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

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

Form 10-Q/A
Amendment No. 1

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

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

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

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

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

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

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

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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.

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

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Except for the information affected by the restatement and the elimination of the condensed consolidating financial statements discussed below, the Company has not updated the information contained herein for events or transactions occurring subsequent to the date the Company s Quarterly Report on Form 10-Q for the quarter ended March 31, 2006 (the March 2006 Form 10-Q) was filed with the SEC. The Company therefore recommends that this Quarterly Report on Form 10-Q/A be read in conjunction with the Company s reports filed subsequent to the filing date of the March 2006 Form 10-Q.

Amended Items

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

PART I
FINANCIAL INFORMATION

Item 1. Financial Statements.

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

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

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

The information set forth under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations is amended to read in its entirety as set forth at pages 4 through 34 herein and is incorporated herein by reference.

PART II
OTHER INFORMATION

Item 6. Exhibits.

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

31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, with respect to the Company s Quarterly Report on Form 10-Q/A for the quarter ended March 31, 2006.
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, with respect to the Company s Quarterly Report on Form 10-Q/A for the quarter ended March 31, 2006.
32	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, with respect to the Company s Quarterly Report on Form 10-Q/A for the quarter ended March 31, 2006.

This certification will not be deemed filed for purposes of Section 18 of the Securities

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

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INTRODUCTION

Management s discussion and analysis of results of operations and financial condition (MD&A) is provided as a supplement to the accompanying consolidated financial statements and notes to help provide an understanding of Time Warner Inc. s (Time Warner or the Company) financial condition, changes in financial condition and results of operations. MD&A is organized as follows:

Overview. This section provides a general description of Time Warner s business segments, as well as recent developments the Company believes are important in understanding the results of operations and financial condition or in understanding anticipated future trends.

Results of operations. This section provides an analysis of the Company s results of operations for the three months ended March 31, 2006. This analysis is presented on both a consolidated and a business segment basis. In addition, a brief description is provided of significant transactions and events that impact the comparability of the results being analyzed.

Financial condition and liquidity. This section provides an analysis of the Company s financial condition as of March 31, 2006 and cash flows for the three months ended March 31, 2006.

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

Use of Operating Income before Depreciation and Amortization

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

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

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

Time Warner Businesses

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

AOL. On April 3, 2006, in connection with an investment by Google Inc. (Google) as more fully described below, America Online, Inc. converted to a Delaware limited liability company and changed its name to AOL LLC (together with its subsidiaries, AOL). AOL operates a leading network of web brands and the largest Internet access subscription service in the United States, with 24.5 million total AOL brand subscribers in the U.S. and Europe at March 31, 2006. AOL reported total revenues of $1.981 billion (19% of the Company s overall revenues), $444 million in Operating Income before Depreciation and Amortization and $277 million in Operating Income for the three months ended March 31, 2006. AOL generates its revenues primarily from subscription fees charged to subscribers and from providing advertising services. AOL is organized into four business units: Access, Audience, Digital Services and International.

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

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

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

AOL s International business unit, which primarily includes AOL Europe, has an Internet access business, sells advertising and develops and offers premium digital services. AOL Europe has focused on increasing revenues from

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

Cable. Time Warner s cable business, Time Warner Cable Inc. and its subsidiaries (TWC), is the second-largest cable operator in the U.S. (in terms of basic cable subscribers). At March 31, 2006, TWC managed approximately 11.039 million basic cable subscribers (including approximately 1.577 million subscribers of unconsolidated investees), in highly clustered and technologically upgraded systems in 27 states. TWC delivered revenues of $2.580 billion (25% of the Company s overall revenues), $937 million of Operating Income before Depreciation and Amortization and $506 million in Operating Income for the three months ended March 31, 2006. As part of the strategy to expand TWC s cable footprint and improve the clustering of its cable systems, TWC, through a subsidiary, entered into agreements on April 20, 2005 to acquire, in conjunction with Comcast Corporation (Comcast), substantially all of the assets of Adelphia Communications Corporation (Adelphia). Refer to Recent Developments for further details.

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

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

TWC s voice product, Digital Phone, was available to over 88% of TWC s homes passed, and approximately 1.4 million subscribers (including 176,000 subscribers of unconsolidated investees) received the service as of March 31, 2006. For a monthly fixed fee, Digital Phone customers typically receive unlimited local, in-state and U.S., Canada and Puerto Rico long-distance calling, as well as call waiting, caller ID and enhanced 911 services. In the future, TWC intends to offer additional plans with a variety of local and long-distance options. Digital Phone enables TWC to offer its customers a convenient package of video, high-speed data and voice services and to compete effectively against similar bundled products available from its competitors. TWC expects strong growth in Digital Phone subscribers and revenues for the foreseeable future.

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

Filmed Entertainment. Time Warner s Filmed Entertainment businesses, Warner Bros. Entertainment Inc. (Warner Bros.) and New Line Cinema Corporation (New Line), generated revenues of $2.779 billion (25% of the Company s overall revenues), $457 million in Operating Income before Depreciation and Amortization and $368 million in Operating Income for the three months ended March 31, 2006.

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

Warner Bros. continues to develop its industry-leading television business, including the successful releases of television series into the home video market. For the 2005-2006 television season, Warner Bros. has more current

prime-time productions on the air than any other studio, with prime-time series on all six broadcast networks (including *Two and a Half Men, ER, Without a Trace, The O.C., Cold Case* and *Smallville*).

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The sale of DVDs has been one of the largest drivers of the segment s profit growth over the last few years and Warner Bros. extensive library of theatrical and television titles positions it to continue to benefit from DVD sales; however, the Company has begun to see slower growth in DVD sales due to several factors, including increasing competition for consumer discretionary spending, piracy, the maturation of the DVD format and the fragmentation of consumer time.

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

Networks. Time Warner s Networks group comprises Turner Broadcasting System, Inc. (Turner), Home Box Office, Inc. (HBO) and The WB Television Network (The WB Network). The Networks segment delivered revenues of $2.351 billion (21% of the Company s overall revenues), $857 million in Operating Income before Depreciation and Amortization and $788 million in Operating Income for the three months ended March 31, 2006.

The Turner networks including such recognized brands as TBS, TNT, CNN, Cartoon Network and CNN Headline News are among the leaders in advertising-supported cable TV networks. For over four consecutive years, more prime-time viewers watched advertising-supported cable TV networks than the national broadcast networks. For the first quarter of 2006, TNT ranked second among advertising-supported cable networks in prime-time delivery of its key demographics, adults 18-49 and adults 25-54, and first in total day delivery of adults 25-54. TBS ranked second among advertising-supported cable networks in prime-time delivery of its key demographic, adults 18-34.

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

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

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

Publishing. Time Warner s Publishing segment consists principally of magazine publishing and a number of direct-marketing and direct-selling businesses. The segment generated revenues of $1.126 billion (10% of the Company s overall revenues), $116 million in Operating Income before Depreciation and Amortization and $71 million in Operating Income for the three months ended March 31, 2006.

Time Inc. publishes over 145 magazines globally, including *People, Sports Illustrated, Southern Living, In Style, Real Simple, Entertainment Weekly, Time, Fortune, Cooking Light* and *What s on TV*. It generates revenues primarily from advertising, magazine subscriptions and newsstand sales, and its growth is derived from higher circulation and advertising on existing magazines, new magazine launches and acquisitions. Time Inc. owns IPC

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Media (the U.K. s largest magazine company, IPC) and the magazine subscription marketer Synapse Group, Inc. In addition, Time Inc. continues to invest in developing digital content, including the launch of Officepirates.com, the redesign of CNNmoney.com and the acquisition of Golf.com. Time Inc. s direct-selling division, Southern Living At Home, sells home decor products through independent consultants at parties hosted in people s homes throughout the U.S.

Recent Developments

AOL-Google Alliance

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

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

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

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

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

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

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

The WB Network

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

Upon the closing of this transaction, the Company will account for its investment in The CW under the equity method of accounting. The Company anticipates that prior to the closing of this transaction it will incur restructuring charges ranging from $25 million to $30 million related to employee terminations and contractual settlements. In addition, The WB Network may incur up to $100 million in terminating certain programming arrangements (primarily licensed movie rights), most of which are not expected to be contributed to the new network and may not be sold or utilized in another manner. Included in these costs are approximately $70 million associated with intercompany programming arrangements with Warner Bros. and New Line. Any costs incurred by The WB Network on such

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

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

Adelphia Acquisition Agreement

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

At the same time that Comcast and TW NY entered into the Adelphia Acquisition agreements, Comcast, TWC and/or their respective affiliates entered into agreements providing for the redemption of Comcast s interests in TWC and Time Warner Entertainment Company, L.P. (TWE) (the TWC Redemption Agreement and the TWE Redemption Agreement, respectively, and, collectively, the TWC and TWE Redemption Agreements). Specifically, Comcast s 17.9% interest in TWC will be redeemed in exchange for 100% of the capital stock of a subsidiary of TWC holding cable systems serving approximately 587,000 subscribers (as of December 31, 2004), as well as approximately $1.9 billion in cash. In addition, Comcast s 4.7% interest in TWE will be redeemed in exchange for 100% of the equity interests in a subsidiary of TWE holding cable systems serving approximately 168,000 subscribers (as of December 31, 2004), as well as approximately $133 million in cash. TWC, Comcast and their respective subsidiaries will also swap certain cable systems to enhance their respective geographic clusters of subscribers (the Cable Swaps).

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

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

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

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

Common Stock Repurchase Program

Time Warner s Board of Directors has authorized a common stock repurchase program that allows the Company to purchase up to an aggregate of $20 billion of common stock during the period from July 29, 2005 through December 31, 2007. Purchases under the stock repurchase program may be made from time to time on the open market and in privately negotiated transactions. Size and timing of these purchases will be based on a number of factors, including price and business and market conditions. As announced on February 1, 2006, the Company

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increased the pace of stock repurchases during the first quarter of 2006. At existing price levels, the Company intends to continue the current pace of purchases under its stock repurchase program within its stated objective of maintaining a net debt-to-Operating Income before Depreciation and Amortization ratio, as defined, of approximately 3-to-1, and expects it will have purchased approximately $15 billion of its common stock under the program by the end of 2006, and the remainder in 2007. From the program s inception through May 2, 2006, the Company repurchased approximately 460 million shares of common stock for approximately $8.0 billion pursuant to trading programs under Rule 10b5-1 of the Securities Exchange Act of 1934, as amended.

Sale of Time Warner Book Group

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

Sale of Turner South

On February 23, 2006, the Company announced an agreement to sell the Turner South network (Turner South), a subsidiary of Turner, to Fox Cable Networks, Inc. (Fox) for approximately $375 million in cash. This transaction closed on May 1, 2006. The results of Turner South have been reflected as discontinued operations for all periods presented. The Company expects to record a pretax gain ranging from approximately $120 million to $140 million (after taking into account selling costs) in the second quarter of 2006. Since the Company has sufficient tax attribute carryforwards to offset the gain, there will not be any tax expense recognized on the sale of Turner South (Note 4).

Time Warner Telecom

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

Amounts Related to Securities Litigation

As previously disclosed, in July 2005, the Company reached an agreement in principle for the settlement of the securities class action lawsuits included in the matters consolidated under the caption *In re: AOL Time Warner Inc. Securities & ERISA Litigation* described in Note 13 to the accompanying consolidated financial statements (the MSBI consolidated securities class action). In connection with reaching the agreement in principle on the securities class action, the Company established a reserve of $2.4 billion during the second quarter of 2005. Ernst & Young LLP also has agreed to a settlement in this litigation matter and will pay $100 million. Pursuant to the settlement, in October 2005, Time Warner paid $2.4 billion into a settlement fund (the MSBI Settlement Fund) for the members of the class represented in the action. In addition, the $150 million previously paid by Time Warner into a fund in connection with the settlement of the investigation by the U.S. Department of Justice (DOJ) was transferred to the MSBI Settlement Fund, and Time Warner is using its best efforts to have the $300 million it previously paid in connection with the settlement of its SEC investigation, or at least a substantial portion thereof, transferred to the MSBI Settlement Fund. The court issued an order dated April 6, 2006 granting final approval of the settlement.

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In addition to the $2.4 billion reserve established in connection with the agreement in principle regarding the settlement of the MSBI consolidated securities class action, during the second quarter of 2005, the Company established an additional reserve totaling $600 million in connection with the other related securities litigation matters (including suits brought by individual shareholders) described in Note 13 to the accompanying consolidated financial statements that are pending against the Company. As of May 1, 2006, the Company has reached agreements to resolve the actions alleging violations of the Employee Retirement Income Security Act (ERISA) and the derivative actions, both of which are subject to preliminary and final court approval, as well as some of the individual suits. Of the $600 million reserve, through May 1, 2006, the Company has paid, or has agreed to pay, approximately $358 million, after considering probable insurance recoveries, to settle certain of these claims. The Company has been successful in reaching settlements with respect to certain of the securities actions brought by individual shareholders. The Company also has engaged in, or expects to engage in, mediation in an attempt to resolve the additional cases brought by shareholders who elected to opt out of the settlement in the consolidated securities action. Such mediation efforts have not been fruitful to date in certain of these matters, in which trials are possible and for which plaintiffs have claimed several billion dollars in aggregated damages. The Company intends to defend these lawsuits vigorously. It is possible that the ultimate amount paid to resolve all unsettled litigation in these matters could be greater than the remaining reserve (Note 13).

The Company recognizes insurance recoveries when it becomes probable that such amounts will be received. Amounts recognized in the first quarter of 2006 and 2005 totaled $50 million and $6 million, respectively. In 2005, the Company reached an agreement with the carriers on its directors and officers insurance policies in connection with the securities and derivative action matters described above (other than the actions alleging violations of ERISA). As a result of this agreement, in the fourth quarter, the Company recorded a recovery of approximately $185 million (bringing the total 2005 recoveries to $206 million), which was collected in the first quarter of 2006.

Government Investigations

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

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

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

restated as reflected in this report. For more information on the restatement, see Restatement of Prior Financial Information on page 1.

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RESULTS OF OPERATIONS

Recently Adopted Accounting Principle

Stock-Based Compensation

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

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

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

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

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

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

grant.

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

Change in Accounting Principle for Recognizing Programming Inventory Costs at HBO

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

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

Discontinued Operations

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

Reclassifications

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

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Significant Transactions and Other Items Affecting Comparability

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

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

Amounts Related to Securities Litigation and Government Investigations

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

Merger and Restructuring Costs

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

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

Asset Impairments

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

Gains on Disposal of Assets, Net

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

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For the three months ended March 31, 2005, the Company recorded a $2 million gain at the AOL segment from the resolution of a previously contingent gain related to the 2004 sale of NSS and an $8 million gain at the Publishing segment related to the collection of a loan made in conjunction with the Company s 2003 sale of Time Life Inc., which was previously fully reserved due to concerns about recoverability.

Investment Gains, Net

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

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

Gain on WMG Option

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

Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2005

Consolidated Results

Revenues. The components of revenues are as follows:

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

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

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

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

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

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

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

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

Amounts Related to Securities Litigation and Government Investigations. As previously discussed in Recent Developments, in the results for the three months ended March 31, 2006 and 2005, the Company recognized legal and other professional fees related to the SEC and DOJ investigations into certain of the Company s historical accounting and disclosure practices and the defense of various shareholder lawsuits, as well as legal reserves, totaling $79 million and $12 million, respectively. In addition, for the three months ended March 31, 2006 and 2005, the Company recognized insurance recoveries of $50 million and $6 million, respectively (Note 1).

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

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

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

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

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

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

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

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Amortization Expense. Amortization expense decreased to $133 million for the three months ended March 31, 2006 from $148 million for the three months ended March 31, 2005. The decrease in amortization expense primarily relates to the Publishing segment as a result of certain short-lived intangibles, such as customer lists, becoming fully amortized in the l