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

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

Form 10-K/A
Amendment No. 1

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2005
Commission file number 001-15062

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

Delaware	**13-4099534**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

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

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

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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

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

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

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

As of the close of business on February 17, 2006, there were 4,418,053,277 shares of the registrant s Common Stock and 87,245,036 shares of the registrant s Series LMCN-V Common Stock outstanding. The aggregate market value of the registrant s voting and non-voting common equity securities held by non-affiliates of the registrant (based upon the closing price of such shares on the New York Stock Exchange on June 30, 2005) was approximately $74.67 billion.

Documents Incorporated by Reference:

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

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Restatement of Prior Financial Information

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

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

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

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

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

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

Amended Items

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

PART II

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

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

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

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

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

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

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

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

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

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

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PART IV

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

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

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

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

(3) *Exhibits:*

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

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

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

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

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

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

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SIGNATURES

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

TIME WARNER INC.

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

Date: September 13, 2006

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INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION

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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 years ended December 31, 2005. This analysis is presented on both a consolidated and a business segment basis. In addition, a brief description is provided of significant transactions and events that impact the comparability of the results being analyzed.

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

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

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

Use of Operating Income before Depreciation and Amortization

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

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

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MANAGEMENT S DISCUSSION AND ANALYSIS
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OVERVIEW

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

Time Warner Businesses

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Warner Bros. continues to develop its industry-leading television business, including the successful releases of television series into the home video market. For the 2005-2006 television season, Warner Bros. has more current prime-time productions on the air than any other studio, with prime-time series on all six broadcast networks (including *Two and a Half Men, ER, Without a Trace, The O.C., Cold Case* and *Smallville*).

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

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

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

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

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

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

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

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

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

Time Inc. publishes over 150 magazines globally, including *People, Sports Illustrated, Southern Living, In Style, Real Simple, Entertainment Weekly, Time, Fortune, Cooking Light*, and *What s on TV*. It generates revenues primarily from advertising, magazine subscription and newsstand sales, and its growth is derived from higher circulation and advertising on existing magazines, new magazine launches and acquisitions. Time Inc. owns IPC Media (the U.K. s largest magazine company) and is the majority shareholder of magazine subscription marketer Synapse Group, Inc. In addition, Time Inc. continues to invest in new magazines, including *Pick Me Up*, a weekly women s magazine, and *TV Easy*, a weekly TV listings magazine, which IPC Media launched in the U.K. during 2005. In the first quarter of 2005, Time Inc. acquired the remaining 51% stake it did not already own in Essence Communications Partners (Essence), the publisher of *Essence*. In the third quarter of 2005, Time Inc. acquired Grupo Editorial Expansión (GEE), a Mexican publisher with a portfolio of 15 consumer and business magazines, primarily for the Mexican market. Time Inc. s book publishing operations are conducted primarily by Time Warner Book Group Inc. (TWBG), which had 69 books on *The New York Times* bestseller list in 2005. Time Inc. s direct-selling division, Southern Living At Home, sells home decor products through independent consultants at parties hosted in people s homes throughout the U.S. As discussed in more detail in Other Recent Developments, on February 6, 2006, the Company announced an agreement to sell TWBG to Hachette Livre SA (Hachette), a

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

Other Recent Developments

Amounts Related to Securities Litigation

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

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

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

Government Investigations

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

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

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

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

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

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

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

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

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

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

AOL-Google Alliance

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

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

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

- Making AOL content more accessible to Google Web crawlers;

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

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

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

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

The WB Network

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

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

Sale of Time Warner Book Group

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

Sale of Canal Satellite Digital

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

Sale of Turner South

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

Common Stock Repurchase Program

On July 29, 2005, Time Warner s Board of Directors authorized a common stock repurchase program that allowed Time Warner to repurchase, from time to time, up to $5 billion of common stock over a two-year period ending in July 2007. In October 2005, Time Warner s Board of Directors approved an increase in the amount authorized to be repurchased under the stock repurchase program to an aggregate of up to $12.5 billion of common stock. In February 2006, the Board of Directors authorized a further increase in the stock repurchase program and an extension of the program s ending date. Under the extended program, the Company is authorized to purchase up to an aggregate of $20 billion of common stock during the period from July 29, 2005 through December 31, 2007. Purchases under the stock repurchase program may be made from time to time on the open market and in privately negotiated transactions. Size and timing of these purchases will be based on a number of factors, including price and business and market conditions. As announced on February 1, 2006, the Company increased the pace of stock repurchases during the first quarter of 2006. At existing price levels, the Company intends to continue the current pace of purchases under its stock repurchase program within its stated objective of maintaining a net debt-to-Operating Income before Depreciation and Amortization ratio of approximately 3-to-1,

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

Common Stock Dividends

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

Magazine Circulation Practices Investigation

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

Adelphia Acquisition Agreement

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

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

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

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

Acquisition during the second quarter of 2006.

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

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Investment in Google

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

Mandatorily Convertible Preferred Stock

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

Urban Cable Works of Philadelphia, L.P.

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

RESULTS OF OPERATIONS

New Accounting Principles To Be Adopted

Stock-Based Compensation

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

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

Reclassifications

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

Significant Transactions and Other Items Affecting Comparability

As more fully described herein and in the related notes to the accompanying consolidated financial statements, the comparability of Time Warner s results from continuing operations has been affected by certain significant transactions and other items in each period as follows:

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

Amounts Related to Securities Litigation and Government Investigations

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

Merger and Restructuring Costs

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

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

Asset Impairments

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

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

Gains on Disposal of Assets, Net

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

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

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

Microsoft Settlement

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

Investment Gains, Net

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

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

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

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

Net Gain on WMG Option

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

2005 vs. 2004

Consolidated Results

Revenues. The components of revenues are as follows:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

U.S. federal tax attribute carryforwards at December 31, 2005, consist primarily of $5.0 billion of net operating losses, $44 million of capital losses, $166 million of research and development tax credits and $180 million of alternative minimum tax credits. In addition, the Company has approximately $1.8 billion of net operating losses in various foreign jurisdictions that are primarily from countries with unlimited carryforward periods. However, many of these foreign losses are attributable to specific operations that may not be utilized against certain other operations of the Company. The utilization of the U.S. federal carryforwards as an available offset to future taxable income is subject to limitations under U.S. federal income tax laws. If the net operating losses are not utilized, they expire in varying amounts, starting in 2019 and continuing through 2023. The capital losses expire in 2008. Research and development tax credits not utilized will expire in varying amounts starting in 2017 and continuing through 2024. Alternative minimum tax credits do not expire. In addition, the Company holds certain assets that have tax basis greater than book basis. The Company has established deferred tax assets for such differences. However, in the event that such assets are sold or the tax basis otherwise realized, it is anticipated that such realization would generate additional losses for tax purposes. Because of the uncertainties surrounding the Company s capacity to generate enough capital gains to utilize such losses, the Company has in most instances offset these deferred tax assets with a valuation allowance (Note 9).

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

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

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

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

Business Segment Results

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

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

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

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

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

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

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

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

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

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

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

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

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

Within the $15 and over per month category, the decrease in ARPU over the prior year was due primarily to a shift in the mix to lower-priced subscriber price plans, partially offset by an increase in the percentage of revenue generating customers. Premium subscription services revenues included in ARPU for the year ended December 31, 2005 and 2004 were $87 million and $92 million, respectively.

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

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

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

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

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

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

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

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

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

As previously discussed under Significant Transactions and Other Items Affecting Comparability, the 2005 results include $17 million in restructuring charges, primarily related to a reduction in headcount associated with AOL s efforts to realign resources more efficiently, partially offset by a $7 million reduction in restructuring costs, reflecting changes in estimates of previously established restructuring accruals. In addition, the 2005 results include an approximate $5 million gain on the sale of a building, a $5 million gain from the resolution of previously contingent gains related to the 2004 sale of Netscape Security Solutions and a $24 million noncash goodwill impairment charge related to AOLA. The 2004 results included a $55 million restructuring charge, partially offset by a $5 million reversal of previously-established restructuring accruals, reflecting changes in estimates, a $13 million gain on the sale of AOL Japan, a $7 million gain on the sale of Netscape Security Solutions and a $10 million impairment charge related to a building that was held for sale.

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

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

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

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

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

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

The components of Subscription revenues are as follows:

	Year Ended December 31,	
	2005	**2004**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

expenses
exclude
depreciation.

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

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

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

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

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

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

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

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

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

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

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