TIME WARNER INC
Form 10-Q
August 02, 2006

Table of Contents

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

Form 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
for the quarterly period ended June 30, 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 larger 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 July 28, 2006**
Common Stock $.01 par value	3,974,314,335
Series LMCN-V Common Stock $.01 par value	92,645,036

TIME WARNER INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION

Table of Contents

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 and six months ended June 30, 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 June 30, 2006 and cash flows for the six months ended June 30, 2006.

C*aution 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 Annual Report on Form 10-K for the year ended December 31, 2005 (the 2005 Form 10-K) and the Company s Quarterly Report on Form 10-Q for the quarter ended March 31, 2006 (the March 2006 Form 10-Q) for a discussion of the risk factors applicable to the Company and to Item 1A of this report for an update to such risk factors.

As discussed more fully in Note 1 to the accompanying consolidated financial statements, the 2005 financial information has been recast so that the basis of presentation is consistent with that of 2006. Specifically, the amounts have been recast for the adoption of Financial Accounting Standards Board (FASB) Statement No. 123 (revised 2004), *Share-Based Payment* (FAS 123R), a change in accounting principle for recognizing programming inventory costs at HBO and certain discontinued operations.

Use of Operating Income (Loss) before Depreciation and Amortization

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

Table of Contents

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

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, *Superman Returns* and *Wedding Crashers*, as well as television programs, including *ER, Two and a Half Men, Cold Case* and *Without a Trace*. During the six months ended June 30, 2006, the Company generated revenues of $21.219 billion (up 1% from $20.948 billion in 2005), Operating Income before Depreciation and Amortization of $5.323 billion (up 170% from $1.974 billion in 2005), Operating Income of $3.670 billion (up 895% from $369 million in 2005), Net Income of $2.462 billion (up 387% from $506 million in 2005) and Cash Provided by Operations of $4.157 billion (up 21% from $3.432 billion in 2005). The 2005 results reflect the effects of a $3 billion pretax charge related to securities litigation as discussed further in Recent Developments.

Time Warner Businesses

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

AOL. AOL LLC (together with its subsidiaries, AOL) operates a leading network of web brands and the largest Internet access subscription service in the United States. At June 30, 2006, AOL had 23.3 million total AOL brand subscribers in the U.S. and Europe. AOL reported total revenues of $4.027 billion (19% of the Company s overall revenues), $949 million in Operating Income before Depreciation and Amortization and $597 million in Operating Income for the six months ended June 30, 2006.

Historically, AOL s primary product offering has been an online subscription service that includes dial-up Internet access, and this product generates the substantial majority of AOL s revenues. AOL has experienced significant declines in the number of its U.S. subscribers, due primarily to the industry-wide decline of the premium dial-up ISP business and growth in the broadband Internet access business. The decline in subscribers has had an adverse impact on AOL s Subscription revenues. AOL s Advertising revenues, in large part, are generated from the traffic to and usage of the AOL service by AOL s subscribers and, therefore, the decline in subscribers could also have an adverse impact on AOL s Advertising revenues.

Over the past few years, AOL has adopted a strategy designed to address these trends and navigate a transition from a business that relied heavily on subscription revenue from dial-up customers to one that could attract more Internet users and take advantage of the growth in online advertising. A key part of AOL s strategy was to make much of its content available for free as part of the 2005 re-launch of the publicly available version of the AOL.com web portal. With the increasing growth in the broadband Internet access market, AOL is implementing the next phase of its strategy, as approved by Time Warner s Board of Directors on July 27, 2006, which is designed to accelerate AOL s transition to a global web services business, which is primarily an advertising-supported business. Pursuant to this phase, AOL plans to emphasize growing its global web services business and managing its access services business, as announced by the Company on August 2, 2006. A goal of AOL s strategy is to maintain and expand relationships with current and former AOL subscribers, whether they continue to purchase the dial-up Internet access subscription service or not. Another component of the strategy is to permit access to most of the AOL services, including use of the AOL client software and an AOL e-mail account, without charge. Therefore, as long as an individual has a means to connect to the Internet, that person will be able to access and use most of the AOL services for free.

Some of the other components of this strategy in connection with the global web services business, several of which are in place today in AOL s existing Audience business, include the following:

- providing advertising services, including display advertising (primarily on AOL s network of interactive properties and services), paid-search advertising (primarily through AOL s strategic alliance with Google), and other advertising run on third-party networks of web publishers (primarily through Advertising.com);

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

providing premium services, including a variety of online safety and security products, digital media (music and video), educational content and services, and related Internet services on a free or subscription basis, to be determined on a case-by-case basis;

providing software for mobile devices that will further the distribution of AOL products and services; and

attracting new, highly-engaged users to AOL s interactive properties, including AIM, AOL.com, Netscape.com, MapQuest and Moviefone, by

- o entering into distribution arrangements with third-party high-speed Internet access providers, such as telephone and cable companies; and
- o offering compelling content, features and tools, including the AOL client software, which will generally be made available to all Internet users for free.

Consistent with its strategy, AOL is pursuing alternatives with respect to its AOL Europe businesses, including the potential sale of its European access services businesses and the expansion of its global web services business in Europe. Divestiture plans are currently being developed, and it is anticipated that such transactions would be entered into beginning in the second half of 2006 and close within one year thereafter.

The access services business will continue to serve the market for dial-up Internet access, which AOL believes will continue to exist for the foreseeable future, by providing dial-up connectivity to the Internet and customer service for those subscribers. The access services business will also, to a lesser extent, continue to serve the market for broadband Internet access through agreements with high-speed Internet access providers. AOL will continue to provide customer service for these subscribers and charge monthly subscription fees; however, AOL will substantially reduce its marketing and customer service efforts previously aimed at attracting and retaining dial-up subscribers to the AOL service.

In connection with its strategy, AOL expects to reduce costs, beginning in the third quarter of 2006, from marketing activities in support of the access services business and customer service activities, as well as by restructuring and streamlining certain general and administrative functions. With the proactive reduction in subscriber acquisition costs, AOL expects acceleration in the rate of the decline in its subscribers and related Subscription revenues. In addition, dial-up network costs are anticipated to continue to decrease as subscribers decline.

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 June 30, 2006, TWC managed approximately 11.057 million basic cable subscribers (including approximately 1.579 million subscribers of unconsolidated investees), in highly clustered and technologically upgraded systems in 27 states. TWC delivered revenues of $5.301 billion (25% of the Company s overall revenues), $1.965 billion of Operating Income before Depreciation and Amortization and $1.096 billion in Operating Income for the six months ended June 30, 2006. As part of the strategy to expand TWC s cable footprint and improve the clustering of its cable systems, on July 31, 2006, TWC acquired, in conjunction with Comcast Corporation (Comcast), substantially all of the assets of Adelphia Communications Corporation (Adelphia) and exchanged certain cable systems with Comcast. 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 its offerings of advanced digital video services such as Video-on-Demand (VOD), Subscription-Video-on-Demand (SVOD) and Digital Video Recorders (DVRs), which are available throughout TWC s footprint, as well as through rate increases and subscriber growth. 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 contractual rate increases, subscriber growth and the expansion of service offerings.

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 from other service providers and by the continued increase in penetration of the high-speed data market.

TWC s voice product, Digital Phone, is available to nearly 90% of TWC s homes passed, and approximately 1.6 million subscribers (including 203,000 subscribers of unconsolidated investees) received the service as of June 30, 2006. For a monthly

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

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. TWC is currently deploying an unlimited in-state calling plan throughout its footprint and, in the future, 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 increases 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 Group (Warner Bros.) and New Line Cinema Corporation (New Line), generated revenues of $5.142 billion (22% of the Company s overall revenues), $686 million in Operating Income before Depreciation and Amortization and $509 million in Operating Income for the six months ended June 30, 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. had 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*). For the 2006-2007 television season, Warner Bros. anticipates having approximately 25 prime-time series on the fall schedule, more than any other studio.

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 slowing 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 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 $5.106 billion (23% of the Company s overall revenues), $1.565 billion in Operating Income before Depreciation and Amortization and $1.419 billion in Operating Income for the six months ended June 30, 2006.

The Turner networks including such recognized brands as TNT, TBS, CNN, Cartoon Network and CNN Headline News are among the leaders in advertising-supported cable TV networks. As discussed in more detail in Recent Developments, in May 2006 the Company acquired the remaining 50% interest in Courtroom Television Network LLC (Court TV) that it did not already own from Liberty Media Corporation (Liberty). For over four consecutive years, more prime-time viewers have watched advertising-supported cable TV networks than the national broadcast networks. For the six months ended June 30, 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 18-49 and adults 25-54. TBS ranked third 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 and news and animation, leading to strong ratings and Advertising and Subscription revenue growth, as well as strong brands and operating efficiency.

Table of Contents

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

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.*

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, as discussed in more detail in Recent Developments. At the same time, Warner Bros. and CBS are preparing to cease the stand-alone 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 $2.448 billion (11% of the Company s overall revenues), $388 million in Operating Income before Depreciation and Amortization and $301 million in Operating Income for the six months ended June 30, 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 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 redesign of CNNmoney.com, the expansion of Sports Illustrated s digital properties, 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

Adelphia Acquisition

On April 20, 2005, a subsidiary of TWC, Time Warner NY Cable LLC (TW NY), and Comcast each entered into separate definitive agreements (the TW Purchase Agreement and the Comcast Purchase Agreement, respectively) with Adelphia to, collectively, acquire substantially all the assets of Adelphia (the Adelphia Acquisition). On June 21, 2006, Adelphia and TW NY entered into Amendment No. 2 to the TW Purchase Agreement (the TW Amendment). Concurrently, Adelphia and Comcast entered into Amendment No. 2 to the Comcast Purchase Agreement, the terms of which are similar to those of the TW Amendment. Under the terms of the TW Amendment, the assets TW NY acquired from Adelphia and the consideration it paid remained unchanged. However, the TW Amendment provided that the Adelphia Acquisition would be effected pursuant to sections 105, 363 and 365 of Title 11 of the United States Bankruptcy Code (the 363 Sale) and the creditors of Adelphia would not be required to approve a plan of reorganization under Chapter 11 of the Bankruptcy Code prior to the consummation of the Adelphia Acquisition. The Adelphia Acquisition closed on July 31, 2006. In connection with the closing of the Adelphia Acquisition, TW NY paid approximately $8.9 billion in cash, after giving effect to certain purchase price adjustments, and shares representing 16% of TWC s common stock for the Adelphia assets it acquired.

At the closing of the Adelphia Acquisition, Adelphia and TWC entered into a registration rights and sale agreement (the RRA). Under the RRA, Adelphia is required to sell, in a registered underwritten public offering (the Offering), at least one-third of the shares of TWC Class A common stock it received in the Adelphia Acquisition within three months following the effectiveness of a registration statement filed by TWC to effect such sale, subject to customary rights to delay for a limited period of time under certain circumstances. TWC is required to use its commercially reasonable efforts to file a registration statement covering these shares as promptly as practicable and to cause the registration statement to be declared effective as promptly as practicable after filing, but in any event not later than January 31, 2007. Any remaining shares received by Adelphia in the Adelphia Acquisition are expected to be distributed to Adelphia s creditors pursuant to a subsequent plan of reorganization under Chapter 11 of the Bankruptcy

Code (the Remainder Plan) to be filed by Adelphia with the United States Bankruptcy Court for the Southern District of New York (the Bankruptcy Court). If a Remainder Plan meeting specified requirements is consummated prior to the closing of the Offering, the shares of TWC Class A common stock received by Adelphia in the Adelphia Acquisition would be distributed to Adelphia s creditors under Section 1145 of the Bankruptcy Code

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

in accordance with the terms of such plan and the Offering would not occur. The shares distributed to Adelphia s creditors under the Remainder Plan would be freely transferable, subject to certain exceptions.

At the same time that Comcast and TW NY entered into the agreements relating to the Adelphia Acquisition in April 2005, Comcast, TWC and/or their respective affiliates entered into separate agreements providing for the redemption of Comcast s interests in TWC and Time Warner Entertainment Company, L.P. (TWE), a subsidiary of TWC (the TWC Redemption Agreement and the TWE Redemption Agreement, respectively, and, collectively, the TWC and TWE Redemption Agreements). These redemptions also occurred on July 31, 2006, immediately before the closing of the Adelphia Acquisition. Specifically, Comcast s 17.9% interest in TWC was redeemed in exchange for 100% of the capital stock of a subsidiary of TWC holding both cable systems serving approximately 589,000 subscribers (based on June 30, 2006 information) and approximately $1.9 billion in cash. In addition, Comcast s 4.7% interest in TWE was redeemed in exchange for 100% of the equity interests in a subsidiary of TWE holding both cable systems serving approximately 162,000 subscribers (based on June 30, 2006 information) and approximately $147 million in cash. As a result, in the third quarter of 2006, the systems transferred in connection with the TWC and TWE redemptions will be reflected as discontinued operations. The book value as of June 30, 2006 of the net assets that were disposed of was primarily comprised of $2.433 billion in franchise intangibles, $135 million in goodwill and $740 million in fixed assets.

Following these redemptions and the Adelphia Acquisition, on July 31, 2006, TWC, Comcast and their respective subsidiaries also swapped certain cable systems to enhance their respective geographic clusters of subscribers (the Cable Swaps) and TW NY paid Comcast approximately $67 million for certain adjustments related to the Cable Swaps.

As a result of the closing of the Adelphia Acquisition, the TWC and TWE redemptions and the Cable Swaps, TWC gained systems with approximately 3.3 million basic subscribers. As of July 31, 2006, Time Warner owns 84% of TWC s common stock (including 83% of the outstanding TWC Class A common stock and all outstanding shares of TWC Class B common stock), as well as an indirect approximately 12% non-voting interest in TW NY, a subsidiary of TWC. As of July 31, 2006, the remaining 16% of TWC s common stock is held by Adelphia, and Comcast has no interest in TWC or TWE (Note 4).

FCC Order Approving the Transactions with Adelphia and Comcast

In its order approving the Adelphia Acquisition, the Federal Communications Commission (FCC) imposed conditions related to regional sports networks (RSNs), as defined in the order, and the resolution of disputes pursuant to the FCC s leased access regulations. In particular, TWC or its affiliates may not offer an affiliated RSN on an exclusive basis to any multichannel video programming distributors (MVPD). Moreover, TWC may not unduly or improperly influence: (i) the decision of any affiliated RSN to sell programming to an unaffiliated MVPD; or (ii) the prices, terms, and conditions of sale of programming by an affiliated RSN to an unaffiliated MVPD. If an MVPD and an affiliated RSN cannot reach an agreement on the terms and conditions of carriage, the MVPD may elect commercial arbitration of the dispute. In addition, if an unaffiliated RSN is denied carriage by TWC, it may elect commercial arbitration of the dispute. With respect to leased access, if an unaffiliated programmer is unable to reach an agreement with TWC, that programmer may elect commercial arbitration of the dispute, with the arbitrator being required to resolve the dispute using the FCC s existing rate formula relating to pricing terms. The application and scope of these conditions, which will expire in six years, have not yet been tested. TWC retains the right to obtain FCC and judicial review of any arbitration awards made pursuant to these conditions.

Dissolution of Texas/Kansas City Cable Joint Venture

As previously reported, following restructurings in 2004 and 2005, Texas and Kansas City Cable Partners, L.P. (TKCCP) is a 50-50 joint venture between Time Warner Entertainment-Advance/Newhouse Partnership (TWE-A/N) (a partnership of TWE and the Advance/Newhouse Partnership) and Comcast serving approximately 1.579 million basic video subscribers as of June 30, 2006. Since June 1, 2006, each of TWC and Comcast could trigger a dissolution of the partnership. If a dissolution is triggered, the non-triggering party has the right to choose and take full ownership of one of two pools of the partnership s systems one pool consisting of the Houston systems (which included approximately 790,000 subscribers as of June 30, 2006) and the other consisting of the Kansas City, Southwest Texas and New Mexico systems (which included approximately 789,000 subscribers as of June 30, 2006). The party triggering the dissolution would own the remaining pool of systems and any debt allocated to that pool. The party triggering the dissolution also determines the allocation of the partnership s debt between the two pools in connection with triggering the dissolution.

Table of Contents

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

On July 3, 2006, Comcast notified TWC of its election to dissolve TKCCP and its allocation of all of TKCCP s debt, totaling approximately $2 billion, to the Houston cable systems. On August 1, 2006, TWC notified Comcast that it had selected the pool consisting of the Kansas City, Southwest Texas and New Mexico systems. As a result, Comcast will be required to refinance the debt allocated to the Houston pool, which includes approximately $600 million of debt owed to each of TWE-A/N and Comcast (for an aggregate of $1.2 billion of debt owed to the partners), within 60 days after the date that TWC exercised its selection right. The consummation of the dissolution of TKCCP is subject to customary closing conditions, including regulatory and franchise review and approvals. Time Warner expects the transaction to close during the first quarter of 2007. Effective July 1, 2006, the economic return to TWC on its interest in TKCCP will track the performance of the Kansas City, Southwest Texas and New Mexico pool, and TWC will no longer reflect any benefits of ownership from the Houston pool (Note 4).

Court TV

On May 12, 2006, the Company acquired the remaining 50% interest in Court TV that it did not already own from Liberty for $697 million in cash, net of cash acquired. As permitted by GAAP, Court TV results have been consolidated retroactive to the beginning of 2006. Previously, the Company had accounted for its investment using the equity method of accounting. For the three and six months ended June 30, 2006, Court TV revenues were $65 million and $127 million, respectively, and Operating Income was $12 million and $22 million, respectively (Note 3).

In addition, the Company is in discussions with Liberty regarding its ownership interest in Time Warner, including a possible exchange of a significant portion of that interest for a subsidiary of the Company that contains a mix of non-strategic assets and cash.

Warner Village Theme Parks

On July 3, 2006, the Company sold its 50% interest in Warner Village Theme Parks (the Theme Parks), a joint venture operating theme parks in Australia, to Village Roadshow Limited (Village) for approximately $195 million in cash, which will result in a pretax gain of approximately $150 million in the third quarter of 2006 (approximately $97 million, net of tax) (Note 3).

Turner FTC Consent Decree

As previously reported, Time Warner is subject to the terms of a consent decree (the Turner Consent Decree) entered into in connection with the FTC s approval of the acquisition of Turner by Historic TW Inc. (Historic TW) in 1996. The Turner Consent Decree required, among other things, that any Time Warner stock held by Liberty be non-voting stock, except that it would be entitled to a vote of 1/100 of a vote per share when voting with the outstanding common stock on the election of directors and a vote equal to the vote of the common stock with respect to corporate matters that would adversely change the rights or terms of the stock. On February 16, 2006, Liberty filed a petition with the FTC seeking to terminate the Turner Consent Decree as it applies to Liberty, including all voting restrictions on its Time Warner stock holdings. On June 14, 2006, the FTC issued an order granting Liberty s petition. As a result, Liberty now has the ability to request that the shares of Series LMCN-V common stock it holds be converted into shares of common stock of Time Warner. On July 31, 2006, Time Warner received notices from Liberty requesting that the Company convert 49,115,656 shares of Series LMCN-V common stock into shares of common stock. Time Warner is in the process of taking the actions to complete the conversion.

AOL-Google Alliance

During December 2005, the Company announced that AOL was expanding its strategic alliance with Google Inc. (Google) to enhance its global online advertising partnership and make more of AOL s content available to Google users. In addition, Google agreed to invest $1 billion to acquire a 5% equity interest in a limited liability company that owns all of the outstanding equity interest in AOL. On March 24, 2006, the Company and Google signed definitive agreements governing the investment and the commercial arrangements. Under the alliance, Google will continue to provide search technology to AOL s network of Internet properties worldwide and provide AOL with an improved share in revenues generated through searches conducted on the AOL network, which AOL will continue to recognize as advertising revenue when such amounts are earned. Additionally, AOL will continue to pay Google a license fee for the use of its search technology, which AOL will continue to recognize as expense when such amounts have been incurred. Other key aspects of the alliance, and the related accounting, include:

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

AOL Marketplace. 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. AOL will record as advertising revenue the sponsored-links advertising sold and delivered to third parties. Amounts paid to Google for Google s share in the sponsored-links advertising sold on the AOL Marketplace will be accounted for by AOL as an expense in the period the advertising is delivered.

Distribution and Promotion. 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. The Company believes that this is an advertising barter transaction in which distribution and promotion is being provided in exchange for AOL agreeing to dedicate its search business to Google on an exclusive basis. Because the criteria in Emerging Issues Task Force (EITF) Issue No. 99-17, *Accounting for Advertising Barter Transactions* for recognizing revenue have not been met, no revenue or expense will be recognized by AOL on this portion of the arrangement.

Google AIM Development. Enabling Google Talk and AIM instant messaging users to communicate with each other provided certain conditions are met. Because this agreement does not provide for any revenue share or other fees, there will be no accounting resulting from this arrangement.

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 recognized a gain of approximately $801 million, 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.

The WB Network results for the three and six months ended June 30, 2006 include shutdown costs of $81 million, including $8 million related to employee terminations, $19 million related to contractual settlements and $54 million related to the termination of certain programming arrangements (primarily licensed movie rights). Included in the $54 million of costs to terminate programming arrangements is $29 million of costs related to terminating intercompany programming arrangements with other Time Warner divisions (e.g., New Line) that have been eliminated in consolidation, resulting in a net charge related to programming arrangements of $25 million.

In addition to the $54 million of costs to terminate programming arrangements, The WB Network has approximately $40 million primarily related to programming commitments, including $20 million of intercompany programming commitments, that are not expected to be contributed to The CW. In the event that such programming is unable to be sold or utilized in another manner, there will be additional restructuring charges associated with such programming incurred by The WB Network, offset by amounts recognized by other Time Warner divisions related to any intercompany programming, resulting in the potential for a net charge of approximately $20 million (Note 3).

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. At existing price levels, the Company intends to continue 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

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

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 August 1, 2006, the Company repurchased approximately 675 million shares of common stock for approximately $11.7 billion pursuant to trading programs under Rule 10b5-1 of the Securities Exchange Act of 1934, as amended, including approximately 206 million shares of common stock for approximately $3.5 billion purchased under the prepaid stock repurchase contracts (Note 8).

Sale of Turner South

On May 1, 2006, the Company sold the Turner South network (Turner South), a subsidiary of Turner, to Fox Cable Networks, Inc. for approximately $371 million in cash, resulting in a pretax gain of approximately $129 million. Turner South has been reflected as discontinued operations for all periods presented (Note 3).

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 $524 million in cash, resulting in a pretax gain of approximately $194 million after taking into account selling costs and estimated working capital adjustments. TWBG has been reflected as discontinued operations for all periods presented (Note 3).

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 and 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 six months ended June 30, 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 12 to the accompanying consolidated financial statements. 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. The court issued an order dated April 6, 2006 granting final approval of the settlement, and the time to appeal that decision has expired. In connection with the settlement, 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. In addition, the $300 million the Company previously paid in connection with the settlement of its Securities and Exchange Commission (SEC) investigation will be distributed to investors through the settlement pursuant to an order issued by the U.S. District Court for the District of Columbia on July 11, 2006.

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 12 to the accompanying consolidated financial statements that are pending against the Company. As of July 31, 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 have received preliminary court approval, but which remain subject to final court approval, as well as certain of the individual suits. Of the $600 million reserve, through July 31, 2006, the Company has paid, or has agreed to pay, approximately $358 million, after considering probable insurance recoveries, to settle certain of these

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

claims. The Company also has engaged in, or may in the future engage in, mediation in an attempt to resolve the remaining cases brought by shareholders who elected to opt out of the settlement in the consolidated securities class action. The mediation efforts conducted to date have not been fruitful in certain of these matters. Accordingly, trials are possible in these matters, for which plaintiffs have claimed several billion dollars in aggregated damages. The Company intends to defend these lawsuits vigorously, including through trial. It is possible, however, that the ultimate amount paid to resolve all unsettled litigation in these matters could be materially greater than the remaining reserve (Note 12).

The Company recognizes insurance recoveries when it becomes probable that such amounts will be received. The Company recognized insurance recoveries of $3 million and $53 million for the three and six months ended June 30, 2006, respectively, and $10 million and $16 million for the three and six months ended June 30, 2005, 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 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 district court judge presiding over that fund has approved the SEC s plan to distribute those monies to investors through the consolidated class action settlement, as provided in its order.

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, which is expected to occur during the third quarter of 2006. At present, the Company is not aware of any conclusions yet reached by the independent examiner. Depending on the independent examiner s conclusions, a further restatement might be necessary. It is also possible that, so long as there are unresolved issues associated with the Company s financial statements, the effectiveness of any registration statement of the Company or its affiliates may be delayed.

RESULTS OF OPERATIONS

Recent Accounting Standards

Stock-Based Compensation

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

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

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

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

Additionally, when recording compensation cost for equity awards, FAS 123R requires companies to estimate the number of equity awards granted that are expected to be forfeited. Prior to the adoption of FAS 123R, the Company recognized forfeitures when they occurred, rather than using an estimate at the grant date and subsequently adjusting the estimated forfeitures to reflect actual forfeitures. Accordingly, a pretax cumulative effect adjustment totaling $40 million ($25 million, net of tax) has been recorded for the six months ended June 30, 2006 to adjust for awards granted prior to January 1, 2006 that are not expected to vest. The total impact of the adoption of FAS 123R and total equity-based compensation expense recognized for the three and six months ended June 30, 2006 and 2005 is as follows:

	Stock Option Expense Three Months Ended		Total Equity-Based Compensation[a] Three Months Ended		Stock Option Expense Six Months Ended		Total Equity-Based Compensation[a] Six Months Ended	
	6/30/06	6/30/05	6/30/06	6/30/05	6/30/06	6/30/05	6/30/06	6/30/05
	(millions)		(millions)		(millions)		(millions)	
AOL	$ 9	$ 22	$ 10	$ 22	$ 22	$ 32	$ 24	$ 33
Cable	6	9	7	9	18	35	21	35
Filmed Entertainment	7	10	10	15	26	37	41	44
Networks	8	11	9	12	21	38	24	40
Publishing	7	11	8	11	18	31	21	31
Corporate	4	6	9	10	16	23	30	30
Total	$ 41	$ 69	$ 53	$ 79	$ 121	$ 196	$ 161	$ 213

[a] 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 for all prior periods presented, including the impact that such a change has on retained earnings for the earliest year presented (Note 1).

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

Accounting For Sabbatical Leave and Other Similar Benefits

In June 2006, the EITF reached a consensus on EITF Issue No. 06-02, *Accounting for Sabbatical Leave and Other Similar Benefits* (EITF 06-02). EITF 06-02 requires that an employee s right to a compensated absence under a sabbatical leave or similar benefit arrangement in which the employee is not required to perform any duties during the absence is an accumulating benefit. Therefore, such arrangements should be accounted for as a liability with the cost recognized over the service period during which the employee earns the benefit. The provisions of EITF 06-02 will be effective for Time Warner as of January 1, 2007 and will impact the accounting for certain of the Company s employment arrangements. The cumulative impact of this guidance, which will be applied retrospectively to all prior periods, is expected to result in a reduction to retained earnings on January 1, 2007 of approximately $69 million ($43 million, net of tax). The retrospective impact on Operating Income for calendar years 2006, 2005 and 2004 is expected to be approximately $7 million, $6 million and $9 million, respectively.

Accounting for Uncertainty in Income Taxes

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in income tax positions. This Interpretation requires that the Company recognize in the consolidated financial statements the impact of a tax position that is more likely than not to be sustained upon examination based on the technical merits of the position. The provisions of FIN 48 will be effective for Time Warner as of the beginning of the Company s 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of adopting FIN 48 on the consolidated financial statements.

Income Statement Classification of Taxes Collected from Customers

In June 2006, the EITF reached a consensus on EITF Issue No. 06-03, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)* (EITF 06-03). EITF 06-03 provides that the presentation of taxes assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer on either a gross basis (included in revenues and costs) or on a net basis (excluded from revenues) is an accounting policy decision that should be disclosed. The provisions of EITF 06-03 will be effective for Time Warner as of January 1, 2007. The Company is currently evaluating the impact of adopting EITF 06-03 on the consolidated financial statements.

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 June 30, 2006 presentation.

Table of Contents

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

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		Six Months Ended	
	6/30/06	6/30/05	6/30/06	6/30/05
	(millions)		(millions)	
Amounts related to securities litigation and government investigations	$ (32)	$ (3,003)	$ (61)	$ (3,009)
Merger-related, restructuring and shutdown costs	(103)	(11)	(133)	(23)
Asset impairments				(24)
Gain on disposal of assets, net		8	22	18
Impact on Operating Income (Loss)	(135)	(3,006)	(172)	(3,038)
Investment gains, net	20	982	315	1,005
Gain (loss) on WMG option		(27)		53
Impact on Other income, net	20	955	315	1,058
Pretax impact	(115)	(2,051)	143	(1,980)
Income tax impact	44	574	(49)	539
After-tax impact	$ (71)	$ (1,477)	$ 94	$ (1,441)

Amounts Related to Securities Litigation and Government Investigations

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 $35 million and $114 million, respectively, for the three and six months ended June 30, 2006 and $3.013 billion and $3.025 billion, respectively, for the three and six months ended June 30, 2005. In addition, the Company recognized insurance recoveries of $3 million and $53 million for the three and six months ended June 30, 2006, respectively, and $10 million and $16 million, respectively, for the three and six months ended June 30, 2005.

Merger-related, Restructuring and Shutdown Costs

During the three and six months ended June 30, 2006, the Company incurred restructuring costs, primarily related to various employee terminations of approximately $41 million and $64 million, respectively, including $15 million at the AOL segment for both the three and six months ended June 30, 2006, $4 million and $10 million, respectively, at the Cable segment for the three and six months ended June 30, 2006, $22 million and $34 million, respectively, at the Publishing segment for the three and six months ended June 30, 2006 and $5 million at the Corporate segment for the six months ended June 30, 2006. The Company also expensed $2 million and $4 million, respectively, at the Filmed Entertainment segment for the three and six months ended June 30, 2006 and $1 million at the AOL segment for the six months ended June 30, 2006 as a result of changes in estimates of previously established restructuring accruals. In addition, during the three and six months ended June 30, 2006, the Cable segment expensed approximately $8 million and $12 million, respectively, of non-capitalizable merger-related costs associated with the Adelphia Acquisition. The results for the three and six months ended June 30, 2006 include shutdown costs of $81 million at The WB Network in connection with the agreement between Warner Bros. and CBS to form a new fully-distributed national broadcast network, to be called The CW. Included in the shutdown costs are termination charges related to terminating intercompany programming arrangements with other Time Warner divisions, of which $29 million has been eliminated in consolidation, resulting in a net pretax charge of $52 million.

During the three and six months ended June 30, 2005, the Company incurred restructuring costs of $13 million and $30 million, respectively, at the Cable segment, primarily related to various employee terminations and exit activities. In addition, restructuring charges at the AOL segment reflect a $2 million reduction for the three months ended June 30, 2005 and a net reduction of $7 million for the six months ended June 30, 2005 relating to changes in estimates of previously established restructuring accruals (Note 10).

Table of Contents

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

Asset Impairments

During the six months ended June 30, 2005, the Company recorded a $24 million noncash impairment charge related to goodwill associated with America Online Latin America, Inc. (AOLA). As previously disclosed, AOLA has been operating under Chapter 11 of the U.S. Bankruptcy Code and has been in the process of winding up its operations. On June 30, 2006, AOLA emerged from bankruptcy pursuant to a joint plan of reorganization and liquidation. Under the plan, AOLA was reorganized into a liquidating limited liability company jointly owned by Time Warner (60%) and the Cisneros Group (40%). In partial satisfaction of debt and obligations held by Time Warner or AOL, the assets representing the AOL Puerto Rico business were transferred to Time Warner or AOL pursuant to the plan. Included in AOL s results is a $7 million charge related to AOLA s bankruptcy resolution.

Gains on Disposal of Assets, Net

For the six months ended June 30, 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).

For the three and six months ended June 30, 2005, the Company recorded an approximate $5 million gain at the AOL segment related to the sale of a building. The three and six months ended June 30, 2005 also include gains of $3 million and $5 million, respectively, at the AOL segment from the resolution of previously contingent gains related to the 2004 sale of NSS. In addition, the six months ended June 30, 2005 includes 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.

Investment Gains, Net

For the three and six months ended June 30, 2006, the Company recognized net gains of $20 million and $315 million, respectively, primarily related to the sale of investments, including for the six months ended June 30, 2006 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. For the three and six months ended June 30, 2006, investment gains, net also include $4 million and $11 million, respectively, of gains to reflect market fluctuations in equity derivative instruments.

For the three and six months ended June 30, 2005, the Company recognized net gains of $982 million and $1.005 billion, respectively, primarily related to the sale of investments, including a $925 million gain on the sale of the Company s remaining investment in Google and a $36 million gain, which was previously deferred, related to the Company s 2002 sale of a portion of its interest in Columbia House Holdings Inc. (Columbia House). For the three and six months ended June 30, 2005, investment gains also include $1 million and $2 million, respectively, of gains to reflect market fluctuations in equity derivative instruments.

Gain (Loss) on WMG Option

For the three and six months ended June 30, 2005, the Company recorded a $27 million loss and a $53 million net gain, reflecting a fair value adjustment related to the Company s option in Warner Music Group (WMG).

Table of Contents

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

Three and Six Months Ended June 30, 2006 Compared to Three and Six Months Ended June 30, 2005

Consolidated Results

Revenues. The components of revenues are as follows:

	Three Months Ended	Six Months Ended
	6/30/06	