Included in the net debt balance is approximately \$248 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 Recent Developments, Time Warner's Board of Directors has authorized a common stock repurchase program that allows the Company 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, as defined, of approximately 3-to-1, and expects it will have purchased 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 May 2, 2006, the Company repurchased approximately 460 million shares of common stock for approximately \$8.0 billion pursuant to trading programs under Rule 10b5-1 of the Securities Exchange Act of 1934, as amended.

In connection with the Company's stock repurchase program, the Company plans to enter into prepaid stock repurchase contracts with a number of counterparties that would provide for repurchases effected over the next three months, or longer, depending on the share price of the Company's common stock. As currently contemplated, the Company would make an aggregate payment of approximately \$3.6 billion upon entry into such contracts and would receive shares of the Company's common stock at the end of each repurchase contract term at prices based upon a formula that is expected to deliver an effective, average repurchase price per share below the volume weighted average price of the common stock over the term of the relevant contract. The majority of the expected \$3.6 billion prepayment amount will be funded through borrowings under the Company's revolving credit facility and/or commercial paper programs.

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. TWC also has agreed to redeem Comcast's interests in TWC and TWE following the Adelphia Acquisition. Upon closing, these transactions will impact the Company's financial condition and liquidity. For additional details, see Overview Recent Developments.

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

As noted in Overview Recent Developments, in December 2005, the Company announced that AOL was expanding its current strategic alliance with Google and that Google would invest \$1 billion for a 5% equity interest in AOL. On March 24, 2006, the Company and Google signed definitive agreements governing the investment and the commercial arrangements and on April 13, 2006, the Company received Google's \$1 billion investment in AOL and will recognize a gain of approximately \$800 million, which will be reflected in shareholders' equity as an adjustment to paid-in-capital in the second quarter of 2006.

As noted in Overview 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 closed on May 1, 2006. The Company expects to record a pretax gain ranging from approximately \$120 million to \$140 million (after taking into account selling costs) in the second quarter of 2006.

In April 2006, the Company purchased the remaining interest in Synapse Group Inc. for \$140 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 and TWE. Time Warner's sources of cash include cash provided by operations, cash and equivalents, available borrowing capacity under its committed credit facilities (\$6.917 billion at Time Warner Inc. and \$12.963 billion at TWC as of March 31, 2006, including \$10.0 billion at TWC which becomes available at the time of the Adelphia Acquisition), availability under its commercial paper programs, the \$1 billion investment in AOL by Google, proceeds from a new \$500 million term loan at AOL and proceeds from the sale of Turner South. The Company may use a portion of its available borrowing capacity to refinance approximately \$1.5 billion of debt maturing in 2006.

With the anticipated Adelphia Acquisition and the accelerated pace of the common stock repurchase program, the Company's outstanding debt is expected to increase. Accordingly, cash paid for interest is expected to negatively impact cash provided by operations.

**Cash Flows**

Cash and equivalents decreased by \$1.925 billion and increased by \$873 million for the three months ended March 31, 2006 and 2005, respectively. The decrease in cash and equivalents is primarily due to repurchases of common stock totaling \$3.936 billion made in connection with the Company's common stock repurchase program in the first quarter of 2006. Components of these changes are discussed in more detail in the pages that follow.

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

*Operating Activities*

Details of cash provided by operations are as follows:

	<b>Three Months Ended</b>	
	<b>3/31/06</b>	<b>3/31/05</b>
	<b>(recast)</b>	
	<b>(restated, millions)</b>	
Operating Income before Depreciation and Amortization	\$ 2,693	\$ 2,485
Legal reserves related to securities litigation and government investigations, net of payments and recoveries <sup>(a)</sup>	5	(300)
Noncash asset impairments		24
Net interest payments <sup>(b)</sup>	(260)	(268)
Net income taxes paid <sup>(c)</sup>	(60)	(69)
Equity-based compensation	108	134
Adjustments relating to discontinued operations <sup>(d)</sup>	6	21
Merger and restructuring payments <sup>(e)</sup>	(44)	(62)
All other, net, including working capital changes	(118)	(133)
 Cash provided by operations	 \$ 2,330	 \$ 1,832

(a) 2006 includes approximately \$210 million paid for securities litigation, partially offset by approximately \$215 million of insurance recoveries. 2005 includes payment of the \$300 million SEC settlement.

(b) Includes interest income received of \$45 million in both 2006 and 2005.

(c) Includes income tax refunds

received of \$16 million and \$13 million in 2006 and 2005, respectively.

- (d) Includes net income from discontinued operations of \$232 million and \$7 million in 2006 and 2005, respectively. Amounts also include working capital-related adjustments associated with discontinued operations of \$(226) million and \$14 million in 2006 and 2005, respectively.

- (e) Includes payments for restructuring and merger-related costs, as well as payments for certain other merger-related liabilities.

Cash provided by operations increased to \$2.330 billion in 2006 compared to \$1.832 billion in 2005. The increase in cash provided by operations is related primarily to a reduction in payments made in settling securities litigation and the government investigations and an increase in Operating Income before Depreciation and Amortization.

*Investing Activities*

Details of cash used by investing activities are as follows:

	<b>Three Months Ended</b>	
	<b>3/31/06</b>	<b>3/31/05</b>
	<b>(millions)</b>	
Investments and acquisitions, net of cash acquired:		
Essence	\$	\$ (127)
All other, principally funding of joint ventures	(126)	(97)
Capital expenditures and product development costs from continuing operations	(781)	(650)

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Capital expenditures and product development costs from discontinued operations		(1)
Proceeds from the sale of other available-for-sale securities	4	13
Proceeds from the sale of Time Warner Book Group	532	
Proceeds from the sale of a portion of the Company's interest in Time Warner Telecom	239	
All other investment and asset sale proceeds	36	73
Cash used by investing activities	\$ (96)	\$ (789)

Cash used by investing activities decreased to \$96 million in 2006 compared to \$789 million in 2005. The decrease in cash used by investing activities is primarily due to proceeds from the sales of TWBG and of a portion of the Company's interest in TWT, partially offset by an increase in capital expenditures and product development costs, principally at the Company's Cable segment.



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

*Financing Activities*

Details of cash used by financing activities are as follows:

	<b>Three Months Ended</b>	
	<b>3/31/06</b>	<b>3/31/05</b>
	<b>(recast)</b>	
	<b>(millions)</b>	
Borrowings	\$ 1	\$
Debt repayments	(226)	(247)
Proceeds from exercise of stock options	242	99
Excess tax benefit on stock options	32	22
Principal payments on capital leases	(23)	(37)
Repurchases of common stock	(3,936)	
Dividends paid	(225)	
Other financing activities	(24)	(7)
Cash used by financing activities	\$ (4,159)	\$ (170)

Cash used by financing activities increased to \$4.159 billion in 2006 compared to \$170 million in 2005. 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 2006.

**AOL Term Loan**

On April 13, 2006, TW AOL Holdings Inc., a wholly owned subsidiary of Time Warner, entered into a \$500 million term loan with a maturity date of April 13, 2009 (the AOL Facility). Simultaneous with the Google investment of \$1 billion for a 5% equity interest in AOL Holdings LLC, a subsidiary of TW AOL Holdings Inc. and the parent of AOL, the liability under the AOL Facility was assigned to AOL Holdings LLC. Immediately following, the AOL Facility was assigned from AOL Holdings LLC to AOL. The AOL Facility is not guaranteed by Time Warner. Borrowings under the AOL Facility bear interest at a rate based on the credit rating of Time Warner, which rate is currently LIBOR plus 0.45% per annum. The AOL Facility includes a maximum leverage ratio covenant restricting consolidated total debt of AOL to 4.5 times the consolidated EBITDA (as defined in the credit agreement) of AOL (excluding AOL guarantees of Time Warner's and its other subsidiaries' debt obligations). The AOL Facility does not contain any credit ratings-based defaults or covenants or any ongoing covenant or representation specifically relating to a material adverse change in Time Warner's or AOL's financial condition or results of operations. The proceeds of the AOL Facility were used to pay off \$500 million of the \$1 billion 6.125% Time Warner notes due April 15, 2006.

**Capital Expenditures and Product Development Costs**

Time Warner's total capital expenditures and product development costs from continuing operations were \$781 million for the three months ended March 31, 2006 compared to \$650 million for the three months ended March 31, 2005. The majority of capital expenditures and product development costs relate to the Company's Cable segment, which had capital expenditures of \$497 million for the three months ended March 31, 2006 as compared to \$387 million for the three months ended March 31, 2005.

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

The Cable segment's capital expenditures include the following major components:

	<b>Three Months Ended</b>	
	<b>3/31/06</b>	<b>3/31/05</b>
	<b>(millions)</b>	
<b>Cable Segment Capital Expenditures</b>		
Customer premise equipment	\$ 282	\$ 198
Scalable infrastructure	54	45
Line extensions	58	63
Upgrades/rebuilds	23	30
Support capital	80	51
Total capital expenditures	\$ 497	\$ 387

TWC 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 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, scalable infrastructure, line extensions, plant upgrades and rebuilds and support capital. With respect to customer premise equipment, which includes converters and cable modems, TWC 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, the useful life is generally 3 to 4 years, and, for plant upgrades, the useful life is up to 16 years.

The increase in capital expenditures in 2006 is primarily associated with the continued roll-out of TWC's advanced digital services, including Digital Phone.

**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 \$4.2 billion and \$4.5 billion at March 31, 2006 and December 31, 2005, respectively. Included in these amounts is licensing of film product from the Filmed Entertainment segment to the Networks segment of \$788 million and \$774 million at March 31, 2006 and December 31, 2005, respectively.

**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 299,000 basic video subscribers as of March 31, 2006, 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 1.278 million basic video subscribers as of March 31, 2006. 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. ( TKCCP ) 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 and 50% by Comcast both before and after the restructuring and 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 continues to account for its investment in the restructured joint venture using the equity method. Beginning on June 1, 2006, either TWC 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

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

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 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 TKCCP 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 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.

*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. As of the date of this filing, Liberty has not given notice to Time Warner nor has Time Warner given notice to Liberty.

**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, in the 2005 Form 10-K, which should be read in conjunction with this report (as updated by Item 1A, Risk Factors, in Part II of the March 2006 Form 10-Q), 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 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, in the 2005 Form 10-K, as well as:



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

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 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, in the 2005 Form 10-K, as updated by Item 1A, Risk Factors, in Part II of the March 2006 Form 10-Q, 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, in 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;

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'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**  
**(Unaudited)**

	<b>March 31, 2006</b>	<b>December 31, 2005 (recast)</b>
	<b>(restated, millions, except per share amounts)</b>	
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and equivalents	\$ 2,295	\$ 4,220
Receivables, less allowances of \$2.044 and \$2.061 billion	5,413	6,546
Inventories	2,134	2,041
Prepaid expenses and other current assets	980	892
Current assets of discontinued operations		351
Total current assets	10,822	14,050
Noncurrent inventories and film costs	4,630	4,597
Investments, including available-for-sale securities	3,550	3,493
Property, plant and equipment, net	13,927	13,647
Intangible assets subject to amortization, net	4,658	3,492
Intangible assets not subject to amortization	38,425	39,685
Goodwill	40,423	40,276
Other assets	3,077	3,121
Noncurrent assets of discontinued operations	232	383
Total assets	\$ 119,744	\$ 122,744
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 1,127	\$ 1,207
Participations payable	2,443	2,401
Royalties and programming costs payable	945	966
Deferred revenue	1,658	1,473
Debt due within one year	84	92
Other current liabilities	5,334	6,159
Current liabilities of discontinued operations	66	230
Total current liabilities	11,657	12,528
Long-term debt	20,031	20,238
Deferred income taxes	13,741	12,984
Deferred revenue	636	681
Other liabilities	5,430	5,464
Noncurrent liabilities of discontinued operations	7	15
Minority interests	5,779	5,729
Commitments and contingencies (Note 13)		

**Shareholders' equity**

Series LMCN-V common stock, \$0.01 par value, 92.6 and 87.2 million shares issued and outstanding	1	1
Time Warner common stock, \$0.01 par value, 4.721 and 4.706 billion shares issued and 4.280 and 4.498 shares outstanding	47	47
Paid-in-capital	168,786	168,635
Treasury stock, at cost (441.3 and 208.0 million shares)	(9,540)	(5,463)
Accumulated other comprehensive loss, net	(18)	(64)
Accumulated deficit	(96,813)	(98,051)
 Total shareholders' equity	 62,463	 65,105
 Total liabilities and shareholders' equity	 \$ 119,744	 \$ 122,744

See accompanying notes.



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**TIME WARNER INC.**  
**CONSOLIDATED STATEMENT OF OPERATIONS**  
**Three Months Ended March 31,**  
**(Unaudited)**

	<b>2006</b>	<b>2005</b>
	<b>(restated, millions, except per share amounts)</b>	
Revenues:		
Subscription	\$ 5,667	\$ 5,485
Advertising	1,761	1,645
Content	2,756	2,976
Other	271	257
Total revenues <sup>(a)</sup>	10,455	10,363
Costs of revenues <sup>(a)</sup>	(5,806)	(5,907)
Selling, general and administrative <sup>(a)</sup>	(2,600)	(2,587)
Amortization of intangible assets	(133)	(148)
Amounts related to securities litigation and government investigations	(29)	(6)
Merger-related and restructuring costs	(30)	(12)
Asset impairments		(24)
Gains on disposal of assets, net	22	10
Operating income	1,879	1,689
Interest expense, net <sup>(a)</sup>	(299)	(346)
Other income, net	318	112
Minority interest expense, net	(79)	(55)
Income before income taxes, discontinued operations and cumulative effect of accounting change	1,819	1,400
Income tax provision	(613)	(488)
Income before discontinued operations and cumulative effect of accounting change	1,206	912
Discontinued operations, net of tax	232	7
Income before cumulative effect of accounting change	1,438	919
Cumulative effect of accounting change, net of tax	25	
Net income	\$ 1,463	\$ 919
Basic income per common share before discontinued operations and cumulative effect of accounting change	\$ 0.27	\$ 0.20
Discontinued operations	0.05	
Cumulative effect of accounting change	0.01	

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Basic net income per common share	\$	0.33	\$	0.20
Average basic common shares		4,499.5		4,587.8
Diluted income per common share before discontinued operations and cumulative effect of accounting change	\$	0.27	\$	0.19
Discontinued operations		0.05		
Cumulative effect of accounting change				
Diluted net income per common share	\$	0.32	\$	0.19
Average diluted common shares		4,542.9		4,722.3
Cash dividends declared per share of common stock	\$	0.05	\$	

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

Revenues		\$	84	\$	68
Costs of revenues			(54)		(48)
Selling, general and administrative			9		8
Interest income, net			11		7
See accompanying notes.					

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**TIME WARNER INC.**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
**Three Months Ended March 31,**  
**(Unaudited)**

	<b>2006</b>	<b>2005</b>
		<b>(recast)</b>
	<b>(restated, millions)</b>	
<b>OPERATIONS</b>		
Net income <sup>(a)</sup>	\$ 1,463	\$ 919
Adjustments for noncash and nonoperating items:		
Cumulative effect of accounting change, net of tax	(25)	
Depreciation and amortization	814	796
Amortization of film costs	822	911
Asset impairments		24
Gain on investments and other assets, net	(309)	(32)
Equity in income of investee companies, net of cash distributions	(12)	(7)
Equity-based compensation	108	134
Amounts related to securities litigation and government investigations	5	(300)
Changes in operating assets and liabilities, net of acquisitions	(310)	(627)
Adjustments relating to discontinued operations	(226)	14
Cash provided by operations <sup>(b)</sup>	2,330	1,832
<b>INVESTING ACTIVITIES</b>		
Investments and acquisitions, net of cash acquired	(126)	(224)
Capital expenditures and product development costs	(781)	(650)
Capital expenditures from discontinued operations		(1)
Investment proceeds from available-for-sale securities	4	13
Other investment proceeds	807	73
Cash used by investing activities	(96)	(789)
<b>FINANCING ACTIVITIES</b>		
Borrowings	1	
Debt repayments	(226)	(247)
Proceeds from exercise of stock options	242	99
Excess tax benefit on stock options	32	22
Principal payments on capital leases	(23)	(37)
Repurchases of common stock	(3,936)	
Dividends paid	(225)	
Other	(24)	(7)
Cash used by financing activities	(4,159)	(170)
<b>INCREASE (DECREASE) IN CASH AND EQUIVALENTS</b>	<b>(1,925)</b>	<b>873</b>
<b>CASH AND EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>4,220</b>	<b>6,139</b>
<b>CASH AND EQUIVALENTS AT END OF PERIOD</b>	<b>\$ 2,295</b>	<b>\$ 7,012</b>

(a) The first quarters of 2006 and 2005 include net income from discontinued operations of \$232 million and \$7 million, respectively.

(b) The first quarters of 2006 and 2005 include an approximate \$181 million source of cash and \$36 million use of cash, respectively, 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 SHAREHOLDERS EQUITY  
Three Months Ended March 31,  
(Unaudited)**

	<b>2006</b>	<b>2005</b> <b>(recast)</b>
	<b>(restated, millions)</b>	
<b>BALANCE AT BEGINNING OF PERIOD</b>	\$ 65,105	\$ 63,297
Net income	1,463	919
Other comprehensive income (loss)	47	(17)
Comprehensive income	1,510	902
Conversion of mandatorily convertible preferred stock		1,500
Cash dividends (\$0.05 per common share)	(225)	
Common stock repurchases	(4,073)	
Other <sup>(a)</sup>	146	129
<b>BALANCE AT END OF PERIOD</b>	<b>\$ 62,463</b>	<b>\$ 65,828</b>

(a) The first quarter of 2006 includes approximately \$164 million pursuant to stock option and other benefit plans and an approximate \$17 million net loss related to changing the fiscal year end of international operations from November 30 to December 31 (net of the related income tax benefit of approximately \$7 million). The first quarter of 2005 includes approximately \$152 million pursuant to stock option and

other benefit plans and an approximate \$23 million net loss related to changing the fiscal year end of certain international operations from November 30 to December 31 (net of the related income tax benefit of approximately \$9 million).

See accompanying notes.

**Table of Contents****TIME WARNER INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****1. 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

**Table of Contents****TIME WARNER INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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.

The net effect of restating these transactions is that the Company's net income has been increased by \$8 million and \$4 million for the three months ended March 31, 2006 and 2005, respectively.

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

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(in millions, except per share amounts)</b>	
Advertising Revenues	\$	\$
Cost of Revenues decrease	13	7
Selling, general and administrative		
Operating Income increase	13	7
Other income, net increase		1
Minority interest expense increase		(1)
Income before income taxes, discontinued operations and cumulative effect of accounting change increase	13	7
Income tax provision increase	(5)	(3)
Net income increase	\$ 8	\$ 4
Basic income per common share before discontinued operations and cumulative effect of accounting change	\$ 0.00	\$ 0.00
Diluted income per common share before discontinued operations and cumulative effect of accounting change increase	\$ 0.01	\$ 0.00
Basic net income per common share increase	\$ 0.01	\$ 0.00
Diluted net income per common share	\$ 0.00	\$ 0.00

At March 31, 2006 and December 31, 2005, the impact of the restatement on Total Assets is an increase of \$10 million and \$1 million, respectively, and the impact of the restatement on Total Liabilities is an increase of \$38 million and \$37 million, respectively. The restatement has no impact on the accompanying consolidated statement of cash flows. Certain of the footnotes that follow have also been restated to reflect the changes described above.

**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. Financial information for Time Warner's various reportable segments is presented in Note 12.

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On April 3, 2006, America Online, Inc. converted to a Delaware limited liability company and changed its name to AOL LLC (together with its subsidiaries, AOL ).

***Pending Transactions******Amounts Related to Securities Litigation***

As previously disclosed, 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 13 (the MSBI consolidated securities class action ). 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. The court issued an order dated April 6, 2006 granting final approval of the settlement.

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 (including suits brought by individual shareholders) described in Note 13 that are pending against the Company. As of May 1, 2006, the Company has reached agreements to resolve the actions alleging violations of the Employee Retirement Income Security Act ( ERISA ) and the derivative actions, both of which are subject to preliminary and final court approval, as well as some of the individual suits. Of the \$600 million reserve, through May 1, 2006, the Company has paid, or has agreed to pay, approximately \$358 million, after considering probable insurance recoveries, to settle certain of these claims. The Company has been successful in reaching settlements with respect to certain of the securities actions brought by individual shareholders. The Company also has engaged in, or expects to engage in, mediation in an attempt to resolve the additional cases brought by shareholders who elected to opt out of the settlement in the consolidated securities action. Such mediation efforts have not been fruitful to date in certain of these matters, in which trials are possible and for which plaintiffs have claimed several billion dollars in aggregated damages. The Company intends to defend these lawsuits vigorously. It is possible that the ultimate amount paid to resolve all unsettled litigation in these matters could be greater than the remaining reserve (Note 13).

The Company recognizes insurance recoveries when it becomes probable that such amounts will be received. Amounts recognized in the first quarter of 2006 and 2005 totaled \$50 million and \$6 million, respectively. In 2005, 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 was collected in the first quarter of 2006.

***Government Investigations***

As previously disclosed by the Company, the DOJ and the SEC have resolved their investigations into the accounting and disclosure practices of the Company, the former through a deferred prosecution agreement entered into in December 2004 for a two-year period, and the latter through a settlement agreement that was approved by the SEC in March 2005. These resolutions are described in more detail in Note 13. The historical accounting adjustments related thereto were reflected in the restatement of the Company's financial results for each of the years ended December 31, 2000 through December 31, 2003, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004 (the 2004 Form 10-K ).

With respect to the \$300 million that was placed into an SEC Fair Fund as a condition of the SEC settlement, the Company has used its best efforts to have the \$300 million, or a substantial portion thereof, transferred to the MSBI

Settlement Fund and distributed in connection with the eventual distribution of proceeds pursuant to the settlement of the MSBI consolidated securities class action. However, the SEC, as yet, has not made any determination as to how to distribute those funds.

Under the terms of the Company's settlement with the SEC, the Company agreed to the appointment of an independent examiner to review whether the Company's historical accounting for transactions with 17 counterparties, which were identified by the SEC

**Table of Contents****TIME WARNER INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

staff, was in conformity with GAAP. The transactions subject to review were entered into between June 1, 2000 and December 31, 2001 (but including subsequent amendments thereto), and principally involve online advertising revenues, as well as three cable programming affiliation agreements with related advertising elements. Revenue related to the 17 transactions principally was recognized prior to January 1, 2002. The independent examiner has been engaged in his review, and, under the terms of the SEC settlement, is required to provide a report to the Company's audit and finance committee of his conclusions. 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.

**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*.

**Changes in Basis of Presentation**

The 2005 financial statements have been recast so that the basis of presentation is consistent with that of 2006. Specifically, the amounts have been recast for the adoption of Financial Accounting Standards Board ( FASB ) Statement No. 123 (revised 2004), *Share-Based Payment* ( FAS 123R ), a change in accounting principle for recognizing programming inventory costs at HBO and certain discontinued operations.

***Stock-Based Compensation***

The Company has adopted the provisions of FAS 123R, as of January 1, 2006. The provisions of FAS 123R require a company to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost is recognized in the statement of operations over the period during which an employee is required to provide service in exchange for the award. FAS 123R also amends FASB Statement No. 95, *Statement of Cash Flows*, to require that excess tax benefits, as defined, realized from the exercise of stock options be reported as a financing cash inflow rather than as a reduction of taxes paid in cash flow from operations.

**Table of Contents****TIME WARNER INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Prior to the adoption of FAS 123R, the Company had followed the provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation ( FAS 123 ), which allowed the Company to follow the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and disclose the pro forma effects on net income (loss) had the fair value of the equity awards been expensed. In connection with adopting FAS 123R, the Company elected to adopt the modified retrospective application method provided by FAS 123R and, accordingly, financial statement amounts for all prior periods presented herein reflect results as if the fair value method of expensing had been applied from the original effective date of FAS 123. The following tables set forth the increase (decrease) to the Company's consolidated statements of operations and balance sheets as a result of the adoption of FAS 123R for the three months ended March 31, 2005 and for the years ended December 31, 2005 and 2004 (in millions, except per share amounts):

	<b>Impact of Change for adoption of FAS 123R</b>		
	<b>For the three months ended March 31, 2005</b>	<b>For the year ended December 31, 2005</b>	<b>December 31, 2004</b>
	<b>(restated, millions, except per share amounts)</b>		
<b>Consolidated Statement of Operations</b>			
Operating Income	\$ 127	\$ 316	\$ 540
Income before income taxes, discontinued operations and cumulative effect of accounting change	(121)	(304)	(525)
Net income	(74)	(242)	(298)
Net income per share (basic)	\$(0.02)	\$(0.05)	\$ (0.07)
Net income per share (diluted)	\$(0.02)	\$(0.05)	\$ (0.06)

	<b>Impact of Change for adoption of FAS 123R</b>	
	<b>December 31, 2005</b>	<b>December 31, 2004</b>
	<b>(restated, millions)</b>	
<b>Consolidated Balance Sheet</b>		
Deferred income tax liabilities, net	\$(2,206)	\$ (2,360)
Minority interest liabilities, net	(37)	(30)
Shareholders' equity	2,243	2,390

Prior to the adoption of FAS 123R, the Company recognized stock-based compensation expense for awards with graded vesting by treating each vesting tranche as a separate award and recognizing compensation expense ratably for each tranche. For equity awards granted subsequent to the adoption of FAS 123R, the Company treats such awards as a single award and recognizes stock-based compensation expense on a straight-line basis (net of estimated forfeitures) over the employee service period. Stock-based compensation expense is recorded in costs of revenues or selling, general and administrative expense depending on the employee's job function.

Additionally, when recording compensation cost for equity awards, FAS 123R requires companies to estimate the number of equity awards granted that are expected to be forfeited. Prior to the adoption of FAS 123R, the Company recognized forfeitures when they occurred, rather than using an estimate at the grant date and subsequently adjusting the estimated forfeitures to reflect actual forfeitures. Accordingly, a pretax cumulative effect adjustment totaling \$40 million (\$25 million, net of tax) has been recorded in the first quarter of 2006 to adjust for awards granted prior to

January 1, 2006, that are not expected to vest.

***Change in Accounting Principle for Recognizing Programming Inventory Costs at HBO***

Effective January 1, 2006, the Company changed its methodology for recognizing programming inventory costs (for both theatrical and original programming) at its HBO division. Previously, the Company recognized HBO's programming costs on a straight-line basis in the calendar year in which the related programming first aired on the HBO and Cinemax pay television services. Now the Company recognizes programming costs on a straight-line basis over the license periods or estimated period of use of the related shows, beginning with the month of initial exhibition. The Company concluded that this change in accounting for programming inventory costs was preferable after giving consideration to the cumulative impact that marketplace and technological changes have had in broadening the variety of viewing options and period over which consumers are now experiencing HBO's programming.

**Table of Contents****TIME WARNER INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Since this change involves a revision to an inventory costing principle, the change is reflected retrospectively to all prior periods presented, including the impact that such a change has on retained earnings for the earliest year presented. Although it was not practical for the Company to continue to calculate its programming costs using the prior methodology, the Company believes that the first quarter 2006 statement of operations would not have been materially different if the prior methodology had been applied. The following tables set forth certain changes to the Company's consolidated statements of operations and balance sheets as a result of the change in the method of accounting for HBO's programming inventory costs for the three months ended March 31, 2005 and for the years ended December 31, 2005 and 2004 (in millions, except per share amounts):

	<b>Three Months Ended March 31, 2005</b>		
	<b>Impact of</b>		
	<b>As</b>		<b>As</b>
	<b>Reported<sup>(a)</sup></b>	<b>Change</b>	<b>Adjusted</b>
	<b>(restated, millions, except per share amounts)</b>		
<b>Consolidated Statement of Operations</b>			
Costs of revenues	\$(5,949)	\$ 42	\$(5,907)
Operating Income	1,647	42	1,689
Income before income taxes, discontinued operations and cumulative effect of accounting change	1,358	42	1,400
Net income	893	26	919
Net income per share (basic)	\$ 0.19	\$0.01	\$ 0.20
Net income per share (diluted)	\$ 0.19	\$	\$ 0.19

(a) Amounts have been adjusted to reflect the impact of adopting FAS 123R and reflecting certain businesses as discontinued operations.

	<b>Year Ended December 31, 2005</b>		
	<b>Impact of</b>		
	<b>As</b>		<b>As Adjusted</b>
	<b>Reported<sup>(a)</sup></b>	<b>Change</b>	<b>As Adjusted</b>
	<b>(restated, millions, except per share amounts)</b>		
<b>Consolidated Statement of Operations</b>			
Costs of revenues	\$(24,776)	\$ (8)	\$(24,784)
Operating Income	4,164	(8)	4,156
	3,744	(8)	3,736

Income before income taxes, discontinued operations and  
cumulative effect of accounting change

Net income	2,678	(5)	2,673
Net income per share (basic)	\$ 0.58	\$	\$ 0.58
Net income per share (diluted)	\$ 0.57	\$	\$ 0.57

(a) Amounts have  
been adjusted to  
reflect the  
impact of  
adopting FAS  
123R and  
reflecting  
certain  
businesses as  
discontinued  
operations.



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

	<b>Year Ended December 31, 2004</b>		
	<b>Impact of</b>		
	<b>As Reported<sup>(a)</sup> (restated, millions, except per share amounts)</b>	<b>Change</b>	<b>As Adjusted</b>
<b>Consolidated Statement of Operations</b>			
Costs of revenues	\$(24,214)	\$ 31	\$(24,183)
Operating Income	5,640	31	5,671
Income before income taxes, discontinued operations and cumulative effect of accounting change	4,395	31	4,426
Net income	3,097	19	3,116
Net income per share (basic)	\$ 0.67	\$0.01	\$ 0.68
Net income per share (diluted)	\$ 0.65	\$0.01	\$ 0.66

(a) Amounts have been adjusted to reflect the impact of adopting FAS 123R and reflecting certain businesses as discontinued operations.

	<b>December 31, 2005</b>		
	<b>Impact of</b>		
	<b>As Reported<sup>(a)</sup> (restated, millions)</b>	<b>Change</b>	<b>As Adjusted</b>
<b>Consolidated Balance Sheet</b>			
Inventories (current and non current)	\$ 6,347	\$291	\$ 6,638
Accumulated deficit	(98,234)	183	(98,051)

(a) Amounts have been adjusted to reflect the impact of adopting FAS 123R and reflecting certain businesses as discontinued operations.

operations.

	<b>December 31, 2004</b>		
	<b>Impact</b>		
	<b>As</b>	<b>of</b>	
	<b>Reported<sup>(a)</sup></b>	<b>Change</b>	<b>As Adjusted</b>
		<b>(restated, millions)</b>	
<b>Consolidated Balance Sheet</b>			
Inventories (current and non current)	\$ 6,101	\$304	\$ 6,405
Accumulated deficit	(100,446)	188	(100,258)

(a) Amounts have been adjusted to reflect the impact of adopting FAS 123R and reflecting certain businesses as discontinued operations.

#### ***Discontinued Operations***

As discussed more fully in Note 4, the Company has reflected the operations of Time Warner Book Group ( TWBG ) and Turner South network ( Turner South ) as discontinued operations for all periods presented.

#### ***Reclassifications***

Certain reclassifications have been made to the prior year financial information to conform to the March 31, 2006 presentation.

#### ***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.

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

**Interim Financial Statements**

The accompanying consolidated financial statements are unaudited; however, in the opinion of management, they contain all the adjustments (consisting of those of a normal recurring nature) considered necessary to present fairly the financial position and the results of operations and cash flows for the periods presented in conformity with GAAP applicable to interim periods. The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements of Time Warner included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005 (the 2005 Form 10-K).

**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:

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005 (recast)</b>
	<b>(restated, millions, except per share amounts)</b>	
Income before discontinued operations and cumulative effect of accounting change — basic and diluted	\$ 1,206	\$ 912
Average number of common shares outstanding — basic	4,499.5	4,587.8
Dilutive effect of stock options and restricted stock	43.4	51.6
Dilutive effect of mandatorily convertible preferred stock		82.9
Average number of common shares outstanding — diluted	4,542.9	4,722.3
Income per common share before discontinued operations and cumulative effect of accounting change:		
Basic	\$ 0.27	\$ 0.20
Diluted	\$ 0.27	\$ 0.19

**2. INTANGIBLE ASSETS**

As a result of increased competition in the publishing business related to certain magazine titles, indefinite-lived tradename intangibles totaling approximately \$1.3 billion at December 31, 2005 were assigned a 25-year finite life and began to be amortized in January 2006. The impact of amortizing such tradenames in 2006 and beyond will be approximately \$50 million annually. Based on the current amount of intangible assets subject to amortization, the total estimated amortization expense for each of the succeeding five years ended December 31 is as follows (millions):

2006	\$482
2007	390

2008	354
2009	302
2010	304

These amounts may vary as acquisitions and dispositions occur in the future and as purchase price allocations are finalized.

**Table of Contents****TIME WARNER INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****3. STOCK-BASED COMPENSATION PLANS**

The Company has two active equity plans under which it is authorized to grant options to purchase up to an aggregate of 300 million shares of Time Warner common stock. Such options have been granted to employees and non-employee directors of Time Warner with exercise prices equal to, or in excess of, the fair market value at the date of grant. Generally, the options vest ratably, over a four-year vesting period, and expire ten years from the date of grant. Certain option awards provide for accelerated vesting upon an election to retire pursuant to the Company's defined benefit retirement plans or after reaching a specified age and years of service, as well as certain additional circumstances for non-employee directors.

Time Warner also has various restricted stock plans for employees and non-employee directors. Under these plans, shares of common stock or restricted stock units ( RSUs ) are granted, which vest generally between three to five years. Certain RSU awards provide for accelerated vesting upon an election to retire pursuant to the Company's defined benefit retirement plans or after reaching a specified age and years of service, as well as certain additional circumstances for non-employee directors. For the three months ended March 31, 2006, the Company issued approximately 3.8 million RSUs at a weighted-average fair value of \$17.40. For the three months ended March 31, 2005, the Company issued approximately 3.4 million RSUs at a weighted-average fair value of \$17.97.

Upon the exercise of a stock option award, the vesting of a RSU or the grant of restricted stock, common shares are issued from authorized but unissued shares or from treasury stock. At March 31, 2006 and December 31, 2005, the Company had approximately 441 million and 208 million, respectively, shares of treasury stock. As noted in Note 9, for the three months ended March 31, 2006 and the year ended December 31, 2005, the Company has repurchased approximately 233 million and 126 million, respectively, shares of common stock pursuant to a Board approved stock repurchase program.

Certain information for stock-based compensation plans for the three months ended March 31, 2006 and 2005 is as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(millions)</b>	
<b>Compensation Cost Recognized:</b>		
Stock option plans	\$ 80	\$ 125
Restricted stock and restricted stock units	28	7
Stock purchase plan <sup>(a)</sup>		2
Total	\$ 108	\$ 134
Tax benefit recognized	\$ 40	\$ 51

(a) Prior to 2006, the Company had a compensatory Stock Purchase Plan that provided certain employees in the AOL

division with the ability to purchase Company stock at a 15% discount. In late 2005, the plan was amended to reduce the discount to 5% and is no longer a compensatory Stock Purchase Plan under applicable accounting literature.

Other information pertaining to each category of stock-based compensation appears below.

### **Stock Option Plans**

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model, consistent with the provisions of FAS 123R and SEC Staff Accounting Bulletin No. 107 Share-Based Payment. Because option-pricing models require the use of subjective assumptions, changes in these assumptions can materially affect the fair value of the options. The assumptions presented in the table below represent the weighted average value of the applicable assumption used to value stock options at their grant date. In determining the volatility assumption, the Company considers implied volatilities from traded options as well as quotes from third-party investment banks. The expected term, which represents the period of time that options granted are expected to be outstanding, is estimated based on the historical exercise experience of Time Warner employees. The Company evaluated the historical exercise behaviors of five employee groups, one of which related to retirement-eligible employees while the other four of which were segregated based on the number of options granted, when determining the expected term assumptions. The risk-free rate assumed in valuing the options is based on the U.S. Treasury yield curve in effect at the time of grant for the expected term of the option. The Company determines the expected dividend yield percentage by dividing the expected annual dividend by the market price of Time Warner common stock at the date of grant.

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

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
Expected volatility	22.2%	24.4%
Expected term to exercise from grant date	5.08 years	4.79 years
Risk-free rate	4.6%	3.9%
Expected dividend yield	1.1%	0%

The following table summarizes information about stock options outstanding at March 31, 2006:

	<b>Number of Options as of 3/31/06 (thousands)</b>	<b>Weighted- Average Exercise Price</b>	<b>Weighted- Average Remaining Contractual Life (In Years)</b>	<b>Aggregate Intrinsic Value (thousands)</b>
<b>Options</b>				
Outstanding at January 1, 2006	590,687	\$30.48		
Granted	51,557	17.40		
Exercised	(20,731)	11.72		
Forfeited or expired	(25,402)	42.04		
Outstanding at March 31, 2006	596,111	29.51	5.68	\$708,675
Exercisable at March 31, 2006	453,625	33.34	4.76	\$595,165

At March 31, 2006, the number, weighted-average exercise price, aggregate intrinsic value and weighted-average remaining contractual term of options vested and expected to vest approximate amounts for options outstanding. As of March 31, 2006, approximately 70 million shares were available for future grants of stock options. Total unrecognized compensation cost related to unvested stock option awards at March 31, 2006 prior to the consideration of expected forfeitures is approximately \$384 million and is expected to be recognized over a weighted-average period of 2 years.

The weighted average fair value of an option granted during the three months ended March 31, 2006 and 2005 was \$4.46 (\$2.77 net of taxes) and \$5.14 (\$3.08, net of taxes), respectively. The total intrinsic value of options exercised during the three months ended March 31, 2006 and 2005 was \$120 million and \$123 million, respectively. Cash received from the exercise of stock options was \$242 million and \$99 million, respectively, for the three months ended March 31, 2006 and 2005. The tax benefits realized from stock options exercised in the three months ended March 31, 2006 and 2005 were approximately \$46 million and \$49 million, respectively.

**Restricted Stock and Restricted Stock Unit Plans**

The following table summarizes information about restricted stock and RSUs unvested at March 31, 2006:

	<b>Number of Shares/Units as of 3/31/06 (thousands)</b>	<b>Weighted- Average Grant Date Fair Value</b>
<b>Restricted Stock and Restricted Stock Units</b>		
Unvested at January 1, 2006	7,960	\$16.32
Granted	3,824	17.40
Vested	(944)	18.01
Forfeited	(90)	16.86

Unvested at March 31, 2006	10,750	17.07
----------------------------	--------	-------

At March 31, 2006, the intrinsic value of restricted stock and restricted stock unit awards is approximately \$180 million. Total unrecognized compensation cost related to unvested restricted stock and restricted stock unit awards at March 31, 2006 prior to the consideration of expected forfeitures is approximately \$106 million and is expected to be recognized over a weighted-average period of 2 years. The fair value of restricted stock and restricted stock units that vested during the three months ended March 31, 2006 was approximately \$17 million.

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**Table of Contents****TIME WARNER INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****4. BUSINESS ACQUISITIONS AND DISPOSITIONS****Sale of Time Warner Book Group**

On March 31, 2006, the Company sold Time Warner Book Group ( TWBG ) to Hachette Livre SA, a wholly-owned subsidiary of Lagardère SCA, for \$532 million in cash, resulting in a pretax gain of approximately \$206 million, after taking into account selling costs and estimated working capital adjustments. As a result of the sale, TWBG has been reflected as discontinued operations for all periods presented. A tax benefit of \$22 million was also recognized on this transaction resulting primarily from the release of a valuation allowance associated with tax attribute carryforwards offsetting the tax gain on the transaction.

**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. for approximately \$375 million in cash. This transaction closed on May 1, 2006. The results of Turner South have been reflected as discontinued operations for all periods presented. The Company expects to record a pretax gain ranging from approximately \$120 million to \$140 million (after taking into account selling costs) in the second quarter of 2006. Since the Company has sufficient tax attribute carryforwards to offset the gain, there will not be any tax expense recognized on the sale of Turner South. As of March 31, 2006, Turner South had assets of approximately \$230 million.

Financial data for TWBG and Turner South operations, included in discontinued operations for the three months ended March 31, 2006 and 2005, is as follows:

	<b>March 31, 2006</b>	<b>March 31, 2005</b>
	<b>(millions)</b>	
Total revenues	\$ 125	\$ 120
Pretax income	210	11
Income tax benefit	22	(4)
Net income	232	7

**The WB Network**

On January 24, 2006, Warner Bros. and CBS Corp. ( CBS ) announced an agreement 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 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 it will incur restructuring charges ranging from \$25 million to \$30 million related to employee terminations and contractual settlements. In addition, The WB Network may incur up to \$100 million in terminating certain programming arrangements (primarily licensed movie rights), most of which are not expected to be contributed to the new network and may not be sold or utilized in another manner. Included in these costs are approximately \$70 million associated with intercompany programming arrangements with Warner Bros. and New Line. Any costs incurred by The WB Network on such intercompany programming would be largely offset by amounts recognized by Warner Bros. and New Line, with the impact of all intercompany transactions being eliminated in consolidation. Excluding the impact of these intercompany transactions, the anticipated exit costs to the Company of programming arrangements and employee and other contractual arrangements range from approximately \$55 million to \$60 million.



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

**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. In addition, Google agreed to invest \$1 billion to acquire a 5% equity interests in a limited liability company that owns all of the outstanding equity interest in AOL. On March 24, 2006, the Company and Google signed definitive agreements governing the investment and the commercial arrangements. Under the alliance, Google will continue to provide search technology to AOL's network of Internet properties worldwide and provide AOL with an improved share in revenues generated through search conducted on the AOL network. 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;

Providing AOL \$300 million of marketing credits for promotion of AOL's content on Google-owned Internet properties as well as \$100 million of AOL/Google co-sponsored promotion of AOL properties;

Collaborating in video search and promoting the AOL Video destination within Google Video; and

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

AOL and Google also agreed to collaborate in the future to expand on the alliance, including the possible sale by AOL of display advertising on the Google network.

On April 13, 2006, the Company completed its issuance of a 5% equity interest in AOL to Google for \$1 billion in cash. In accordance with Staff Accounting Bulletin No. 51, *Accounting for the Sales of Stock of a Subsidiary*, Time Warner will recognize a gain of approximately \$800 million, which will be reflected in shareholders' equity, as an adjustment to paid-in capital in the second quarter of 2006.

**5. TIME WARNER CABLE INC.****Ownership**

Comcast Corporation ( Comcast ) has a 21% economic interest in Time Warner Cable Inc.'s ( TWC ) cable business held through a 17.9% direct common ownership interest in TWC (representing a 10.7% voting interest) and a limited partnership interest in Time Warner Entertainment Company, L.P. ( TWE ) representing a 4.7% residual equity interest. Time Warner's 79% economic interest in TWC's cable business is held through an 82.1% common ownership interest in TWC (representing an 89.3% voting interest) and a limited partnership interest in TWE representing a 1% residual equity interest. Time Warner also holds a \$2.4 billion mandatorily redeemable preferred equity interest in TWE. The remaining interests in TWE are held indirectly by TWC.

**Adelphia/Comcast****Adelphia Acquisition Agreement**

On April 20, 2005, a subsidiary of TWC, Time Warner NY Cable LLC ( TW NY ), and Comcast each entered into separate definitive agreements with Adelphia Communications Corporation ( 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 (the Adelphia Acquisition ).

At the same time that Comcast and TW NY entered into the Adelphia Acquisition agreements, Comcast, TWC and/or their respective affiliates entered into agreements providing for the redemption of Comcast's interests in TWC and TWE (the TWC Redemption Agreement and the TWE Redemption Agreement, respectively, and, collectively, the TWC and TWE Redemption Agreements ). Specifically, Comcast's 17.9% interest in TWC will be redeemed in exchange for 100% of the capital stock of a subsidiary of TWC 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 100% of the equity 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, Comcast and their respective subsidiaries will also swap certain cable systems to enhance their respective geographic clusters of subscribers (the Cable Swaps ).

**Table of Contents****TIME WARNER INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

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 certain local franchise approvals, as well as completion of the bankruptcy process. The parties expect to close the Adelphia Acquisition on or before July 31, 2006.

The closing of the Adelphia Acquisition is not dependent on the closing of the Cable Swaps or the transactions contemplated by the TWC 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 stock at TWC's discretion.

Pursuant to registration rights granted to Comcast and certain of its affiliates in conjunction with the restructuring of TWE in 2003, TWC has an obligation to file a shelf registration statement with the SEC by June 1, 2006 covering all the shares of TWC Class A Common Stock held by Comcast and its affiliates if the transactions contemplated by the TWC Redemption Agreement have not occurred as of such date.

**6. TIME WARNER TELECOM**

As of December 31, 2005, wholly-owned subsidiaries of the Company owned a total of 50.4 million shares of Class B common stock of Time Warner Telecom Inc. (TWT), a publicly traded telecommunications company. The Company accounts for this investment using the equity method of accounting and, as a result of the Company's share in losses of TWT and impairment losses recognized in previous years, the carrying value of the investment is zero. In the first quarter of 2006, the Company's subsidiaries participated as selling shareholders in a TWT secondary offering, converted approximately 17 million shares of Class B common stock into Class A common stock of TWT and sold the Class A common stock for approximately \$239 million, net of underwriter commissions. This sale resulted in a pretax gain of approximately \$239 million, which is included as a component of Other income, net, in the accompanying consolidated statement of operations for the three months ended March 31, 2006. The Company does not consider its remaining investment in TWT to be strategic and, therefore, additional sales or other dispositions may occur in the future, subject to customary restrictions on transfer agreed to in connection with the offering and as provided in a stockholders agreement among the holders of the Class B common stock of TWT.

**Table of Contents****TIME WARNER INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****7. INVENTORIES AND FILM COSTS**

Inventories and film costs consist of:

	<b>March 31, 2006</b>	<b>December 31, 2005 (recast)</b>
	<b>(millions)</b>	
Programming costs, less amortization	\$ 3,249	\$ 3,213
Videocassettes, DVDs, books, paper and other merchandise	451	410
Film costs Theatrical:		
Released, less amortization	565	724
Completed and not released	219	123
In production	806	782
Development and pre-production	85	80
Film costs Television:		
Released, less amortization	494	529
Completed and not released	225	230
In production	663	545
Development and pre-production	7	2
Total inventories and film costs <sup>(a)</sup>	6,764	6,638
Less: current portion of inventory <sup>(b)</sup>	(2,134)	(2,041)
Total noncurrent inventories and film costs	\$ 4,630	\$ 4,597

(a) Does not include \$2.847 billion and \$2.903 billion of net film library costs as of March 31, 2006 and December 31, 2005, respectively, which are included in intangible assets subject to amortization on the accompanying consolidated

balance sheet.

- (b) Current inventory as of March 31, 2006 and December 31, 2005 is comprised of programming inventory at the Networks segment (\$1.685 billion and \$1.629 billion, respectively), books, magazines, paper and other merchandise at the Publishing segment (\$189 million and \$170 million, respectively), DVDs and videocassettes at the Filmed Entertainment segment (\$258 million and \$239 million, respectively) and general merchandise at the AOL segment (\$2 million and \$3 million, respectively).

#### **8. AOL TERM LOAN**

On April 13, 2006, TW AOL Holdings Inc., a wholly owned subsidiary of Time Warner, entered into a \$500 million term loan with a maturity date of April 13, 2009 (the AOL Facility ). Simultaneous with the Google investment of \$1 billion for a 5% equity interest in AOL Holdings LLC, a subsidiary of TW AOL Holdings Inc. and the parent of AOL, the liability under the AOL Facility was assigned to AOL Holdings LLC. Immediately following, the AOL Facility was assigned from AOL Holdings LLC to AOL. The AOL Facility is not guaranteed by Time Warner. Borrowings under the AOL Facility bear interest at a rate based on the credit rating of Time Warner, which rate is currently LIBOR plus 0.45% per annum. The AOL Facility includes a maximum leverage ratio covenant restricting consolidated total debt of AOL to 4.5 times the consolidated EBITDA (as defined in the credit agreement)

of AOL (excluding AOL guarantees of Time Warner's and its other subsidiaries' debt obligations). The AOL Facility does not contain any credit ratings-based defaults or covenants or any ongoing covenant or representation specifically relating to a material adverse change in Time Warner's or AOL's financial condition or results of operations. The proceeds of the AOL Facility were used to pay off \$500 million of the \$1 billion 6.125% Time Warner notes due April 15, 2006.

## **9. SHAREHOLDERS' EQUITY**

### **Shares Authorized and Outstanding**

As of March 31, 2006, shareholders' equity of Time Warner included 92.6 million shares of Series LMCN-V common stock and 4.280 billion shares of common stock (net of approximately 441 million shares of common stock held in treasury). As of March 31, 2006, Time Warner is authorized to issue up to 750 million shares of preferred stock, up to 25 billion shares of common stock and up to 1.8 billion shares of additional classes of common stock, including Series LMCN-V common stock. Shares of Series LMCN-V common stock have substantially identical rights as shares of Time Warner's common stock, except that shares of Series LMCN-V common stock have limited voting rights and are nonredeemable. The holders of Series LMCN-V common stock are entitled to 1/100 of a vote per share on the election of directors and do not have any other voting rights, except as required by law or with respect to limited matters, including amendments to the terms of the Series LMCN-V common stock adverse to such holders. The Series LMCN-V common stock is not transferable, except in limited circumstances, and is not listed on any securities exchange. Each share of Series



**Table of Contents****TIME WARNER INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

LMCN-V common stock is convertible into one share of Time Warner common stock at any time, assuming certain restrictive provisions have been met. During the first quarter of 2006, 5.4 million shares of common stock were converted into 5.4 million shares of Series LMCN-V common stock. This conversion partially reverses the conversion of 9.4 million shares of Series LMCN-V common stock into common stock that took place on February 1, 2005 to facilitate Liberty Media's stock loan arrangement.

**Common Stock Repurchase Program**

Time Warner's Board of Directors has authorized a common stock repurchase program that allows the Company 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, as defined, of approximately 3-to-1, and expects it will have purchased 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 March 31, 2006, the Company repurchased approximately 359 million shares of common stock for approximately \$6.3 billion pursuant to trading programs under Rule 10b5-1 of the Securities Exchange Act of 1934, as amended.

**Common Stock Dividends**

On March 15, 2006, the Company paid a cash dividend of \$0.05 per share on its common stock to shareholders of record on February 28, 2006. The total amount of dividends paid during the first quarter of 2006 was \$225 million.

**10. BENEFIT PLANS**

Time Warner and certain of its subsidiaries have both funded and unfunded noncontributory defined benefit pension plans covering a majority of domestic employees and, to a lesser extent, have various defined benefit plans covering 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. Time Warner uses a December 31 measurement date for the majority of its plans. A summary of the components of the net periodic benefit cost recognized by substantially all of Time Warner's domestic and international defined benefit pension plans for the three months ending March 31, 2006 and 2005 are as follows (millions):

**Components of Net Periodic Benefit Costs**

	Domestic March 31, 2006      2005 (millions)		International March 31, 2006      2005 (millions)	
Service cost	\$ 42	\$ 31	\$ 6	\$ 5
Interest cost	46	42	9	9
Expected return on plan assets	(57)	(49)	(13)	(10)
Amounts amortized	18	13	2	2
Net periodic benefit costs	\$ 49	\$ 37	\$ 4	\$ 6
Contributions	\$ 3	\$ 5	\$ 4	\$ 4

**Expected cash flows**

After considering the funded status of the Company's defined benefit pension plans, movements in the discount rate, investment performance and related tax consequences, the Company may choose to make contributions to its

pension plans in any given year. There currently are no minimum required contributions for domestic funded plans and no discretionary or noncash contributions are currently planned. For domestic unfunded plans, contributions will continue to be made to the extent benefits are paid. Expected benefit payments for domestic unfunded plans for 2006 is approximately \$18 million.

**Table of Contents****TIME WARNER INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****11. MERGER AND RESTRUCTURING COSTS****Merger Costs*****Adelphia Merger-Related Costs***

For the year ended December 31, 2005 and for the three months ended March 31, 2006, the Company incurred non-capitalizable merger-related costs of approximately \$8 million and \$4 million, respectively, at the Cable segment related primarily to consulting fees covering integration planning for the Adelphia Acquisition and the Cable Swaps. None of the 2005 charges occurred in the first quarter of 2005.

As of March 31, 2006, payments of \$7 million (\$3 million in the first quarter of 2006) have been made against this accrual. The remaining \$5 million was classified as a current liability in the accompanying consolidated balance sheet.

***Merger Costs Capitalized as a Cost of Acquisition***

In connection with the AOL-Historic TW Merger, the Company reviewed its operations and implemented several plans to restructure the operations of both companies. As of December 31, 2005, out of the original \$1.031 billion charge, approximately \$32 million of liabilities remained. During the first quarter of 2006, \$5 million was paid against these liabilities and \$1 million was recorded as a noncash reduction, which represents adjustments to the restructuring accrual, with a corresponding reduction in goodwill, as actual costs related to employee terminations and other exit costs were less than originally estimated.

As of March 31, 2006, out of the remaining liability of \$26 million, \$5 million was classified as a current liability, with the remaining \$21 million classified as a long-term liability in the accompanying consolidated balance sheet. Amounts are expected to be paid through 2013.

**Restructuring Costs*****2006 Restructuring Costs***

For the three months ended March 31, 2006, the Company incurred restructuring costs of approximately \$23 million, including \$6 million at the Cable segment, \$12 million at the Publishing segment and \$5 million at the Corporate segment. These charges primarily related to various employee terminations and the total number of employees terminated was 172. As of March 31, 2006, 158 employees had been terminated. During the first quarter of 2006, \$2 million was paid against these liabilities.

As of March 31, 2006, out of the remaining liability of \$21 million, \$15 million was classified as a current liability, with the remaining \$6 million classified as a long-term liability in the accompanying consolidated balance sheet. Amounts are expected to be paid through 2009.

***2005 Restructuring Costs***

During 2005, the Company incurred restructuring costs of approximately \$116 million, including \$17 million at the AOL segment, \$34 million at the Cable segment, \$33 million at the Filmed Entertainment segment, \$4 million at the Networks segment and \$28 million at the Publishing segment. These charges primarily related to various employee terminations and the total number of employees terminated was 1,333. As of March 31, 2006, all employees had been terminated. The termination costs occurred across each of the segments and ranged from senior executives to line personnel. In addition, in the first quarter of 2006, the Company incurred \$3 million of additional restructuring charges (\$2 million at the Filmed Entertainment segment and \$1 million at the AOL segment) as a result of changes in estimates of previously established restructuring accruals.

As of March 31, 2006, out of the remaining liability of \$66 million, \$45 million was classified as a current liability, with the remaining \$21 million classified as a long-term liability in the accompanying consolidated balance sheet. Amounts are expected to be paid through 2011.

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

Selected information relating to the 2005 restructuring costs is as follows (millions):

	<b>Employee Terminations</b>	<b>Other Exit Costs</b>	<b>Total</b>
2005 accruals <sup>(a)</sup>	\$ 109	\$ 7	\$ 116
Cash paid 2005 <sup>(b)</sup>	(23)	(2)	(25)
Remaining liability as of December 31, 2005	86	5	91
Additional accruals	3		3
Cash paid 2006	(27)	(1)	(28)
Remaining liability as of March 31, 2006	\$ 62	\$ 4	\$ 66

(a) Of the \$116 million charge, \$17 million was incurred during the three months ended March 31, 2005.

(b) Of the \$25 million paid in 2005, no payments were made during the three months ended March 31, 2005.

**2004 and Prior Restructuring Costs**

The Company incurred various restructuring charges prior to 2005 with remaining accruals totaling \$34 million as of December 31, 2005 and \$28 million as of March 31, 2006. During the first quarter of 2006, \$6 million was paid against these liabilities and there were no noncash reductions during the first quarter of 2006. The first quarter of 2005 results included a \$5 million net noncash reduction as a result of changes in estimates of previously established restructuring accruals that were no longer required at the AOL segment.

As of March 31, 2006, out of the remaining liability of \$28 million, \$8 million was classified as a current liability, with the remaining \$20 million classified as a long-term liability in the accompanying consolidated balance sheet. Amounts are expected to be paid through 2013.

**12. SEGMENT INFORMATION**

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.

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Information as to the operations of Time Warner in each of its business segments is set forth below based on the nature of the products and services offered. Time Warner evaluates performance based on several factors, of which the primary financial measure is operating income before depreciation of tangible assets and amortization of intangible assets ( Operating Income before Depreciation and Amortization ). Additionally, the Company has provided a summary of Operating Income by segment.

**Three Months Ended March 31, 2006**

	<b>Subscription</b>	<b>Advertising</b>	<b>Content (millions)</b>	<b>Other</b>	<b>Total</b>
<b>Revenues</b>					
AOL	\$ 1,538	\$ 392	\$	\$ 51	\$ 1,981
Cable	2,463	117			2,580
Filmed Entertainment			2,709	70	2,779
Networks	1,442	702	195	12	2,351
Publishing	372	583	20	151	1,126
Intersegment elimination	(148)	(33)	(168)	(13)	(362)
Total revenues	\$ 5,667	\$ 1,761	\$ 2,756	\$ 271	\$ 10,455

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**TIME WARNER INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**Three Months Ended March 31, 2005**

	Subscription	Advertising	Content (millions) (recast)	Other	Total
<b>Revenues</b>					
AOL	\$ 1,774	\$ 311	\$	\$ 48	\$ 2,133
Cable	2,127	119			2,246
Filmed Entertainment Networks	1,334	681	2,951 253	60 7	3,014 2,275
Publishing	381	571	20	157	1,129
Intersegment elimination	(131)	(40)	(248)	(15)	(434)
Total revenues	\$ 5,485	\$ 1,645	\$ 2,976	\$ 257	\$ 10,363

**Intersegment Revenues**

In the normal course of business, the Time Warner segments enter into transactions with one another. The most common types of intersegment transactions include:

The Filmed Entertainment segment generating Content revenues by licensing television and theatrical programming to the Networks segment;

The Networks segment generating Subscription revenues by selling cable network programming to the Cable segment;

The AOL, Cable, Networks and Publishing segments generating Advertising revenues by cross-promoting the products and services of all Time Warner segments; and

The AOL segment generating Other revenues by providing the Cable segment's customers access to the AOL Transit Data Network for high-speed access to the Internet.

These intersegment transactions are recorded by each segment at estimated fair value as if the transactions were with third parties and, therefore, impact segment performance. While intersegment transactions are treated like third-party transactions to determine segment performance, the revenues (and corresponding expenses or assets recognized by the segment that is counterparty to the transaction) are eliminated in consolidation and, therefore, do not themselves impact consolidated results. Additionally, transactions between divisions within the same reporting segment (e.g., a transaction between HBO and Turner within the Networks segment) are eliminated in arriving at segment performance and, therefore, do not themselves impact segment results. Revenues recognized by Time Warner's segments on intersegment transactions are as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005 (recast)</b>
	<b>(millions)</b>	
<b>Intersegment Revenues <sup>(a)</sup></b>		
AOL	\$ 14	\$ 6
Cable	7	10
Filmed Entertainment	155	242

Networks		171		158
Publishing		15		18
Total intersegment revenues		\$ 362	\$	434

(a) Intersegment revenues include intercompany Advertising revenues of \$33 million and \$40 million for the three months ended March 31, 2006 and 2005, respectively.

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

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005 (recast)</b>
	<b>(restated, millions)</b>	
<b>Operating Income before Depreciation and Amortization</b>		
AOL <sup>(a)</sup>	\$ 444	\$ 508
Cable	937	801
Filmed Entertainment	457	383
Networks	857	794
Publishing <sup>(b)</sup>	116	140
Corporate <sup>(c)</sup>	(126)	(119)
Intersegment elimination	8	(22)
<b>Total Operating Income before Depreciation and Amortization</b>	<b>\$ 2,693</b>	<b>\$ 2,485</b>

(a) For the three months ended March 31, 2006, includes a \$2 million gain from the resolution of a previously contingent gain related to the 2004 sale of NSS. For the three months ended March 31, 2005, includes a \$24 million noncash goodwill impairment charge related to AOL and a \$2 million gain from the resolution of a previously contingent gain related to the 2004 sale of



NSS.

- (b) For the three months ended March 31, 2005, includes 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.
- (c) For the three months ended March 31, 2006, includes a \$20 million gain on the sale of two aircraft and \$29 million in net expenses related to securities litigation and government investigations. For the three months ended March 31, 2005, includes \$6 million in net expenses related to securities litigation and government investigations.

**Three Months Ended March  
31,  
2006                      2005  
(recast)  
(restated, millions)**

**Depreciation of Property, Plant and Equipment**

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AOL	\$	(127)	\$	(145)
Cable		(411)		(376)
Filmed Entertainment		(34)		(30)
Networks		(66)		(55)
Publishing		(30)		(33)
Corporate		(13)		(9)
Total depreciation of property, plant and equipment	\$	(681)	\$	(648)

	<b>Three Months Ended March</b>			
	<b>31,</b>			
	<b>2006</b>		<b>2005</b>	
			<b>(recast)</b>	
	<b>(millions)</b>			
<b>Amortization of Intangible Assets</b>				
AOL	\$	(40)	\$	(47)
Cable		(20)		(20)
Filmed Entertainment		(55)		(52)
Networks		(3)		(4)
Publishing		(15)		(25)
Total amortization of intangible assets	\$	(133)	\$	(148)

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

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005 (recast)</b>
	<b>(restated, millions)</b>	
<b>Operating Income</b>		
AOL <sup>(a)</sup>	\$ 277	\$ 316
Cable	506	405
Filmed Entertainment	368	301
Networks	788	735
Publishing <sup>(b)</sup>	71	82
Corporate <sup>(c)</sup>	(139)	(128)
Intersegment elimination	8	(22)
 Total operating income	 \$ 1,879	 \$ 1,689

(a) For the three months ended March 31, 2006, includes a \$2 million gain from the resolution of a previously contingent gain related to the 2004 sale of NSS. For the three months ended March 31, 2005, includes a \$24 million noncash goodwill impairment charge related to AOL and a \$2 million gain from the resolution of a previously contingent gain related to the 2004 sale of

NSS.

- (b) For the three months ended March 31, 2005, includes 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.
- (c) For the three months ended March 31, 2006, includes a \$20 million gain on the sale of two aircraft and \$29 million in net expenses related to securities litigation and government investigations. For the three months ended March 31, 2005, includes \$6 million in net expenses related to securities litigation and government investigations.

<b>March 31, 2006</b>	<b>December 31, 2005 (recast)</b>
<b>(restated, millions)</b>	

**Assets**

AOL	\$ 5,855	\$ 5,872
Cable	43,686	43,677
Filmed Entertainment	17,409	17,796
Networks	34,508	34,425
Publishing	14,338	14,682
Corporate	3,948	6,292
Total assets	\$ 119,744	\$ 122,744

### 13. COMMITMENTS AND CONTINGENCIES

#### Securities Matters

##### *Consolidated Securities Class Action*

As of May 1, 2006, 30 shareholder class action lawsuits have been filed naming as defendants the Company, certain current and former executives of the Company and, in several instances, AOL. These lawsuits were filed in U.S. District Courts for the Southern District of New York, the Eastern District of Virginia and the Eastern District of Texas. The complaints purport to be made on behalf of certain shareholders of the Company and allege that the Company made material misrepresentations and/or omissions of material fact in violation of Section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act), Rule 10b-5 promulgated thereunder, and Section 20(a) of the Exchange Act. Plaintiffs claim that the Company failed to disclose AOL's declining advertising revenues and that the Company and AOL inappropriately inflated advertising revenues in a series of transactions. Certain of the lawsuits also allege that certain of the individual defendants and other insiders at the Company improperly sold their personal holdings of Time Warner stock, that the Company failed to disclose that the AOL-Historic TW Merger was not generating the synergies anticipated at the time of the announcement of the merger and, further, that the Company inappropriately delayed writing down more than \$50 billion of goodwill. The lawsuits seek an unspecified amount in compensatory damages. All of these lawsuits have been centralized in the U.S. District Court for the Southern District of New York for coordinated or consolidated pretrial proceedings (along with the federal derivative lawsuits and certain lawsuits brought under ERISA described below) under the caption *In re AOL Time Warner Inc. Securities and ERISA Litigation*. Additional lawsuits brought by individual shareholders have also been filed, and the federal actions have been (or are in the process of being) transferred and/or consolidated for pretrial proceedings.

**Table of Contents****TIME WARNER INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Minnesota State Board of Investment ( MSBI ) was designated lead plaintiff for the consolidated securities actions and filed a consolidated amended complaint on April 15, 2003, adding additional defendants including additional officers and directors of the Company, Morgan Stanley & Co., Salomon Smith Barney Inc., Citigroup Inc., Banc of America Securities LLC and JP Morgan Chase & Co. Plaintiffs also added additional allegations, including that the Company made material misrepresentations in its registration statements and joint proxy statement-prospectus related to the AOL-Historic TW Merger and in its registration statements pursuant to which debt securities were issued in April 2001 and April 2002, allegedly in violation of Section 11 and Section 12 of the Securities Act of 1933. On July 14, 2003, the defendants filed a motion to dismiss the consolidated amended complaint. On May 5, 2004, the district court granted in part the defendants' motion, dismissing all claims with respect to the registration statements pursuant to which debt securities were issued in April 2001 and April 2002 and certain other claims against other defendants, but otherwise allowing the remaining claims against the Company and certain other defendants to proceed. On August 11, 2004, the court granted MSBI's motion to file a second amended complaint. On July 30, 2004, defendants filed a motion for summary judgment on the basis that plaintiffs cannot establish loss causation for any of their claims, and thus plaintiffs do not have any recoverable damages. On April 8, 2005, MSBI moved for leave to file a third amended complaint to add certain new factual allegations and four additional individual defendants.

In July 2005, the Company reached an agreement in principle with MSBI for the settlement of the consolidated securities actions. 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 granted final approval of the settlement in a written opinion dated April 6, 2006. 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 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 SEC investigation, or at least a substantial portion thereof, transferred to the MSBI Settlement Fund.

*Other Related Securities Litigation Matters*

As of May 1, 2006, three putative class action lawsuits have been filed alleging violations of ERISA in the U.S. District Court for the Southern District of New York on behalf of current and former participants in the Time Warner Savings Plan, the Time Warner Thrift Plan and/or the TWC Savings Plan (the Plans ). Collectively, these lawsuits name as defendants the Company, certain current and former directors and officers of the Company and members of the Administrative Committees of the Plans. The lawsuits allege that the Company and other defendants breached certain fiduciary duties to plan participants by, *inter alia*, continuing to offer Time Warner stock as an investment under the Plans, and by failing to disclose, among other things, that the Company was experiencing declining advertising revenues and that the Company was inappropriately inflating advertising revenues through various transactions. The complaints seek unspecified damages and unspecified equitable relief. The ERISA actions have been consolidated as part of the *In re AOL Time Warner Inc. Securities and ERISA Litigation* described above. On July 3, 2003, plaintiffs filed a consolidated amended complaint naming additional defendants, including TWE, certain current and former officers, directors and employees of the Company and Fidelity Management Trust Company. On September 12, 2003, the Company filed a motion to dismiss the consolidated ERISA complaint. On March 9, 2005, the court granted in part and denied in part the Company's motion to dismiss. The court dismissed two individual defendants and TWE for all purposes, dismissed other individuals with respect to claims plaintiffs had asserted involving the TWC Savings Plan, and dismissed all individuals who were named in a claim asserting that their stock sales had constituted a breach of fiduciary duty to the Plans. The Company filed an answer to the consolidated ERISA complaint on May 20, 2005. On January 17, 2006, plaintiffs filed a motion for class certification. On the same day, defendants filed a motion for summary judgment on the basis that plaintiffs cannot establish loss causation for any of

their claims and therefore have no recoverable damages, as well as a motion for judgment on the pleadings on the basis that plaintiffs do not have standing to bring their claims. The parties have reached an agreement to resolve this matter, and have submitted their settlement agreement and associated documentation to the court for approval. A preliminary approval hearing was held on April 26, 2006 and the parties are now awaiting the court's decision. At this time, there can be no assurance that the settlement will receive either preliminary or final court approval.

As of May 1, 2006, 11 shareholder derivative lawsuits have been filed naming as defendants certain current and former directors and officers of the Company, as well as the Company as a nominal defendant. Three have been filed in New York State Supreme Court for the County of New York, four have been filed in the U.S. District Court for the Southern District of New York and four have been filed in the Court of Chancery of the State of Delaware for New Castle County. The complaints allege that defendants breached

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their fiduciary duties by causing the Company to issue corporate statements that did not accurately represent that AOL had declining advertising revenues and by failing to conduct adequate due diligence in connection with the AOL-Historic TW Merger, that the AOL-Historic TW Merger was not generating the synergies anticipated at the time of the announcement of the merger, and that the Company inappropriately delayed writing down more than \$50 billion of goodwill, thereby exposing the Company to potential liability for alleged violations of federal securities laws. The lawsuits further allege that certain of the defendants improperly sold their personal holdings of Time Warner securities. The lawsuits request that (i) all proceeds from defendants' sales of Time Warner common stock, (ii) all expenses incurred by the Company as a result of the defense of the shareholder class actions discussed above and (iii) any improper salaries or payments, be returned to the Company. The four lawsuits filed in the Court of Chancery for the State of Delaware for New Castle County have been consolidated under the caption, *In re AOL Time Warner Inc. Derivative Litigation*. A consolidated complaint was filed on March 7, 2003 in that action, and on June 9, 2003, the Company filed a notice of motion to dismiss the consolidated complaint. On September 16, 2005, plaintiffs in that action filed a motion for leave to file a second amended complaint. On May 2, 2003, the three lawsuits filed in New York State Supreme Court for the County of New York were dismissed on *forum non conveniens* grounds and plaintiffs' time to appeal has expired. The four lawsuits pending in the U.S. District Court for the Southern District of New York have been centralized for coordinated or consolidated pre-trial proceedings with the securities and ERISA lawsuits described above under the caption *In re AOL Time Warner Inc. Securities and ERISA Litigation*. On October 6, 2004, plaintiffs filed an amended consolidated complaint in three of these four cases. On April 20, 2006, plaintiffs in the four lawsuits filed in the Court of Chancery of the State of Delaware for New Castle County filed a new complaint in the U.S. District Court for the Southern District of New York. The parties to all of these actions have reached an agreement to resolve all remaining matters, and have submitted their settlement agreement and associated documentation to the federal district court in New York for approval. A preliminary approval hearing was held on April 26, 2006 and the parties are now awaiting the court's decision. At this time, there can be no assurance that the settlement will receive either preliminary or final court approval.

On July 1, 2003, *Stichting Pensioenfonds ABP v. AOL Time Warner Inc. et al.* was filed in the U.S. District Court for the Southern District of New York against the Company, current and former officers, directors and employees of the Company and Ernst & Young LLP. Plaintiff alleges that the Company made material misrepresentations and/or omissions of material fact in violation of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, Section 11, Section 12, Section 14(a) and Rule 14a-9 promulgated thereunder, Section 18 and Section 20(a) of the Exchange Act. The complaint also alleges common law fraud and negligent misrepresentation. The plaintiff seeks an unspecified amount of compensatory and punitive damages. This lawsuit has been consolidated for coordinated pretrial proceedings under the caption *In re AOL Time Warner Inc. Securities and ERISA Litigation* described above. On July 16, 2004, plaintiff filed an amended complaint adding certain institutional defendants, including Historic TW, and certain current directors of the Company. On November 22, 2004, the Company filed a motion to dismiss the complaint. This lawsuit has been settled. The aggregate amount for which the Company has settled this as well as related lawsuits is described below.

In late 2005 and early 2006, additional shareholders determined to opt-out of the settlement reached in the consolidated federal securities class action, and some have since filed lawsuits in various federal jurisdictions. As of May 1, 2006, these lawsuits included: *DEKA Investment GMBH et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Southern District of New York on December 30, 2005; *Nw. Mut. Life Found., Inc. et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Eastern District of Wisconsin on January 30, 2006; *Cement Masons Pension Trust for N. Cal., Inc. et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Eastern District of California on January 30, 2006; *1199 SEIU Greater New York Pension Fund et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Southern District of New York on January 30, 2006; *Capstone Asset Management Co. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Southern District of Texas on January 30, 2006; *Beaver County Ret. Bd. et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Western District of Pennsylvania on January 30, 2006; *Carpenters Pension Fund of Ill. et al. v.*



*AOL Time Warner Inc. et al.*, filed in the U.S. District Court of the Northern District of Illinois on January 31, 2006; *Teachers Ret. Sys. of the State of Ill. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Northern District of Illinois on January 31, 2006; *S. Cal. Lathing Indus. Pension Fund et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Central District of California on January 31, 2006; *Wayne County Emps. Ret. Sys. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Eastern District of Michigan on January 31, 2006; *Carpenters Ret. Trust of Western Washington et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Western District of Washington on February 1, 2006; *Alaska Elec. Pension Fund et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the District of Alaska on February 1, 2006; *I.A.M. Nat l Pension Fund et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the District of the District of Columbia on February 1, 2006; *Municipal Employers Ret. Sys. of Mich. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Eastern District of Michigan on February 1, 2006; *Charter Twp. of Clinton Police & Fire Ret. Sys. et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Eastern District of Michigan on February 1, 2006; *United Food and Commercial Workers Union Local 880 Retail Food Employers Joint Pension Fund et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Northern District of Ohio on February 2, 2006; *Vermont State Emps. Ret. Sys. et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the District of Vermont

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on February 2, 2006; *Nat'l Asbestos Workers Pension Fund et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the District of Maryland on February 2, 2006; *Nat'l Elevator Indus. Pension Fund v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Eastern District of Pennsylvania on February 3, 2006; *Emps. Ret. Sys. of the State of Hawaii v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the District of Hawaii on February 3, 2006; *Laborers' Nat'l Pension Fund v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Northern District of Texas on February 3, 2006; *Robeco Groep N.V. for Robeco N.V. et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the District of the District of Columbia on February 3, 2006; *Employer-Teamsters Local Nos. 175 & 505 Pension Trust Fund et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Southern District of West Virginia on February 3, 2006; *Norges Bank v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the District of the District of Columbia on February 3, 2006; *Hawaii Electricians' Annuity Fund et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the District of the District of Columbia on February 7, 2006; *Frost Nat'l Bank et al. v. AOL Time Warner Inc. et al.* filed in the U.S. District Court for the Southern District of Texas on February 7, 2006; *Heavy & General Laborers' Locals 472 & 172 Pension and Annuity Funds et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the District of New Jersey on February 8, 2006; *B.S. Pension Fund Trustee Ltd. et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the District of the District of Columbia on February 9, 2006; *CSS Board ABN 19415 776861 et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the District of the District of Columbia on February 9, 2006; *Carpenters' Pension Trust Fund of St. Louis v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Eastern District of Missouri on February 9, 2006; *The West Virginia Laborers' Trust Fund et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Southern District of West Virginia on February 9, 2006; *Boilermakers Nat'l Health & Welfare Fund et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the District of Kansas on February 10, 2006; *Plumbers & Pipefitters Local 152 Pension Fund et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Northern District of West Virginia on February 13, 2006; *New Mexico Education et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the District of New Mexico on February 14, 2006; *Hibernia Nat'l Bank v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the Southern District of Texas on February 16, 2006; and *New England Health Care Employees Pension Fund et al. v. AOL Time Warner Inc. et al.*, filed in the U.S. District Court for the District of Massachusetts on February 16, 2006. The claims alleged in these actions are substantially identical to the claims alleged in the consolidated federal securities class action described above, and all of these cases have been transferred to the U.S. District Court for the Southern District of New York for coordinated or consolidated pre-trial proceedings. Additional cases filed by opt-out shareholders in state courts are described below. The Company intends to defend against these lawsuits vigorously.

On November 11, 2002, Staro Asset Management, LLC filed a putative class action complaint in the U.S. District Court for the Southern District of New York on behalf of certain purchasers of Reliant 2.0% Zero-Premium Exchangeable Subordinated Notes for alleged violations of the federal securities laws. Plaintiff is a purchaser of subordinated notes, the price of which was purportedly tied to the market value of Time Warner stock. Plaintiff alleges that the Company made misstatements and/or omissions of material fact that artificially inflated the value of Time Warner stock and directly affected the price of the notes. Plaintiff seeks compensatory damages and/or rescission. This lawsuit has been consolidated for coordinated pretrial proceedings under the caption *In re AOL Time Warner Inc. Securities and ERISA Litigation* described above. The Company intends to defend against this lawsuit vigorously.

On April 14, 2003, *Regents of the University of California et al. v. Parsons et al.*, was filed in California Superior Court, County of Los Angeles, naming as defendants the Company, certain current and former officers, directors and employees of the Company, Ernst & Young LLP, Citigroup Inc., Salomon Smith Barney Inc. and Morgan Stanley & Co. Plaintiffs allege that the Company made material misrepresentations in its registration statements related to the AOL-Historic TW Merger and stock option plans in violation of Sections 11 and 12 of the Securities Act of 1933. The complaint also alleges common law fraud and breach of fiduciary duties under California state law. Plaintiffs seek

disgorgement of alleged insider trading proceeds and restitution for their stock losses. Three related cases have been filed in California Supreme Court and have been coordinated in the County of Los Angeles. On January 26, 2004, certain individuals filed motions to dismiss for lack of personal jurisdiction. On September 10, 2004, the Company filed a motion to dismiss plaintiffs' complaints and certain individual defendants (who had not previously moved to dismiss plaintiffs' complaints for lack of personal jurisdiction) filed a motion to dismiss plaintiffs' complaints. On April 22, 2005, the court granted certain motions to dismiss for lack of personal jurisdiction and denied certain motions to dismiss for lack of personal jurisdiction. The court issued a series of rulings on threshold issues presented by the motions to dismiss on May 12, July 22 and August 2, 2005. These rulings granted in part and denied in part the relief sought by defendants, subject to plaintiffs' right to make a *prima facie* evidentiary showing to support certain dismissed claims. In January 2006, the Los Angeles County Employees Retirement Agency, which had filed one of the three related cases described above, voluntarily dismissed its lawsuit; an order of dismissal was entered on January 17, 2006. Also in January 2006, two additional individual actions were filed in California Superior Court against the Company and, in one instance, Ernst & Young LLP and certain former officers, directors and executives of the Company. Both of these newly-filed actions assert claims substantially identical to those asserted in the four actions already coordinated in California Superior Court, and the

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Company will seek to have these additional cases included within the coordinated proceedings. The Company intends to defend against these lawsuits vigorously.

On May 23, 2003, *Treasurer of New Jersey v. AOL Time Warner Inc. et al.*, was filed in the Superior Court of New Jersey, Mercer County, naming as defendants the Company, certain current and former officers, directors and employees of the Company, Ernst & Young LLP, Citigroup Inc., Salomon Smith Barney, Morgan Stanley, JP Morgan Chase and Banc of America Securities. The complaint is brought by the Treasurer of New Jersey and purports to be made on behalf of the State of New Jersey, Department of Treasury, Division of Investments (the Division) and certain funds administered by the Division. Plaintiff alleges that the Company made material misrepresentations in its registration statements in violation of Sections 11 and 12 of the Securities Act of 1933. Plaintiff also alleges violations of New Jersey state law for fraud and negligent misrepresentation. Plaintiffs seek an unspecified amount of damages. On October 29, 2003, the Company moved to stay the proceedings or, in the alternative, dismiss the complaint. Also on October 29, 2003, all named individual defendants moved to dismiss the complaint for lack of personal jurisdiction. This lawsuit has been settled. The aggregate amount for which the Company has settled this as well as related lawsuits is described below.

On July 18, 2003, *Ohio Public Employees Retirement System et al. v. Parsons et al.* was filed in Ohio, Court of Common Pleas, Franklin County, naming as defendants the Company, certain current and former officers, directors and employees of the Company, Citigroup Inc., Salomon Smith Barney Inc., Morgan Stanley & Co. and Ernst & Young LLP. Plaintiffs allege that the Company made material misrepresentations in its registration statements in violation of Sections 11 and 12 of the Securities Act of 1933. Plaintiffs also allege violations of Ohio law, breach of fiduciary duty and common law fraud. Plaintiffs seek disgorgement of alleged insider trading proceeds, restitution and unspecified compensatory damages. On October 29, 2003, the Company moved to stay the proceedings or, in the alternative, dismiss the complaint. Also on October 29, 2003, all named individual defendants moved to dismiss the complaint for lack of personal jurisdiction. On October 8, 2004, the court granted in part the Company's motion to dismiss plaintiffs' complaint; specifically, the court dismissed plaintiffs' common law claims but otherwise allowed plaintiffs' remaining statutory claims against the Company and certain other defendants to proceed. The Company answered the complaint on February 22, 2005. On November 17, 2005, the court granted the jurisdictional motions of twenty-five of the individual defendants, and dismissed them from the case. The Company intends to defend against this lawsuit vigorously.

On July 18, 2003, *West Virginia Investment Management Board v. Parsons et al.* was filed in West Virginia, Circuit Court, Kanawha County, naming as defendants the Company, certain current and former officers, directors and employees of the Company, Citigroup Inc., Salomon Smith Barney Inc., Morgan Stanley & Co., and Ernst & Young LLP. Plaintiff alleges the Company made material misrepresentations in its registration statements in violation of Sections 11 and 12 of the Securities Act of 1933. Plaintiff also alleges violations of West Virginia law, breach of fiduciary duty and common law fraud. Plaintiff seeks disgorgement of alleged insider trading proceeds, restitution and unspecified compensatory damages. On May 27, 2004, the Company filed a motion to dismiss the complaint. Also on May 27, 2004, all named individual defendants moved to dismiss the complaint for lack of personal jurisdiction. The Company intends to defend against this lawsuit vigorously.

On January 28, 2004, *McClure et al. v. AOL Time Warner Inc. et al.* was filed in the District Court of Cass County, Texas (purportedly on behalf of several purchasers of Company stock) naming as defendants the Company and certain current and former officers, directors and employees of the Company. Plaintiffs allege that the Company made material misrepresentations in its registration statements in violation of Sections 11 and 12 of the Securities Act of 1933. Plaintiffs also allege breach of fiduciary duty and common law fraud. Plaintiffs seek unspecified compensatory damages. On May 8, 2004, the Company filed a general denial and a motion to dismiss for improper venue. Also on May 8, 2004, all named individual defendants moved to dismiss the complaint for lack of personal jurisdiction. The Company intends to defend against this lawsuit vigorously.

On February 24, 2004, *Commonwealth of Pennsylvania Public School Employees Retirement System et al. v. Time Warner Inc. et al.* was filed in the Court of Common Pleas of Philadelphia County naming as defendants the

Company, certain current and former officers, directors and employees of the Company, AOL, Historic TW, Morgan Stanley & Co., Inc., Citigroup Global Markets Inc., Banc of America Securities LLC, J.P. Morgan Chase & Co and Ernst & Young LLP. Plaintiffs had previously filed a request for a writ of summons notifying defendants of commencement of an action. Plaintiffs allege that the Company made material misrepresentations in its registration statements in violation of Sections 11 and 12 of the Securities Act of 1933. Plaintiffs also allege violations of Pennsylvania law, breach of fiduciary duty and common law fraud. The plaintiffs seek unspecified compensatory and punitive damages. Plaintiffs dismissed the four investment banks from the complaint in exchange for a tolling agreement. The remaining parties have agreed to stay this action and to coordinate discovery proceedings with the securities and ERISA lawsuits described above under the caption *In re AOL Time Warner Inc. Securities and ERISA Litigation*. Plaintiffs filed an amended complaint on June 14, 2005. The parties to this lawsuit have reached an understanding to settle this matter, subject to definitive documentation. The aggregate amount for which the Company has agreed to settle this as well as related lawsuits is described below.

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On April 1, 2004, *Alaska State Department of Revenue et al. v. America Online, Inc. et al.* was filed in Superior Court in Juneau County, Alaska, naming as defendants the Company, certain current and former officers, directors and employees of the Company, AOL, Historic TW, Morgan Stanley & Co., Inc., and Ernst & Young LLP. Plaintiffs allege that the Company made material misrepresentations in its registration statements in violation of Alaska law and common law fraud. The plaintiffs seek unspecified compensatory and punitive damages. On July 26, 2004, all named individual defendants moved to dismiss the complaint for lack of personal jurisdiction. On August 13, 2004, the Company filed a motion to dismiss plaintiffs' complaint. On August 10, 2005, the court issued an order granting in part and denying in part the motions to dismiss for failure to state a claim. With respect to the jurisdictional motions, the court delayed its ruling 90 days to permit plaintiffs to conduct additional discovery and supplement the allegations in the complaint. On September 9, 2005, plaintiffs moved for leave to amend their complaint. That motion was granted by the court on October 10, 2005. The Company intends to defend against this lawsuit vigorously.

On November 15, 2002, the California State Teachers' Retirement System filed an amended consolidated complaint in the U.S. District Court for the Central District of California on behalf of a putative class of purchasers of stock in Homestore.com, Inc. ( Homestore ). Plaintiff alleges that Homestore engaged in a scheme to defraud its shareholders in violation of Section 10(b) of the Exchange Act. The Company and two former employees of its AOL division were named as defendants in the amended consolidated complaint because of their alleged participation in the scheme through certain advertising transactions entered into with Homestore. Motions to dismiss filed by the Company and the two former employees were granted on March 7, 2003, and a final judgment of dismissal was entered on March 8, 2004. On April 7, 2004, plaintiff filed a notice of appeal in the Ninth Circuit Court of Appeals. The Ninth Circuit heard oral argument on this appeal on February 6, 2006. The Company intends to defend against this lawsuit vigorously.

On April 30, 2004, a second amended complaint was filed in the U.S. District Court for the District of Nevada on behalf of a putative class of purchasers of stock in PurchasePro.com, Inc. ( PurchasePro ). Plaintiffs allege that PurchasePro engaged in a scheme to defraud its shareholders in violation of Section 10(b) of the Exchange Act. The Company and four former officers and employees were added as defendants in the second amended complaint and are alleged to have participated in the scheme through certain advertising transactions entered into with PurchasePro. Three similar putative class actions had previously been filed against the Company, AOL and certain former officers and employees, and have been consolidated with the Nevada action. On February 17, 2005, the Judge in the consolidated action granted the Company's motion to dismiss the second amended complaint with prejudice. The parties have since reached an oral agreement to settle this dispute, and are in the process of preparing a written settlement agreement. The aggregate amount for which the Company has agreed to settle this as well as related lawsuits is described below. That agreement will be subject to preliminary and final approval by the district court; however, there can be no assurance that either preliminary or final approval will be granted.

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 this section that were pending against the Company, 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 ERISA. Of this amount, through May 1, 2006, the Company has paid, or has agreed to pay, approximately \$358 million, after considering probable insurance recoveries, to settle certain of these claims. As described above, the Company has been successful in reaching settlements with respect to certain of the securities actions brought by individual shareholders. The Company also has engaged in, or expects to engage in, mediation in an attempt to resolve the additional cases brought by shareholders who elected to "opt out" of the settlement in the consolidated securities action. Such mediation efforts have not been fruitful to date in certain of these matters, in which trials are possible and for which plaintiffs have claimed several billion dollars in aggregated damages. The Company intends to defend these lawsuits vigorously. It is possible that the ultimate amount paid to resolve these lawsuits may be greater than the remaining reserve.

**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.

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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 for the members of the class covered by the MSBI consolidated securities class action described above.

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. 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 for the members of the class represented in the action. 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 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 in Note 1.

**Other Matters**

Warner Bros. (South) Inc. (WBS), a wholly-owned subsidiary of the Company, is litigating numerous tax cases in Brazil. WBS currently is the theatrical distribution licensee for Warner Bros. Entertainment Netherlands (Warner Bros.) in Brazil and acts as a service provider to the Warner Bros. home video licensee. All of the ongoing tax litigation involves WBS distribution activities prior to January 2004, when WBS conducted both theatrical and home video distribution. Much of the tax litigation stems from WBS position that in distributing videos to rental retailers, it was conducting a distribution service, subject to a municipal service tax, and not the industrialization or sale of videos,



subject to Brazilian federal and state VAT-like taxes. Both the federal tax authorities and the State of Sao Paulo, where WBS is based, have challenged this position. In some additional tax cases, WBS, often together with

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other film distributors, is challenging the imposition of taxes on royalties remitted outside of Brazil and the constitutionality of certain taxes. The Company intends to defend all of these various tax cases vigorously, but is unable to predict the outcome of these suits.

On October 8, 2004, certain heirs of Jerome Siegel, one of the creators of the Superman character, filed suit against the Company, DC Comics and Warner Bros. Entertainment Inc. in the U.S. District Court for the Central District of California. Plaintiffs' complaint seeks an accounting and demands up to one-half of the profits made on Superman since the alleged April 16, 1999 termination by plaintiffs of Siegel's grants of one-half of the rights to the Superman character to DC Comics' predecessor-in-interest. Plaintiffs have also asserted various Lanham Act and unfair competition claims, alleging wasting of the Superman property by DC Comics and failure to accord credit to Siegel. The Company answered the complaint and filed counterclaims on November 11, 2004, to which plaintiffs replied on January 7, 2005. This case has been consolidated for discovery purposes with the Superboy litigation described immediately below. The Company intends to defend against this lawsuit vigorously, but is unable to predict its outcome.

On October 22, 2004, the same Siegel heirs filed a second lawsuit against the Company, DC Comics, Warner Bros. Entertainment Inc., Warner Communications Inc. and Warner Bros. Television Production Inc. in the U.S. District Court for the Central District of California. Plaintiffs claim that Jerome Siegel was the sole creator of the character Superboy and, as such, DC Comics has had no right to create new Superboy works since the alleged October 17, 2004 termination by plaintiffs of Siegel's grants of rights to the Superboy character to DC Comics' predecessor-in-interest. This lawsuit seeks a declaration regarding the validity of the alleged termination and an injunction against future use of the Superboy character. Plaintiffs have also asserted Lanham Act and unfair competition claims alleging false statements by DC Comics regarding the creation of the Superboy character. The Company answered the complaint and filed counterclaims on December 21, 2004, to which plaintiffs replied on January 7, 2005. The case was consolidated for discovery purposes with the Superman action described immediately above. The parties filed cross-motions for summary judgment or partial summary judgment on February 15, 2006. In its ruling dated March 23, 2006, the Court denied the Company's motion for summary judgment, granted plaintiffs' motion for partial summary judgment on termination and held that further proceedings are necessary to determine whether the Company's Smallville television series may infringe on plaintiffs' rights to the Superboy character. The Company intends to defend against this lawsuit vigorously, but is unable to predict its outcome.

On May 24, 1999, two former AOL Community Leader volunteers filed *Hallissey et al. v. America Online, Inc.* in the U.S. District Court for the Southern District of New York. This lawsuit was brought as a collective action under the Fair Labor Standards Act (FLSA) and as a class action under New York state law against AOL and AOL Community, Inc. The plaintiffs allege that, in serving as Community Leader volunteers, they were acting as employees rather than volunteers for purposes of the FLSA and New York state law and are entitled to minimum wages. On December 8, 2000, defendants filed a motion to dismiss on the ground that the plaintiffs were volunteers and not employees covered by the FLSA. On March 10, 2006, the court denied defendants' motion to dismiss. A related case was filed by several of the *Hallissey* plaintiffs in the U.S. District Court for the Southern District of New York alleging violations of the retaliation provisions of the FLSA. This case was stayed pending the outcome of the *Hallissey* motion to dismiss and has not yet been activated. Three related class actions have been filed in state courts in New Jersey, California and Ohio, alleging violations of the FLSA and/or the respective state laws. The New Jersey and Ohio cases were removed to federal court and subsequently transferred to the U.S. District Court for the Southern District of New York for consolidated pretrial proceedings with *Hallissey*. The California action was remanded to California state court, and on January 6, 2004 the court denied plaintiffs' motion for class certification. Plaintiffs appealed the trial court's denial of their motion for class certification to the California Court of Appeals. On May 26, 2005, a three-justice panel of the California Court of Appeals unanimously affirmed the trial court's order denying class certification. The plaintiffs' petition for review in the California Supreme Court was denied. The Company has settled the remaining individual claims in the California action. The Company intends to defend against the remaining lawsuits vigorously, but is unable to predict the outcome of these suits.

On January 17, 2002, Community Leader volunteers filed a class action lawsuit in the U.S. District Court for the Southern District of New York against the Company, AOL and AOL Community, Inc. under ERISA. Plaintiffs allege that they are entitled to pension and/or welfare benefits and/or other employee benefits subject to ERISA. In March 2003, plaintiffs filed and served a second amended complaint, adding as defendants the Company's Administrative Committee and the AOL Administrative Committee. On May 19, 2003, the Company, AOL and AOL Community, Inc. filed a motion to dismiss and the Administrative Committees filed a motion for judgment on the pleadings. Both of these motions are pending. The Company intends to defend against these lawsuits vigorously, but is unable to predict the outcome of these suits.

On August 1, 2005, Thomas Dreiling filed a derivative suit in the U.S. District Court for the Western District of Washington against AOL and Infospace Inc. as nominal defendant. The complaint, brought in the name of Infospace by one of its shareholders, asserts violations of Section 16(b) of the Securities Exchange Act of 1934. Plaintiff alleges that certain AOL executives and the founder of Infospace, Naveen Jain, entered into an agreement to manipulate Infospace's stock price through the exercise of warrants that AOL had received in connection with a commercial agreement with Infospace. Because of this alleged agreement, plaintiff asserts

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that AOL and Mr. Jain constituted a group that held more than 10% of Infospace's stock and, as a result, AOL violated the short-swing trading prohibition of Section 16(b) in connection with sales of shares received from the exercise of those warrants. The complaint seeks disgorgement of profits, interest and attorneys fees. On September 26, 2005, AOL filed a motion to dismiss the complaint for failure to state a claim, which was denied by the Court on December 5, 2005. The Company intends to defend against this lawsuit vigorously, but is unable to predict the outcome of this suit or reasonably estimate the range of possible loss.

On June 16, 1998, plaintiffs in *Andrew Parker and Eric DeBrauwere, et al. v. Time Warner Entertainment Company, L.P. and Time Warner Cable* filed a purported nationwide class action in U.S. District Court for the Eastern District of New York claiming that TWE sold its subscribers personally identifiable information and failed to inform subscribers of their privacy rights in violation of the Cable Communications Policy Act of 1984 and common law. The plaintiffs are seeking damages and declaratory and injunctive relief. On August 6, 1998, TWE filed a motion to dismiss, which was denied on September 7, 1999. On December 8, 1999, TWE filed a motion to deny class certification, which was granted on January 9, 2001 with respect to monetary damages, but denied with respect to injunctive relief. On June 2, 2003, the U.S. Court of Appeals for the Second Circuit vacated the District Court's decision denying class certification as a matter of law and remanded the case for further proceedings on class certification and other matters. On May 4, 2004, plaintiffs filed a motion for class certification, which the Company has opposed. This lawsuit has been settled on terms that are not material to the Company. The court granted preliminary approval of the class settlement on October 25, 2005 and has scheduled a final approval hearing for May 19, 2006.

On October 20, 2005, a group of syndicate participants, including BNZ Investments Limited, filed three related actions in the High Court of New Zealand, Auckland Registry, against New Line Cinema Corporation, a wholly-owned subsidiary of the Company, and its subsidiary, New Line Productions Inc. (collectively, New Line). The complaints allege breach of contract, breach of duties of good faith and fair dealing, and other common law and statutory claims under California and New Zealand law. Plaintiffs contend, among other things, they have not received proceeds from certain financing transactions they entered into with New Line relating to three motion pictures: *The Lord of the Rings: The Fellowship of the Ring*; *The Lord of the Rings: The Two Towers*; and *The Lord of the Rings: The Return of the King*. The parties to these actions have agreed that all claims will be heard before a single arbitrator before the International Court for Arbitration and that the proceedings before the High Court of New Zealand will be dismissed without prejudice. The Company intends to defend against these proceedings vigorously, but is unable to predict the outcome of the proceedings.

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.

In the normal course of business, the Company's tax returns are subject to examination by various domestic and foreign taxing authorities. Such examinations may result in future tax and interest assessments on the Company. In instances where the Company believes that it is probable that it will be assessed and the amount will ultimately be paid under the assessment is reasonably estimatable, it has accrued a liability. The Company does not believe that these liabilities are material, individually or in the aggregate, to its financial condition or liquidity. Similarly, the Company does not expect the final resolution of tax examinations to have a material impact on the Company's financial results.

From time to time, the Company receives notices from third parties claiming that it infringes their intellectual property rights. Claims of intellectual property infringement could require Time Warner to enter into royalty or licensing agreements on unfavorable terms, incur substantial monetary liability or be enjoined preliminarily or permanently from further use of the intellectual property in question. In addition, certain agreements entered into by

the Company may require the Company to indemnify the other party for certain third-party intellectual property infringement claims, which could increase the Company's damages and its costs of defending against such claims. Even if the claims are without merit, defending against the claims can be time-consuming and costly.

The costs and other effects of pending or future litigation, governmental investigations, legal and administrative cases and proceedings (whether civil or criminal), settlements, judgments and investigations, claims and changes in those matters (including those matters described above), and developments or assertions by or against the Company relating to intellectual property rights and intellectual property licenses, could have a material adverse effect on the Company's business, financial condition and operating results.

**Table of Contents****TIME WARNER INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****14. ADDITIONAL FINANCIAL INFORMATION****Cash Flows**

Additional financial information with respect to cash (payments) and receipts is as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(millions)</b>	
Cash payments made for interest	\$ (305)	\$ (313)
Interest income received	45	45
Cash interest payments, net	\$ (260)	\$ (268)
Cash payments made for income taxes	\$ (76)	\$ (82)
Income tax refunds received	16	13
Cash tax payments, net	\$ (60)	\$ (69)

The consolidated statement of cash flows does not reflect an approximate \$115 million capital expenditure included in other current liabilities, as this amount had not been paid as of March 31, 2006.

The consolidated statement of cash flows reflects approximately \$109 million of common stock repurchases that were included in other current liabilities at December 31, 2005 but were not paid until the first quarter of 2006. Additionally, the consolidated statement of cash flows does not reflect an approximate \$246 million of common stock repurchases included in other current liabilities, as this amount had not been paid as of March 31, 2006.

**Interest Expense, Net**

Interest expense, net, consists of:

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(millions)</b>	
Interest income	\$ 93	\$ 74
Interest expense	(392)	(420)
Total interest expense, net	\$ (299)	\$ (346)

**Other Income, Net**

Other income, net, consists of:

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(restated, millions)</b>	
Investment gains, net	\$ 295	\$ 23
Net gain on WMG option		80
Income on equity method investees	22	12
Losses on accounts receivable securitization programs	(13)	(7)

Other		14		4
Total other income, net	\$	318	\$	112

**Other Current Liabilities**

Other current liabilities consist of:

		<b>March 31, 2006</b>	<b>December 31, 2005</b>
			<b>(recast)</b>
		<b>(millions)</b>	
Accrued expenses	\$	4,337	\$ 4,686
Accrued compensation		820	1,316
Accrued income taxes		177	157
Total other current liabilities	\$	5,334	\$ 6,159

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**TIME WARNER INC.  
SIGNATURE**

Pursuant to the requirements 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.  
(Registrant)

Date: September 13, 2006

/s/ Wayne H. Pace

Wayne H. Pace  
Executive Vice President and Chief Financial Officer  
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**EXHIBIT INDEX**

**Exhibit No.    Description of Exhibit**

- 31.1            Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, with respect to the Company's Quarterly Report on Form 10-Q/A for the quarter ended March 31, 2006.
- 31.2            Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, with respect to the Company's Quarterly Report on Form 10-Q/A for the quarter ended March 31, 2006.
- 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 Company's Quarterly Report on Form 10-Q/A for the quarter ended March 31, 2006.

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.