Using the above inputs in a formula for the present value of a growing perpetuity (e.g., PV = 1/(k–g), where k = cost of capital and g = perpetual growth rate), we derive a terminal multiple on projected 2009 FCFF (gross up from projected 2008 FCFF at the long-term growth rate) of 24.4x.

Exhibit 8: Standalone America Online Discounted Cash Flow Valuation

($ millions)	1999PF	2000E	2001E	2002E	2003E	2004E	2005E	2006E	2007E	2008E
Free Cash Flow	(308)	1,299	2,233	3,138	4,148	5,336	6,567	7,869	9,267	10,806
Add: After-Tax Interest (0 if Net Cash)										
Free Cash Flow to Firm (FCFF)	**(308)**	**1,299**	**2,233**	**3,138**	**4,148**	**5,336**	**6,567**	**7,869**	**9,267**	**10,806**
% Change		-521.7%	72.0%	40.5%	32.2%	28.7%	23.1%	19.8%	17.8%	16.6%
Assumptions:										
Long-Term Terminal Growth Rate	10.0%									
Proxy Market Return	12.0%									
Historical Beta	1.78									
Assumed Forward Beta	1.17									
Cost of Capital	14.10%									
Terminal	24.4x									
Years to Discount	0	1	2	3	4	5	6	7	8	9
		0	1	2	3	4	5	6	7	8
			0	1	2	3	4	5	6	7
				0	1	2	3	4	5	6
					0	1	2	3	4	5
						0	1	2	3	4
							0	1	2	3
								0	1	2
									0	1
										0
Present Value of FCFF	(308)	1,149	1,749	2,175	2,544	2,896	3,154	3,345	3,486	3,597
		1,299	1,977	2,457	2,874	3,273	3,564	3,780	3,939	4,065
			2,233	2,777	3,248	3,698	4,027	4,271	4,451	4,593
				3,138	3,670	4,179	4,551	4,826	5,030	5,190
					4,148	4,722	5,143	5,454	5,684	5,865
						5,336	5,811	6,163	6,423	6,628
							6,567	6,964	7,258	7,489
								7,869	8,201	8.463
									9,267	9.563
										10,806
Sum of Present Value or FCFF Stream	23,787	27,228	29,300	30,585	31,015	30,360	28,277	24,533	18,830	10,806
Present Value of Terminal Value	95,689	108,129	122,186	138,070	156,019	176,301	199,220	225,119	254,385	287.454
Option Cash	382	382	382	382	382	382	382	382	382	382
Investments										
$1.5 Billion in DirecTV Preferred (6.4%, convert within 3 yrs 6/03)	1,500	1,500	1,500	1,500	1,725	1,984	2,281	2,624	3,017	3,470
25% China.com @ Mkt Value +20% Yr		860	1,032	1,238	1,486	1,783	2,140	2,568	3,082	3,698
Other Investments @ Mkt +20% Yr		6,300	7,560	9,072	10,886	13,064	15,676	18,812	22,574	27,089
Gateway Investment		620	744	893	1,071	1,286	1,543	1,851	2,222	2,666
80% of AOL Canada	4,431	5,112	5,842	6,689	7,678	8,794	10,025	11,394	12,915	14,608
50% of AOL Europe	11,955	13,632	15,587	17,861	20,467	23,432	26,783	30,557	34,791	39,536
50% of AOL Hong Kong	371	431	497	577	672	787	914	1,061	1,228	1,417
50% of AOL Japan	2,771	3,190	3,680	4,273	4,955	5,750	6,642	7,647	8,763	10,012
50% of AOL Australia	886	1,016	1,169	1,347	1,568	1,817	2,099	2,415	2,772	3,174
50% of AOL Latin America	5,545	6,385	7,336	8,440	9,787	11,353	13,144	15,181	17,474	20,044
NOL		8,200	7,896	7,476	6,923	6,209	5,324	4,252	2,970	1,451
Gross Company Value	**147,319**	**182,984**	**204,710**	**228,402**	**254,635**	**283,301**	**314,451**	**348,394**	**385,404**	**425,807**
Ending Net Cash (Debt)	954	2,253	4,486	7,624	11,772	17,108	23,674	31,543	40,811	51,617
Net Present Value	**148,273**	**185,237**	**209,196**	**236,027**	**266,407**	**300,409**	**338,126**	**379,938**	**426,214**	**477,424**
Diluted Shares	2,496	2,496	2,496	2,496	2,496	2,496	2,496	2,496	2,496	2,496
NPV per Share	**$59.40**	**$74.21**	**$83.81**	**$94.56**	**$106.73**	**$120.36**	**$135.47**	**$152.22**	**$170.76**	**$191.28**
% Change		24.9%	12.9%	12.8%	12.9%	12.8%	12.6%	12.4%	12.2%	12.0%

Source: Credit Lyonnais Securities estimates

Note that the derived NPV per share figures above do not imply a target on AOL shares, as they reflect their growth prospects from the Time Warner acquisitions while not reflecting the shares to be issued.

2. **What multiple does one attach to the Turner basic cable networks and Time Inc. magazine businesses?**

- We have historically valued mature basic cable networks at 13.0x–14.5x EBITDA, based primarily on recorded acquisitions of basic cable networks (notably News Corp.'s purchase of International Family Entertainment at 18x and USA Networks' purchase of the USA Network and The Sci-Fi Channel at an estimated 17x). However, several factors should be taken into consideration:

  (a) Family Channel and USA are general networks with limited merchandising opportunities. In Family's case, a large block of prime ad time is devoted to religious programming. Further, USA's international growth opportunities have historically been limited by its general content.

  (b) Family Channel did not have the ad pricing power of MTV, Nickelodeon, ESPN, or the Turner or Disney networks.

  (c) Unlike cable systems, radio stations, and TV stations, transactions involving widely distributed networks have been few and far between over the past two years, reflecting their growing value to incumbent owners. Thus, using the Family Channel and USA/Sci-Fi transactions may well not fully reflect the growing value, supported by continued rapid growth in advertising dollars and viewership landmarks vis-à-vis broadcast networks.

  (d) With large media/entertainment conglomerates (e.g., Disney, Viacom, Time Warner) controlling the vast majority of major basic cable networks, there are few pure-play public companies against which we can set a comparative valuation benchmark. Liberty Media Group, with its interest in 100-plus networks, remains the purest play on cable programming, but even its suitability as a benchmark has become diluted with its Internet and broadband communications investments over the past year.

  In our AOL Time Warner valuation we make allocations of basic cable network segment EBITDA to individual networks, as they differ in their stage of development. Our multiples for mature domestic networks range from 14.5x–16.5x, depending their growth prospects. We accord TBS/TNT multiples at the high end of the range due to their (1) wide distribution, (2) growing appeal to advertising due to their increasing original programming, theatricals, and off-network syndicated programming. We value CNN/Headline News at 14.5x due to greater competition for TV news from local and national cable news networks and the Internet, as well as the dependence of cable news viewership upon high-profile events.

  The resulting valuations for the entertainment and news segments are presented below. Following them are DCF valuations. (In these and that for Time magazine publishing that follows, we make allocations of depreciation, amortization and net debt based on their relative contributions to segment-wide or companywide EBITDA.) The aggregate values of both segments correspond relatively well with those from our base EBITDA-multiple driven models.

Exhibit 9: Basic Cable Network (Entertainment and Other) EBITDA Valuation

($ millions, except where indicated)	1999E	2000E	2001E	2002E	2003E	2004E	2005E
Core TNT/TBS and Other (@ 16.5x EBITDA)	10,016	10,146	10,920	12,029	12,874	13,549	14,212
Startup Networks (@ 16.5x 2005 EBITDA, discounted @ 12%)	6,793	7,608	8,521	9,544	10,689	11,972	13,409
Total TBS-Entertainment Fair Trading Value	16,809	17,755	19,441	21,573	23,563	25,521	27,621
Cross-Check							
Combined Startup Network Households	163	205	231	257	279	300	320
FTV Per Household	$42	$37	$37	$37	$38	$40	$42
Total Entertainment/Other EBITDA	781	872	1,042	1,221	1,382	1,522	1,674
Implied FTV Multiple on Segment EBITDA	**21.5x**	**20.4x**	**18.7x**	**17.7x**	**17.1x**	**16.8x**	**16.5x**

Source: Credit Lyonnais Securities estimates

Exhibit 10: Basic Cable Network (Entertainment and Other) DCF valuation

($ millions, except where indicated)		1999E	2000E	2001E	2002E	2003E	2004E	2005E
Revenue		2,673.6	3,152.7	3,579.4	4,000.4	4,426.2	4,868.5	5,352.8
EBITDA		781.0	871.6	1,042.1	1,221.3	1,381.6	1,522.2	1,674.0
Allocated Depreciation		69.3	75.0	80.9	87.0	93.3	99.7	106.4
Allocated Goodwill		134.5	134.5	134.5	134.5	134.5	134.5	134.5
Operating Income		577.2	662.0	826.7	999.8	1,153.8	1,287.9	1,433.1
Interest Expense, Net		(105.8)	(74.4)	(35.1)	14.5	74.8	145.3	226.3
Pretax Income		471.3	587.6	791.6	1,014.3	1,228.6	1,433.2	1,659.4
Allocated Tax Expense (Assume 41% Effective Rate)		(248.4)	(296.1)	(379.7)	(471.0)	(558.9)	(642.8)	(735.5)
Net Income		222.9	291.5	411.9	543.3	669.7	790.5	923.9
Depreciation/Amortization		203.8	209.5	215.4	221.5	227.8	234.3	240.9
Capital Spending		(70.0)	(72.1)	(74.3)	(76.5)	(78.8)	(81.1)	(83.6)
Free Cash Flow		356.7	429.0	553.1	688.3	818.7	943.6	1,081.2
Net Debt:								
Beginning		(1,501.1)	(1,144.4)	(715.4)	(162.4)	526.0	1,344.7	2,288.3
Ending		(1,144.4)	(715.4)	(162.4)	526.0	1,344.7	2,288.3	3,369.5
Average		(1,322.8)	(929.9)	(438.9)	181.8	935.3	1,816.5	2,828.9
Free Cash Flow		356.7	429.0	553.1	688.3	818.7	943.6	1,081.2
Add: After-Tax Interest Expense (0 if Net Cash)		62.4	43.9	20.7				
Free Cash Flow to Firm		419.2	472.9	573.8	688.3	818.7	943.6	1,081.2
% Change			12.8%	21.3%	20.0%	18.9%	15.2%	14.6%
Assumptions:								
WACC	12.0%							
Long-Term Growth	7.5%							
Terminal Multiple	22.2x							
Years to Discount:		0.0	1.0	2.0	3.0	4.0	5.0	6.0
			0.0	1.0	2.0	3.0	4.0	5.0
				0.0	1.0	2.0	3.0	4.0
					0.0	1.0	2.0	3.0
						0.0	1.0	2.0
							0.0	1.0
								0.0
Discounted FCFF		419.2	422.2	457.4	489.9	520.3	535.4	547.8
			472.9	512.3	548.7	582.8	599.6	613.5
				573.8	614.6	652.7	671.6	687.1
					688.3	731.0	752.2	769.6
						818.7	842.5	861.9
							943.6	965.4
								1,081.2
Sum of PV of FCFF Streams		3,392.2	3,329.8	3,199.8	2,941.1	2,523.1	1,908.9	1,081.2
PV of Terminal Value		13,085.7	14,656.0	16,414.8	18,384.5	20,590.7	23,061.6	25,829.0
Gross Present Value		16,478.0	17,985.8	19,614.5	21,325.7	23,113.8	24,970.5	26,910.2
Less: Allocated Year-end Net Debt		(1,144.4)	(715.4)	(162.4)	526.0	1,344.7	2,288.3	3,369.5
NPV		**15,333.6**	**17,270.4**	**19,452.2**	**21,851.6**	**24,458.5**	**27,258.7**	**30,279.6**
EBITDA		**781.0**	**871.6**	**1,042.1**	**1,221.3**	**1,381.6**	**1,522.2**	**1,674.0**
Implied Fair Trading Multiple		**19.6x**	**19.8x**	**18.7x**	**17.9x**	**17.7x**	**17.9x**	**18.1x**

Source: Credit Lyonnais Securities estimates

Exhibit 11: Basic Cable Network (News) EBITDA Valuation

($ millions, except where indicated)	1999E	2000E	2001E	2002E	2003E	2004E	2005E
News (14 5x EBITDA)	5 141 3	5,265 6	5,402 7	5 678.8	5 954 9	6.229 9	6 502 3
CNNI (16.0x Est. 2005 EBITDA, disct'd @ 13%)	2.725 7	3,080 0	3.480 4	3.932.8	4.444 1	5.021 8	5.674 7
CNNfn (16x est. 2003 EBITDA, disct'd @ 13%)	352 9	398.8	450 7	509.2	575 4	650 2	734 8
CNNSi (16x est. 2005 EBITDA, disct'd @ 13%)	560 6	633.5	715 9	809.0	914.1	1.033 0	1 167 2
Gross News Network Fair Trading Value	**8,780.5**	**9,377.9**	**10,049.6**	**10,929.9**	**11,888.6**	**12,934.9**	**14,079.0**
Cross-Check:							
Households Reached (millions)							
CNN Domestic	76	78	80	83	85	88	90
CNN Headline News	67	70	73	75	77	78	80
Mature Domestic News Networks	142	148	154	158	162	166	170
CNNI	119	155	186	205	225	248	272
CNNfn	22	28	33	37	41	46	50
CNNSI	14	20	25	32	40	48	54
FTV per Household							
Mature Domestic News Networks	$36	$36	$35	$36	$37	$38	$38
CNNI	$23	$20	$19	$19	$20	$20	$21
CNNfn	$16	$14	$14	$14	$14	$14	$15
CNNSI	$40	$32	$29	$25	$23	$22	$22
Total	$30	$27	$25	$25	$25	$25	$26
Total CNN EBITDA	380	465	545	621	710	813	922
Implied FTV Multiple on Segment EBITDA	**23.1x**	**20.2x**	**18.4x**	**17.6x**	**16.8x**	**15.9x**	**15.3x**

Source: Credit Lyonnais Securities estimates

Exhibit 12: Basic Cable Network (News) DCF Valuation

($ millions, except where indicated)	1999E	2000E	2001E	2002E	2003E	2004E	2005E
Revenue	1,268.4	1,464.1	1,647.6	1,826.9	2,029.2	2,257.6	2,503.7
EBITDA	380.1	464.8	545.0	620.9	709.6	813.1	922.0
Allocated Depreciation	33.7	36.5	39.4	42.3	45.4	48.5	51.8
Allocated Goodwill	65.5	65.5	65.5	65.5	65.5	65.5	65.5
Operating Income	280.9	362.8	440.2	513.1	598.7	699.1	804.7
Interest Expense, Net	(78.8)	(65.1)	(46.9)	(24.0)	3.9	37.8	78.4
Pre-Tax Income	202.2	297.7	393.3	489.0	602.6	736.9	883.2
Allocated Tax Expense (Assume 41% Effective Rate)	(109.7)	(148.9)	(188.1)	(227.4)	(273.9)	(329.0)	(388.9)
Net Income	92.4	148.8	205.2	261.7	328.7	408.0	494.2
Depreciation/Amortization	99.2	102.0	104.9	107.8	110.9	114.0	117.3
Capital Spending	(50.0)	(51.5)	(53.0)	(54.6)	(56.3)	(58.0)	(59.7)
Free Cash Flow	141.6	199.3	257.0	314.9	383.3	464.0	551.8
% Change		40.7%	29.0%	22.5%	21.7%	21.1%	18.9%
Net Debt:							
Beginning	(1,055.4)	(913.7)	(714.5)	(457.5)	(142.6)	240.7	704.7
Ending	(913.7)	(714.5)	(457.5)	(142.6)	240.7	704.7	1,256.5
Average	(984.5)	(814.1)	(586.0)	(300.0)	49.1	472.7	980.6
Free Cash Flow	141.6	199.3	257.0	314.9	383.3	464.0	551.8
Add: After-Tax Interest Expense (0 if Net Cash)	46.5	38.4	27.7	14.2			
Free Cash Flow to Firm	188.1	237.7	284.7	329.0	383.3	464.0	551.8
% Change		26.4%	19.8%	15.6%	16.5%	21.1%	18.9%
Assumptions:							
WACC	12.0%						
Long-Term Growth	7.5%						
Terminal Multiple	22.2x						
Years to Discount:	0.0	1.0	2.0	3.0	4.0	5.0	6.0
		0.0	1.0	2.0	3.0	4.0	5.0
			0.0	1.0	2.0	3.0	4.0
				0.0	1.0	2.0	3.0
					0.0	1.0	2.0
						0.0	1.0
							0.0
Discounted FCFF	188.1	212.2	226.9	234.2	243.6	263.3	279.5
		237.7	254.2	262.3	272.8	294.9	313.1
			284.7	293.8	305.6	330.3	350.7
				329.0	342.2	369.9	392.7
					383.3	414.3	439.9
						464.0	492.7
							551.8
Sum of PV of FCFF Streams	1,647.9	1,635.0	1,564.9	1,433.9	1,237.5	956.7	551.8
PV of Terminal Value	6,678.1	7,479.4	8,377.0	9,382.2	10,508.1	11,769.1	13,181.3
Gross Present Value	8,326.0	9,114.4	9,941.9	10,816.1	11,745.5	12,725.7	13,733.1
Less: Allocated Yearend Net Debt	(913.7)	(714.5)	(457.5)	(142.6)	240.7	704.7	1,256.5
NPV	**7,412.2**	**8,399.9**	**9,484.5**	**10,673.5**	**11,986.3**	**13,430.4**	**14,989.6**
EBITDA	**380.1**	**464.8**	**545.0**	**620.9**	**709.6**	**813.1**	**922.0**
Implied Fair Trading Multiple	**19.5x**	**18.1x**	**17.4x**	**17.2x**	**16.9x**	**16.5x**	**16.3x**

Source: Credit Lyonnais Securities estimates

- The issue in valuing Time magazine publishing, in our view, is the question of how high to set the benchmark for the industry leader. We believe Time is the unchallenged leader in consumer magazine publishing due to its (1) ability to deliver high shares of targeted demographics, (2) ability to leverage powerful brands into new franchises, and (3) ability to mine content from all the Time Warner operations.

In valuing Time Warner shares we applied a 14.0x multiple to magazine publishing EBITDA, in line with the low- to mid-teens annual EBITDA growth it has delivered in a near-clockwork manner. We are raising this multiple to 15.5x, to reflect its industry leadership and synergy benefits from the AOL-Time Warner merger (see Synergies section on page 10). While this multiple represents a steep premium to its publicly traded peers (e.g., Meredith Corp., Reader's Digest, and Primedia), none of its peers are positioned nearly as well as Time. The higher multiple is supported by a standalone DCF analysis, which yields an NPV of $17.3 billion on 2001 estimates. Moreover, the NPV produced by our DCF corresponds to 13.1x–20.7x EBITDA multiples—declining over time as a function of the subscription, advertising, and online merger synergies stemming from Time Warner's acquisition by AOL.

Exhibit 13: Time Magazine Publishing EBITDA Valuation

($ millions, except where indicated)	1999E	2000E	2001E	2002E	2003E	2004E	2005E
EBITDA	623.5	740.5	1,009.5	1,318.7	1,542.7	1,794.9	2,078.7
Multiple	15.5x	15.5x	15.5x	15.5x	15.5x	15.5x	15.5x
Fair Trading Value	9,664.7	11,478.1	15,647.9	20,440.1	23,911.2	27,821.2	32,219.5

Source: Credit Lyonnais Securities estimates

Exhibit 14: Time Magazine Publishing DCF Valuation

($ millions)		1999E	2000E	2001E	2002E	2003E	2004E	2005E
Revenue		3,422.3	3,690.0	4,117.2	4,654.5	5,026.3	5,433.1	5,878.3
EBITDA		623.5	740.5	1,009.5	1,318.7	1,542.7	1,794.9	2,078.7
Allocated Depreciation		60.9	65.7	69.1	72.6	76.4	80.3	84.4
Operating Income		562.6	674.9	940.5	1,246.1	1,466.3	1,714.6	1,994.2
Interest Expense, Net		(126.5)	(101.5)	(66.1)	(15.1)	31.7	81.2	140.2
Pretax Income		436.2	573.4	874.4	1,231.0	1,498.0	1,795.8	2,134.4
Allocated Tax Expense (Assume 41% Effective Rate)		(178.8)	(235.1)	(358.5)	(504.7)	(614.2)	(736.3)	(875.1)
Net Income		257.3	338.3	515.9	726.3	883.8	1,059.5	1,259.3
Depreciation/Amortization		60.9	65.7	69.1	72.6	76.4	80.3	84.4
Capital Spending		(48.0)	(50.4)	(52.9)	(55.6)	(58.3)	(61.3)	(64.3)
Free Cash Flow		270.2	353.5	532.0	743.4	901.8	1,078.6	1,279.4
Net Debt:								
Beginning		(1,715.8)	(1,445.5)	(1,092.0)	(560.0)	183.4	1,085.2	2,163.8
Ending		(1,445.5)	(1,092.0)	(560.0)	183.4	1,085.2	2,163.8	3,443.3
Average		(1,580.7)	(1,268.8)	(826.0)	(188.3)	634.3	1,624.5	2,803.5
Free Cash Flow		270.2	353.5	532.0	743.4	901.8	1,078.6	1,279.4
Add: After-Tax Interest Expense (0 if Net Cash)		74.6	59.9	39.0	8.9			
Free Cash Flow to Firm		344.9	413.4	571.0	752.3	901.8	1,078.6	1,279.4
% Change			19.9%	38.1%	31.7%	19.9%	19.6%	18.6%
Assumptions:								
WACC	12.0%							
Long-Term Growth	6.0%							
Terminal Multiple	16.7x							
Years to Discount:		0.0	1.0	2.0	3.0	4.0	5.0	6.0
			0.0	1.0	2.0	3.0	4.0	5.0
				0.0	1.0	2.0	3.0	4.0
					0.0	1.0	2.0	3.0
						0.0	1.0	2.0
							0.0	1.0
								0.0
Discounted FCFF		344.9	369.1	455.2	535.4	573.1	612.0	648.2
			413.4	509.8	599.7	641.9	685.5	726.0
				571.0	671.7	718.9	767.7	813.1
					752.3	805.2	859.8	910.7
						901.8	963.0	1,019.9
							1,078.6	1,142.3
								1,279.4
Sum of PV of FCFF Streams		3,538.0	3,576.3	3,542.4	3,328.0	2,884.8	2,220.9	1,279.4
PV of Terminal Value		11,451.5	12,825.6	14,364.7	16,088.5	18,019.1	20,181.4	22,603.1
Gross Present Value		14,989.5	16,401.9	17,907.1	19,416.5	20,903.9	22,402.3	23,882.6
Less: Allocated Year-end Net Debt		(1,445.5)	(1,092.0)	(560.0)	183.4	1,085.2	2,163.8	3,443.3
NPV		**13,543.9**	**15,309.9**	**17,347.2**	**19,599.8**	**21,989.2**	**24,566.1**	**27,325.8**
EBITDA		**623.5**	**740.5**	**1,009.5**	**1,318.7**	**1,542.7**	**1,794.9**	**2,078.7**
Implied Fair Trading Multiple			**20.7x**	**17.2x**	**14.9x**	**14.3x**	**13.7x**	**13.1x**

Source: Credit Lyonnais Securities estimates

Weighted Enterprise Value/EBITDA Multiple

We believe AOL Time Warner should trade at a weighted 20x–21x estimated 2001 EBITDA

Based upon the relative contributions from AOL and Time Warner to projected consolidated AOL Time Warner EBITDA over the 2000PF–2005 period, we estimate a fair trading multiple on EBITDA of 19.9x to 21.6x. This weighted multiple is derived by applying multiples equal to the projected 2000PF–2005 projected EBITDA growth rates of the Time Warner and AOL assets (16.6x and 31.2x, respectively). The weighted multiple increases over time as the faster-growing AOL EBITDA (accorded a higher FTV multiple) makes a contribution to total EBITDA. Prior to the AOL transaction, Time Warner traded in a range of 14.0x–17.0x estimated 2001 EBITDA.

Exhibit 15: AOL Time Warner Valuation Using a Blended EBITDA Multiple

($ millions)	2000PF	2001E	2002E	2003E	2004E	2005E
EBITDA Contribution						
TWX Assets	7,825.2	9,890.0	11,977.3	13,492.9	15,139.7	16,899.1
AOL Assets	2,233.4	3,403.0	4,515.6	5,744.2	7,198.7	8,680.4
EBITDA Contribution						
TWX Assets	77.8%	74.4%	72.6%	70.1%	67.8%	66.1%
AOL Assets	22.2%	25.6%	27.4%	29.9%	32.2%	33.9%
FTV Multiple (Using Projected 2000–2005 EBITDA CAGR):						
TWX Assets	16.6x	16.6x	16.6x	16.6x	16.6x	16.6x
AOL Assets	31.2x	31.2x	31.2x	31.2x	31.2x	31.2x
Weighted Average FTV Multiple	**19.9x**	**20.4x**	**20.6x**	**21.0x**	**21.3x**	**21.6x**
Combined EBITDA (pre Corp. Overhead and Eliminations)	10,059	13,293	16,493	19,237	22,338	25,579
Consolidated AOL Time Warner Fair Trading Value	**199,935**	**270,791**	**340,245**	**403,798**	**476,583**	**552,093**
Non-Consolidated Assets (See Exhibit 17)	57,256	64,463	72,663	82,385	93,453	106,060
Gross AOL Time Warner Value	**257,191**	**335,254**	**412,908**	**486,184**	**570,036**	**658,154**
Less: Ending Net Debt	(16,142)	(9,040)	1,366	14,788	31,686	52,334
Less: 20% Minority in Consolidated TWE						
Asset Value (@ 15.5x EBITDA)	(11,576)	(14,452)	(17,406)	(19,207)	(21,336)	(23,770)
Less: 20% Minority in TWE Investments	(1,107)	(1,282)	(1,449)	(1,620)	(1,790)	(1,976)
Add: 20% Minority in TWE Net Debt	1,026	522	(238)	(1,129)	(2,166)	(3,368)
Add: 50% Warner EMI Net Debt	1,375	880	166	(725)	(1,808)	(3,036)
Net Fair Trading Value	**230,767**	**311,882**	**395,347**	**478,289**	**574,623**	**678,336**
Average Common Shares Outstanding (millions)	4,800	4,800	4,800	4,800	4,800	4,800
Fair Trading Value per Share	**$48.08**	**$64.98**	**$82.36**	**$99.64**	**$119.71**	**$141.32**

Source: Credit Lyonnais Securities estimates

DCF Analysis on AOL Time Warner

Similar to our DCF analysis for AOL, we make two crucial assumptions in our AOL Time Warner DCF valuation. Our WACC assumption is driven by applying projected betas (1.2 for AOL and 1.05 for Time Warner and pre-merger market capitalizations), which yields a combined beta of 1.11 and a cost of equity of 13.3%. Combined with a 6%/94% debt/equity capitalization, we then derive a WACC of 12.8%.

Exhibit 16: AOL Time Warner DCF Valuation

($ millions)		2000E	2001E	2002E	2003E	2004E	2005E
Free Cash Flow to Equity		3,714	7,102	10,405	13,422	16,898	20,648
Add: After-Tax Interest (0 if net cash)		876	613	187			
Free Cash Flow to Firm		**4,590**	**7,715**	**10,592**	**13,422**	**16,898**	**20,648**
			68.1%	37.3%	26.7%	25.9%	22.2%
Assumptions:							
Long-Term Terminal Growth Rate							
Proxy Market Return	12.0%						
Assumed Forward AOL Beta	1.17						
Projected TWX Beta	1.05						
TWX Market Cap	107,800						
AOL Market Cap	130,000						
Weighted Average Forward Beta	1.11						
Cost of Equity	13.3%						
After-Tax Cost of Debt	4.4%						
WACC	12.8%						
Long-Term FCFF Growth Rate	7.0%						
Terminal Multiple of 2006E FCFF	17.2x						
Years to Discount		0	1	2	3	4	5.0
			0	1	2	3	4.0
				0	1	2	3.0
					0	1	2.0
						0	1.0
							0.0
Discounted FCFF		4,590	6,810	8,254	9,234	10,262	11,069
			7,715	9,350	10,460	11,625	12,539
				10,592	11,849	13,169	14,204
					13,422	14,918	16,091
						16,898	18,227
							20,648
Sum of PV of FCFF Streams		50,221	51,689	49,814	44,430	35,126	20,648
PV of Terminal Value		209,713	237,560	269,106	304,840	345,320	391,174
Non-Consolidated Assets (See Exhibit 17)		57,256	64,463	72,663	82,385	93,453	106,060
Gross AOL Time Warner Value		**317,189**	**353,713**	**391,583**	**431,656**	**473,898**	**517,882**
Less: Ending Net Debt		(16,142)	(9,040)	1,366	14,788	31,686	52,334
Less: 20% Minority in Consolidated TWE Asset Value (@ 15.5x EBITDA)		(11,576)	(14,452)	(17,406)	(19,207)	(21,336)	(23,770)
Less: 20% Minority in TWE Investments		(1,107)	(1,282)	(1,449)	(1,620)	(1,790)	(1,976)
Add: 20% Minority in TWE Net Debt		1,026	522	(238)	(1,129)	(2,166)	(3,368)
Add: 50% Warner EMI Net Debt		1,375	880	166	(725)	(1,808)	(3,036)
Net Present Value		**290,765**	**330,340**	**374,022**	**423,761**	**478,485**	**538,065**
AOL Time Warner NPV per Share		**$60.58**	**$68.82**	**$77.92**	**$88.28**	**$99.68**	**$112.10**

Source: Credit Lyonnais Securities estimates

A Word on AOL Time Warner's Off-Balance Sheet Assets

In all of the above valuation methods, the off-balance sheet assets of Time Warner and AOL are valued separately and added to FTV. In Time Warner's case, we estimate OBS assets were worth $10.0 billion in 1999 and are increasing in value to $11.6 billion in 2001. AOL's main OBS assets are its 50% interests in AOL Europe, Latin America, Hong Kong, Japan and Australia.

We value AOL's share of these assets at $30 billion on 2000 estimates on a discounted cash flow basis. We believe this valuation is justified by projected subscriber and advertising/e-commerce revenue growth from all three entities. As a cross-check, Terra Networks, operating in Spain and Latin America, has a current market capitalization of $27 billion. Further, Bertelsmann CEO Thomas Middlehoff has stated he believes AOL Europe would trade at up to $20 billion or more on a standalone basis, and market estimates more or less coincide with this number. (Please refer to the individual spreadsheets in this report for the DCFs on these assets.) Market estimates for the value of AOL Europe are $20–$30 billion, based on work done in anticipation of Bertelsmann's sale of its 50% interest. In addition to its 50-50 Internet access ventures, AOL has a $1.5 billion investment in GMH shares and investments in other companies with an estimated value of about $6.3 billion.

Exhibit 17: Off-Balance Sheet Valuation Summary

($ millions)	2000PF	2001E	2002E	2003E	2004E	2005E
Off-Balance Sheet Assets:						
TWX:						
Time Warner Telecom (51% @ FTV)	1,533	1,792	2,051	2,365	2,708	3,100
CDNow (37% at FTV)	630	739	871	1,021	1,194	1,395
Court TV (+15% yr. - 50%)	345	397	456	525	603	694
TWE Japan (37.3%) +20% yr.	498	597	717	860	1,032	1,238
Road Runner (38%)	1,467	1,685	1,957	2,293	2,707	3,183
TWE:						
Cable TV Systems (Same Multiples as Consol.; EBITDA $27 (+7% yr) less debt x 50%)	238	257	277	299	323	349
50% of Texas Partnership	1,886	2,243	2,540	2,805	3,027	3,255
50% of Kansas City Cable Partners	979	1,150	1,298	1,447	1,573	1,706
WB Network (75%; @13x 2007 EBITDA, disct'd @ 13%)	1,384	1,564	1,768	1,998	2,257	2,551
Comedy Central (@ 16x Est. 2005 EBITDA, disct'd @ 13%)	625	707	798	902	1,020	1,152
PrimeStar Partners LP - 31% - Value +13% Yr	10	12	13	15	17	19
PrimeStar Subscribers ($1400/sub) + 25% yr	13	16	20	24	31	38
Australia Theme Parks (+15%/yr)	402	463	532	612	704	809
AOL:						
$1.5 Billion in DirecTV Preferred (6.4%, convert within 3 yrs 6/03)	1,500	1,500	1,500	1,725	1,984	2,281
25% China.com @ Mkt Value +20% Yr	860	1,032	1,238	1,486	1,783	2,140
Other Investments @ Mkt +20% Yr	6,300	7,560	9,072	10,886	13,064	15,676
Gateway Investment	620	744	893	1,071	1,286	1,543
80% of AOL Canada	5,112	5,842	6,689	7,678	8,794	10,025
50% of AOL Europe	13,632	15,587	17,861	20,467	23,432	26,783
50% of AOL Hong Kong	431	497	577	672	787	914
50% of AOL Japan	3,190	3,680	4,273	4,955	5,750	6,642
50% of AOL Australia	1,016	1,169	1,347	1,568	1,817	2,099
50% of AOL Latin America	6,385	7,336	8,440	9,787	11,353	13,144
NOL	8,200	7,896	7,476	6,923	6,209	5,324
Total FTV of Off-Balance Sheet Assets	**57,256**	**64,463**	**72,663**	**82,385**	**93,453**	**106,060**

Source: Credit Lyonnais Securities estimates

Our valuation includes the following as outstanding shares: (1) AOL employee stock options for 399.1 million shares exercisable at an average $8.88 per share; and (2) Time Warner options for 148.1 million shares exercisable at an average $20.14 per share. At the 1.5x Warner share ratio, options add a total of 621.2 million shares and $6.52 billion in cash. In other words, options are dilutive to the new combined entity's FTV. Both companies use the treasury method of accounting for these options.

Relative Entertainment Group Valuation

The exhibit below shows the entertainment peer group trading multiples on EBITDA.

Exhibit 18: Relative EV/EBITDA Multiples

($ millions unless specified)	The Walt Disney Co. DIS	Fox Ent. Group FOX	Liberty Media LMGa	News Corp. NWSa	Seagram VO	Time Warner TWX	Viacom VIA.B	MGM MGM	USA Net, Inc. USAI.O
Share Price (@ 2/25/00 Close)	$31.00	$23.50	$54.06	$48.25	$55.13	$59.63	$54.69	$23.31	$23.94
Shares Outstanding (Diluted) 00E	2,082.0	724.0	1,352.7	996.7	493.3	4,800.0	1,577.7	219.8	815.3
Market Cap 00E	64,542.0	17,014.0	73,127.6	48,090.8	27,193.7	286,200.0	86,283.1	5,124.1	19,516.8
Ending Net Debt/(Cash)									
1999E	11,160.6	3,167.3	1,140.5	3,725.3	5,384.8	21,616.5	5,617.4	1,506.2	170.8
2000E	10,987.8	3,050.2	650.1	4,320.5	4,781.8	19,225.3	5,270.3	949.8	(2,399.3)
2001E	10,135.3	2,847.9	(308.1)	4,224.5	4,576.7	14,110.3	2,686.3	923.6	(2,893.5)
Preferred Shares									
1999E	0.0	0.0	0.0	1,575.5	0.0	0.0	0.0	0.0	0.0
2000E	0.0	0.0	0.0	1,575.5	0.0	0.0	0.0	0.0	0.0
2001E	0.0	0.0	0.0	1,575.5	0.0	0.0	0.0	0.0	0.0
Non-Cash Flow Assets									
1999E	9,279.6	1,251.8	28,861.9	12,326.5	10,949.7	7,758.6	10,046.1	4,926.2	5,304.7
2000E	13,654.5	2,074.4	33,063.3	17,553.5	12,523.2	56,148.2	11,434.7	4,551.2	6,283.9
2001E	15,556.6	2,536.7	37,993.1	35,229.0	14,364.5	63,180.9	13,563.1	4,525.0	7,194.5
Enterprise Value									
1999E	66,423.1	16,626.5	45,406.3	41,079.5	18,746.8	97,231.6	81,854.4	776.3	12,728.2
2000E	61,875.3	17,989.8	40,714.4	36,433.2	19,452.3	249,277.1	80,118.7	1,522.7	10,833.6
2001E	59,120.7	17,325.2	34,826.4	18,661.7	17,405.8	237,129.4	75,406.3	1,522.7	9,428.8
EBITDA									
1999E	4,313.8	1,103.2	1,490.3	2,035.2	1,378.6	5,519.5	3,519.9	(19.1)	723.9
2000E	4,525.9	1,258.0	1,843.5	2,228.4	1,722.9	8,988.3	5,087.9	33.6	815.3
2001E	5,697.6	1,388.1	2,256.2	2,573.5	2,080.5	12,087.4	5,899.5	161.2	925.4
Enterprise Value/EBITDA									
1999E	15.4x	15.1x	30.5x	20.2x	13.6x	17.6x	23.3x	(40.7x)	17.6x
2000E	13.7x	14.3x	22.1x	16.3x	11.3x	27.7x	15.7x	45.4x	13.3x
2001E	10.4x	12.5x	15.4x	7.3x	8.4x	19.6x	12.8x	9.4x	10.2x
Target Price									
1999E	$28.70	$26.27	$47.27	$34.32	$50.38	$57.50	$46.00	$8.94	$20.63
2000E	$33.37	$26.07	$60.84	$41.47	$57.74	$68.13	$53.17	$15.13	$25.32
2001E	$41.25	$29.18	$69.60	$61.80	$66.95	$79.95	$61.93	$17.96	$29.30
Potential Appreciation									
2000E	7.6%	11.0%	12.5%	-14.1%	4.7%	14.3%	-2.8%	-35.1%	5.8%
2001E	33.1%	24.2%	28.7%	28.1%	21.4%	34.1%	13.2%	-22.9%	22.4%

Source: Credit Lyonnais Securities estimates

Sensitivity Analyses

Due to the long-term nature of our valuation models, we are incorporating sensitivity analyses to reflect two factors:

1. The possible impact of an accelerated erosion of subscription pricing power by AOL; and

2. The sensitivity to our AOL Time Warner 2001 target of changes in our AOL DCF valuation (i.e., changes to our long-term FCFF growth rate and WACC assumptions).

Sensitivity to Accelerated Subscription Price Declines

In our base AOL model, we assume that subscription rates for the core domestic AOL service will decrease at a 3% rate annually, beginning in 2001. While some believe that the commoditization of Internet content and competitive entrance of free ISPs will reduce subscription rates at a faster rate, we believe AOL will be able to hold prices relatively firm, for the following reasons:

1. AOL's premium service costs far less than cable TV, local/long distance telephony, and wireless telephony.

2. AOL offers Internet solutions that competitors cannot meet.

3. AOL has been able to maintain its pricing while reducing churn over the past 18 months.

Exhibit 19 below presents a sensitivity analysis of AOL's NPV as well as our projected 2001 AOL Time Warner target price to erosion in annual subscription pricing. We have excluded CompuServe and broadband delivery of AOL for this purpose due to (1) CompuServe's niche focus on professional users, whose demand for Internet access we regard as less price-elastic; and (2) the differentiated appeal (e.g., speed, "always-on" connectivity) and less competitive environment of broadband access.

Exhibit 19: Sensitivity to Changes in Subscription Rates for the Core AOL Service

[illegible]	[illegible]	2001E AOL Time Warner FTV
0%	214.2	$69.15
-1%	212.4	$68.79
-2%	210.8	$68.45
-3%	**209.2**	**$68.13**
-4%	207.7	$67.82
-5%	206.3	$67.54
-6%	205.0	$67.27
-7%	203.8	$67.01

Source: Credit Lyonnais Securities estimates

As can be seen above, our 2001 DCF valuation of AOL and projected fair trading valuation of AOL Time Warner is marginally affected by changes in subscription pricing—ranging from $203.8–$214.2 billion and $67.01–$69.15 per share, respectively. This narrow range is due to the growing contribution of advertising/e-commerce and other AOL revenue streams, the projected ability of AOL to vary its cost structure (maintain margins), and the incorporation of Time Warner assets in the overall valuation.

Sensitivity of AOL Time Warner Valuation to WACC and Long-Term Growth Assumptions

Changes to the essential DCF valuation parameters themselves (the inputs in the terminal multiple equation—WACC and long-term growth) naturally have greater impact on the bottom-line AOL valuation. This is due to the small denominator in the $PV = 1/(k-g)$ equation. For example, reducing our WACC assumption from 14.1% to 13% raises our 2001 AOL NPV from $209.2 billion to $270.8 billion, which would raise our one-year AOL Time Warner target from $68 to $81 per share.

Issues to be Considered

1. **Valuation**

   See preceding discussion.

2. **The threat from free ISPs**

   Europe has been at the forefront of the world in offering free ISP services, beginning with Freeserve in the U.K. However, we believe the free ISP model does not appear to apply in the U.S., as free ISPs rely upon kickbacks of per-minute local call charges from the telephone companies and have far less loyal customer bases that are not primary advertiser targets. We believe the European (and South American) free ISPs will eventually go out of business when advertising revenues fail to materialize.

3. **Intellectual copyright on the Internet**

   The recorded music industry is at the forefront of the battle for intellectual copyright on the Internet. Currently, consumers can download recorded music from the Internet using MP3 software and numerous other means and send it to friends via e-mail, thus bypassing all payments due to recorded music companies and artists. We believe the secure digital music initiative (SDMI) and other developing encryption systems should hold piracy in check, although we expect piracy to remain as much a problem as it is today. Encryption will be essential to other content forms on the Internet, as well. The solution to this problem probably involves the ability of established media companies to find new ways to distribute their copyrights online—in other words, finding creative ways to take advantage of the new online media. This involves not only new ways of selling music, but more efficient ways of breaking new acts. Because piracy is already a $10 billion revenue problem for the music industry, we do not believe Internet piracy will add meaningfully to revenues lost by Warner EMI. However, we think new distribution should be additive in the next five years.

4. **The relationship with AT&T**

   Aside from Warner's ongoing negotiations with AT&T about the residential telephony venture and the 20% economic interest in TWE that AT&T will acquire with MediaOne, AOL's presence brings yet new issues, most notably the question of open access to AT&T's and the cable industry's broadband pipeline.

   At issue is AOL's desire not only to have direct access to the consumer but also to receive full subscription prices for its service, rather than the $9.95 per month it receives as part of the @Home and Road Runner packages. AT&T appears to be leaning toward open access at this juncture, having signed a conditional agreement to provide open access to Mindspring Enterprises once AT&T's exclusivity agreement with @Home expires in June 2002. AT&T also clearly needs a residential telephony deal with Time Warner to further its national local telephony strategy.

   We believe some sort of deal will be completed that involves AT&T trading its 20% economic interest in TWE for TWE cable systems, a resTel agreement, and open access for AOL (assuming an exclusive Time Warner Cable carriage agreement with Road Runner can be ended before its 2001 expiration). Such a deal, although it would be exceedingly complex, would benefit all parties involved, as well as drawing the remainder of the MSO industry into the open-access camp. We believe Comcast would likely follow suit due to its "most-favored-nation" status on an AT&T resTel partnership. @Home's exclusive deals with MSOs begin to expire in about two years, thus opening the door for further open access agreements.

5. **The possibility of asset sales**

   Although there has been speculation of late about slimming down the combined company, the only asset we see as a sale candidate might be Time Warner's cable systems, provided AOL secures open access to the Warner Cable pipeline. We do not believe the magazines will be sold because of the expansion potential of their brands and the value of their consumer databases in establishing Internet-related businesses.

AOL Strategies

At its core, AOL is a consumer products/services company, and as such its strategies are similar to those of other consumer products companies. These involve leveraging the core brand to add new products and expansion into new geographic and end markets. All the while, the company seeks to strengthen its core brand, which is the engine behind growth and the ultimate interface with consumers.

AOL wants to be ubiquitous, following the consumer migration toward landline and wireless broadband Internet access

What differentiates AOL from other ISPs? What are the real strengths of the company? Despite criticisms from sophisticated Internet users that AOL (1) is a dumbed-down Internet access service, (2) gets in the way, and (3) is a plodding middleman, AOL thrives, adding customers at an accelerating pace.

AOL's strategies are as follows:

1. **Provide millions of current and future subscribers with an Internet environment that works and is easy and fun.**

   Its service caters to time-constrained people who do not have the time or the energy to struggle with mastering the intricacies of the Internet (e-mail is the killer application of the Internet).

   AOL's service is extremely convenient, as it offers a distilled version of the best of the Internet, at least in its customers' eyes. These customers rely upon AOL because they believe the company will continue to bring them the best of new technology and features on the Internet. Because AOL creates an experience that is "cozy and convenient," it caters to the "Home is a haven" concept that is becoming more important in society as life outside the home becomes more stressful. We believe this is what distinguishes AOL from other ISPs. In spite of the logic that says the middleman will be eliminated when possible, AOL disproves this theory, continuing to add services that not only make life more convenient for subscribers (home banking and bill-paying to come) but also create rapidly growing new revenue streams. This is why advertisers and merchants continue to flock to AOL.

AOL can be likened to the USA Today of the Internet, offering a distillation of what is important in easy-to-manage sound bites

2. **Become ubiquitous by gaining direct consumer access on all possible platforms for Internet access in order to reinforce and protect the America Online brand.**

   AOL's paying subscriber base is the bedrock on which the company builds new businesses. AOL has grown from a one-brand, one-vehicle (the PC) company operating only in the U.S. to a multi-brand, multimedia, multi-country company.

   Reinforcing and protecting this subscriber base—making it indispensable to more

Internet users—is the central strategy underlying AOL's existence. This is amply evidenced by the AOL Anywhere marketing plan, which entails delivery of the company's services in multiple ways, from PC to TV to Palm Pilot to Internet access devices not yet on the market. Further, the expansion of the CompuServe 2000 service for value customers and the introduction of the free Netscape access service in the U.K. have helped to protect against low- and zero-cost ISPs entering the market.

Because of the importance of direct consumer access, AOL has fought to gain open access to broadband cable pipelines and has struck carriage and cross-marketing agreements for DSL services with SBC Communications (including the Ameritech territories) and Bell Atlantic (including GTE), which together reach 65% of U.S. households. The company invested $1.5 billion in DirecTV to secure a foothold in the DBS Internet access service (now one-way with telephone return path but expected to be two-way in 2003–2004) and has now acquired the nation's second-largest MSO to secure broadband carriage. Further, it will launch AOL TV this year and invested $800 million in Gateway as part of a venture to develop and market Internet appliances and home networking devices. The company also struck marketing/technology agreements with 3Com that will place AOL's e-mail services on 3Com's Palm Pilots. AOL appears to lack only a major wireless agreement to secure access to broadband wireless services being introduced. The company has secured an agreement with Motorola under which Instant Messenger will be available on Motorola's smart wireless devices early this year.

At stake for AOL is potential freedom from Microsoft's Windows operating system, which is the de facto gateway through which all PC users pass before they reach AOL. The so-called information appliance market (Palm Pilots, wireless smart phones, Internet access devices) is expected to reach more than 50 million units in annual sales by 2002-03, greater than PC unit sales. The info-appliance market is virgin territory, free of the Windows operating environment. Assuming the Windows CE system is not selected for a majority of Internet appliances, AOL has the opportunity to deploy a relaunched Netscape browser to gain better control over its customer base.

3. **Become more central to customers' lives by introducing products that bind them closer to AOL.**

Cases in point include AOL's addition of Instant Messenger with its Buddy Lists, Online photo albums, Internet-based calendars, extended community chat groups, and free personalized Web pages. These products transform the routine e-mail service into a more personal community of friends/family experience and lessen the chances that customers will move to other e-mail services. More than 15 million AOL members are part of Buddy Lists and well over 30 million Instant Messenger users send more than 600 million messages per day. AOL leverages these ties to provide discounted long distance services and online billing (through TALK.com), travel services (through Netmarket Group), as well as shopping, Web search, and other services. Virtually all of AOL's services are highly personalized (calendars, parental controls, news, stock quotes, horoscopes, etc). The more personalized the services, the less incentive for a customer to move to another service and the more willing the customer is to pay for the service.

4. **Through acquisition and internal development, leverage the company's paying subscriber base to expand products and services beyond the company's core access and chat services (Instant Messenger, etc.).**

AOL has made several acquisitions in the past three years to expand its customer base and service offerings, most notably the $4.8 billion all-stock acquisition of Netscape in 1998. This acquisition added Netscape Netcenter and Netscape's browser, which is offered free to new customers in the U.K. AOL announced its intention to acquire to a 16-person board consisting of eight members from each company. Current Time Warner Vice Chairman Ted Turner will assume a similar position in the new company.

Reporting to Levin will be AOL COO Bob Pittman and Time Warner President Richard Parsons as co-COOs of AOL Time Warner, as well as AOL CFO J. Michael Kelly, who will be CFO of the new company. Also reporting to Levin will be a four-person integration committee consisting of Pittman, Parsons, AOL Vice Chairman Ken Novack, and Time Warner Digital Media CEO Rich Bressler.

Below Case and Levin are co-COOs Richard Parsons, who will run the combined Warner EMI Music, and Robert Pittman.

Robert Pittman, president of AOL: Pittman is firmly established in both the established media and the Internet worlds and is widely expected to provide the vital linkage between the disparate AOL and Time Warner cultures. Pittman is viewed as a top-flight marketer, dating from his youth as a radio disc jockey to management of WNBC in New York and Warner Amex Satellite, where he helped found MTV Networks and its various networks. After briefly heading his own company, Quantum Media, Pittman returned to Warner in 1990 at the request of Steve Ross. Pittman ran the Six Flags theme parks within Warner but departed to run the Century 21 Real Estate Corp. Pittman joined AOL in October 1996 and has been credited with stabilizing the company after the turmoil created when it switched from per-minute to fixed-access subscription pricing. He has also led AOL's aggressive moves into new revenue streams, notably advertising and e-commerce, as well as the creation of content. Pittman is a brand manager and a marketer, believing that the importance of leading-edge technology lies only in making the Internet experience easier for consumers. Pittman is close to both Levin and Time Inc. CEO Don Logan, and he will most likely be responsible for unifying the numerous Time Warner businesses in the aggressive pursuit of Internet expansion for their brands.

Richard Parsons, president of Time Warner: Viewed as an excellent politician, diplomat, and deal-maker, Parsons has become an essential cog in Time Warner's stable of talented executives. With a background in law (practicing lawyer), politics (aide to former New York Governor and U.S. Vice President Nelson Rockefeller), and banking (CEO of Dime Savings Bank), Parsons was considered by many when selected by Levin as president in 1994. Parsons was entrusted with handling two of the most significant issues in Time Warner's recent history—the 1996 acquisition of Turner Broadcasting (which involved winning the support of John Malone, Turner's largest shareholder) and maintaining relations with US West (now MediaOne). Given the changes that will be ahead for AOL Time Warner, we believe Parsons' diplomacy will remain in demand.

Will the Other Major Internet Players Make Content Deals?

Yahoo!, Microsoft, and AT&T are viewed as the most likely—indeed only—potential acquirers of large entertainment companies today. The AOL/Time Warner transaction set off a wave of speculative fever, primarily centered around Yahoo! and Microsoft.

Yahoo!

Widely viewed as the major challenger to AOL in terms of Internet audience aggregation, Yahoo! began its existence as a cataloger of Web sites (a search engine). Although it has no direct billing relationships with customers (relying on advertising and e-commerce fees for all of its running 12-month $804 million in revenues as of 4Q99), nor does it own content, the company has expanded its product offerings through internal development, marketing/content partnerships and acquisitions. Yahoo! is now the leading Internet portal and maintains a firm agnostic position about delivering content and services, thus insuring that its products and services reach as wide a market as possible. It is this agnosticism that makes Yahoo! want to remain independent at this juncture, remaining open to partnerships with many companies.

Yahoo! continues to expand its e-commerce capabilities through the hub-like qualities of its portals and via ad/merchant relationships. Yahoo! has signed several recent marketing partnerships that potentially expand the range of its services, including an agreement with the nation's third-largest retailer, Kmart, to create a free Internet access service with discs distributed at Kmart stores, et al, as well as a major partnership with Ford under which the company will create car information services on Yahoo!.

Because Yahoo! sources its content from many independent providers, its gross margins are almost 90% and the company is consistently profitable. In our opinion, however, the company's reliance on outside content perhaps places it at a competitive disadvantage to a company such as AOL Time Warner, which has the ability to create greater "stick" through owned and developed content.

Microsoft Corp.

Microsoft is an infrastructure company, not a content provider. Further, Microsoft has spent the better part of its existence as a business-products rather than a consumer-products company. After a brief flirtation with media businesses, Microsoft has returned to its software-technology supplier roots. It relies upon the installed base of its Microsoft Windows operating system (145 million PCs worldwide) and its influence over MSOs, in which it has invested some $6.0 billion domestically (AT&T $5.0 billion; Comcast $1.0 billion) and another $2.0 billion internationally (Telewest, NTL, Globo Cabo, UPC). Further, the company has invested $660 million in Nextel. These relationships have gained the company contracts to deploy Microsoft software in more than 10 million interactive set-top boxes. The company's goal appears to be to become a dominant provider of system software and Internet services for digital devices. In short, it seeks ubiquity for its Windows-branded products and services, much as AOL does for its Internet access services. We think the major battleground between the two companies will be over future ISP and Internet customers.

Like AOL, Microsoft has invested heavily for the so-called post-PC era of the Internet, but primarily to secure distribution for high-speed Internet access across a variety of broadband platforms (noted previously). The company has also spent heavily to develop personalized Internet services such as e-mail, news, stock prices, etc. Nevertheless, the company is an information aggregator, not a creator.

Microsoft has historically used the power of its Windows installed base to bundle new services and effectively change the economics of the business it enters by giving away the new service. This occurred with Web browsers and could also be the case with improved online software and service offerings this year. The company is expected to use direct cash rebates for long-term service agreements, as opposed to the rebates applicable only to PC purchases, which it has used since last year.

Microsoft reaches an estimated 190 million consumers through its Windows operating system, another 45 million or so from visitors to MSN and MSNBC.com, and about 2 million through subscriptions to MSN itself. Among the company's more popular Web sites are the Expedia travel and Carpoint auto sites, but the company trails AOL in total unique visitors—54 million to 40 million.

According to Media Metrix's December 1999 numbers, the AOL family of Web sites (including its service) reaches 79% of the Internet universe (54 million people) and its users are online with the service for an average of 342 minutes per month. Yahoo! reaches 62.3% of the market (and its users are on the service 70 minutes per month). The comparable numbers for Microsoft, Lycos and Excite are 59.5% and 63 minutes, 45% and 18 minutes and 40% and 28 minutes. AOL proprietary subscribers use the service for 510 minutes per month.

We do not believe Microsoft needs to make a major content acquisition in order to achieve its Internet goals, primarily because its goals are not content-oriented. However, the company has $17 billion in cash, no debt, and should generate EBITDA of close to $16 billion in FY00.

AT&T Corp.

AT&T is frequently mentioned as a potential acquirer of content. However, the company's commitment lies in providing bundled long distance and local telephony, cable TV and Internet access services. Following the MediaOne acquisition, AT&T will have an estimated 25 million cable customers (including partnerships) and access to more than 30 million households across the country. AT&T's ownership of 25% of Excite@Home has created problems because of the dual ISP/content nature of the latter. Excite@Home will split its media/content assets in a tracking stock.

AT&T has sought a co-marketing/open access deal with AOL in order to be able to market its own high-speed Internet access services to AOL's customer base. With AOL's acquisition of Time Warner, AT&T has less chance of cutting such a deal with AOL, although the three companies may ultimately work together in some form of alliance. While such an alliance furthers the interests of AOL and AT&T, relations with SBC and Bell Atlantic could become more strained. (AOL markets DSL service to its customer base in return for open access.) Both companies are reportedly disappointed in the Time Warner transaction because of its potential effects on DSL deployment in Manhattan and Houston.

Historic Business Segments

1. **Cable TV Systems (14.7% of 2000E Revenues & 28.3% of EBITDA):** With wholly and equity-owned cable systems serving 13 million basic subscribers, Time Warner is the second-largest operator of cable systems in the United States. The company also owns 51% of publicly traded Time Warner Telecom, a competitive local exchange carrier (CLEC) operating in 19 markets, and 38% of Road Runner, a high-speed data service with 550,000 subscribers as of December 31, 1999. The bulk of the company's cable

systems are owned by its Time Warner Entertainment (TWE) partnership, in which it owns an 80% economic stake.

2. **AOL (13.7% of 2000E Revenues & 22.2% of EBITDA):** AOL provides Internet access through AOL (20.5 million subscribers globally, including 3.1 million AOL subscribers in Europe), the value-oriented CompuServe 2000, and CompuServe Classic (2.5 million subscribers), the free Netscape in the U.K., and the Gateway.net service (740,000 subscribers).

   AOL derives revenues from two major sources: (1) subscriber fees ranging from $21.95 for the traditional AOL dial-up service to nothing for Netscape, accounting for 66% of revenues in 2Q00, or a running 12-month $4.27 billion; and (2) advertising and e-commerce, accounting for 27% of revenues in 2Q00, or a 12-month run rate of $1.75 billion. The company also derives revenues from the Netscape-Sun Microsystems alliance, which provides enterprise solutions to business customers.

3. **Filmed Entertainment (20.9% of 2000E Revenues & 9.6% of EBITDA):** Through Warner Brothers, New Line Cinema, and Castle Rock Entertainment, Time Warner is a leading global producer and distributor of theatrical films and TV programming. Time Warner has averaged 14% domestic box office market share over the past 10 years, and it has been one of the leading suppliers of TV programs for the broadcast networks' prime-time schedules for the past 13 years. Time Warner's filmed entertainment operations are owned by TWE.

4. **Basic Cable Networks (11.1% of 2000E Revenues & 13.3% of EBITDA):** Through its Turner Broadcasting subsidiary, Time Warner operates 17 basic cable networks reaching an estimated 450 million households domestically and 200 million internationally. The company's basic cable networks, which account for 27% of all cable TV viewing and ad revenues in the United States, include TNT, TBS, Cartoon Network, and CNN. Time Warner also owns 50% of Comedy Central and Court TV.

We regard Time Inc. as the premier consumer magazine publisher in the world

5. **Publishing (12.0% of 2000E Revenues & 8.8% of EBITDA):** Through its Time Inc. subsidiary, Time Warner is the world's leading publisher of weekly and monthly consumer magazines. It also operates Time Life Books, Book-of-the-Month Club, Warner Books, and other book publishing/direct marketing businesses. The company's magazine portfolio includes four main weekly brands: *Time*, *People*, *Sports Illustrated*, and *Entertainment Weekly*, and two major semi-weeklies/monthlies, *Money* and *Fortune*. Time Warner has achieved stellar magazine publishing growth by leveraging its core brands through *Teen People*, *InStyle*, *People en Español*, and the various For Kids magazine titles.

6. **Recorded Music (20.5% of 2000E Revenues & 12.4% of EBITDA):** Through its Atlantic, Warner Brothers, Elektra, and other labels, Time Warner is a leading U.S. producer, distributor, and publisher of recorded music, having averaged 20% domestic market share over the four years ended 1998 (before falling off sharply to 14% in 1999). It is also the world's third-largest recorded music company. In January 2000, Time Warner and EMI Music agreed to form Warner EMI Music as a joint venture that will become the world's largest music company, with annual revenues and EBITDA of a respective $8.0 billion and $1.0 billion. The venture combines Warner's historic strength in the U.S. with EMI's far stronger presence in Europe and other international markets. Warner will consolidate the results of the venture (see note dated January 25, 2000).

7. **HBO (5.4% of 2000E Revenues & 6.5% of EBITDA):** HBO is the world's largest pay-TV service and is emerging as a top-flight producer of original cable series and films. Through its HBO and Cinemax channels, HBO has more than 36 million pay-

TV subscribers in the United States and, through joint ventures, more than 10 million internationally. HBO is owned by TWE.

8. **The WB Network (1.1% of 2000E Revenues & Negative EBITDA):** Time Warner owns 75% of the WB Network, which was launched in January 1995. The WB Network added a sixth night of programming this season, and now provides a total of 11 hours of programming to 90% of U.S. households. WB Network, with its focus on teen viewers, had been the only one of the six networks to consistently gain audience share until this season, where ratings are down about 15%.

9. **Time Warner Digital (0.1% of 2000E Revenues & Negative EBITDA):** Created in 1999, Time Warner Digital houses all of Time Warner's Internet-related businesses, including:

   - The three Time Warner Internet content hubs, based upon content from the Time Inc. magazines and other Time Warner assets;
   - Its interest in Road Runner; and
   - A pro forma 37% of the merged CDNow online music retailer and Columbia House record and video club operations.

   We expect Time Warner Digital to be absorbed into AOL's content operations unless AOL Time Warner decides it needs a pure Internet company to make acquisitions.

Growth Drivers

AOL

- Continued growth in domestic paying subscribers to the dial-up access product and eventually broadband access; ongoing implementation of deals to secure access to all potential broadband delivery technologies.
- Continued growth of relationships with advertisers and e-commerce merchants, which need exposure to AOL's subscriber base, creating a virtuous cycle wherein more relationships means greater appeal to potential subscribers.
- AOL Anywhere's ability to create increasing customer loyalty and higher subscriber revenues.
- Improved performance in international markets where the company faces more, less expensive competitors.
- Ongoing development of new content to enhance the uniqueness of the AOL services.

Cable TV Systems

- Completion of 750 MHz network buildout and widespread launching of new services. We project that capex should be in the $2.0 billion range in 2000 and fall to $1.0 billion and lower each year thereafter. Nearly 70% of networks are now upgraded to 550–750

MHz and are two-way capable. The capex program is being accelerated in the wake of the AOL deal.

- Growth of analog cable service EBITDA in the high single digits through 4%–6% basic rate increases, rollout of advanced analog and/or digital TV to rest of systems, and ongoing high teens growth in local ad revenues.
- Completion of AT&T venture that will roll out resTel services across the Time Warner cable footprint beginning in 2001.
- Mitigation of competition through new services necessary as competition becomes more meaningful (with DBS services offering local programming), moving toward a cellular competitive model, and beginning to offer data services.
- Regulatory threats, mainly from the municipality level, which continue to fail to see the big picture in a competitive telecommunications world.
- Implementation of ambitious digital strategy, capitalizing on Time Warner's reach to over 21% percent of the country's cable homes, by: (1) driving penetration for the Road Runner high-speed data service; (2) leveraging the company's library and studio deals for video-on-demand (VoD)/subscription-on-demand (SoD); and (3) delivering music via broadband.

Cable Networks

- Original program creation triggers ratings growth, leading to higher advertising rates, higher costs per thousand (CPMs), and increased carriage by MSOs and DBS service providers. Ad rate CPM growth expected in the 8%–10% range and carriage rate increases at 5%–6%.
- Gap between network TV CPMs and basic cable network CPMs is still 30% in most cases. We believe this gap should disappear by 2001–03.
- Programming paid for early in cycle; new networks (Cartoon and TCM) reach EBITDA breakeven in one to two years.
- Ownership and distribution leverage of popular programming: news, sports, animation and movies.
- Maturation of startup domestic networks Cartoon, Turner Classic Movies, CNNfn, and CNNSI.
- Ongoing penetration in international markets for TNT and Cartoon, coupled with land-based cable infrastructure development leading to higher ad and carriage revenues.
- Introduction of new technologies, evolution of multiple broadband delivery pipelines for entertainment and education, evolution of Internet as content medium and development of new ancillary markets—licensing and merchandising.
- Development of quality digital networks in line with Time Inc. publishing content.
- Control of marketing and other costs to maintain margins in the face of 15%–20% annual program cost growth.

HBO

- Continued subscription revenue growth, driven by increasing DBS subscribers (up to over 10 million) and inflation level rate increases.
- Further packaging into multiplexes of 10 themed channels, increasing value proposition for subscribers and reducing annual churn rates from the 50%–55% range.
- Continued production of original movies and series such as *The Sopranos*, *Sex and the City*, and *Oz* to drive subscriptions.
- International penetration through wholly owned and joint venture operations.
- Leverage of the HBO brand into a pay-per-view/on-demand business based on acquisition rights deals with studios, split between studio, HBO, and MSO/DBS carriers.
- Control of non-programming costs, as programming budget appears to be growing more than 10% per year.
- High EBITDA growth trajectory from (50%-owned) Comedy Central due to higher ratings, rapid increases in carriage.

Filmed Entertainment

- TV programming (off-network syndication) continues to drive business with *ER*, *Friends*, etc. contributing an estimated $220 million in EBITDA in 1998; off-network syndication drives this business in the 1999–2002 period.
- Need to restore feature film business to cash flow breakeven through less expensive films, co-productions, cost-cutting at the studios, and lesser reliance on older stars (New Line now more profitable than Warner Brothers). Still need to balance cost controls with selected tentpole films such as *Superman*, *Legend*, etc.
- Business still driven by Home Video (20% of which is now via the DVD format), accounting for all of feature film EBITDA. Need to roll into an actual PPV model and perhaps release films directly to the home.

Publishing

- Tremendous free cash business, with CROIC approaching 50%.
- Solid economic growth necessary to sustain ad page growth.
- Excellent demographics: Time magazines reach 46% of all U.S. men; 52% of all U.S. women; 61% of professionals; 58% of households earning 50,000+ per year; and 62% of all U.S. college graduates.
- Core circulation continues to trend downwards in magazines, with growth driven by increasing discounts in subscriptions; Time Inc.'s special issues help drive circulation.
- Maturation of newer magazines such as *Entertainment Weekly*, *Teen People*, *InStyle*, *People en Español*, all on rapid growth trajectories in revenue and EBITDA.
- Continued success at new magazine introductions, cross-promotions, and special issues.

- Potential increase in paper and postage costs in two years, with paper supply/demand imbalance corrected.

Recorded Music

- Fundamental shift in the way music is distributed is affecting Warner as well as the other major record companies. Secure digital downloading is critical to industry, although record companies' role as marketer and packager cannot be underestimated.
- Integrating the EMI Music operations under the dual management structure of Warner EMI Music.
- Management now much improved with Roger Ames from PolyGram and Ken Berry from EMI both having strong international experience.
- Increasing costs of signing artists, as big names can most easily sell on the Internet.
- Need for new artists/fresh blood, reducing reliance on established megastars and tie-ins to feature films.
- Need for more coherent international thrust, as Warner Music Group has stagnated in growing international markets, particularly Europe and Asia.
- Combined, EMI and Warner/Chappell will form the largest music publisher in the world, with 25%–30% margins on 4%–6% annual growth from $1,000 million revenue base. Easily the most consistent part of the business.
- Columbia House transaction removes an estimated $49 million of EBITDA from segment; growth had been flat to down.

Operating Summary

Exhibit 20: SWOT Table

Segment	Strengths	Weaknesses	Opportunities	Threats
AOL	• By far largest paying Internet subscriber base • Growing relationships with advertisers and e-merchants • Simplicity of service binds customers	• Non-technological focus perceived by some as a weakness • Primarily a content "gateway" or aggregator, not a content creator	• Wider-spread broadband access and more compelling Internet content mean accelerating AOL subscriber growth opportunities • Anywhere to create multiple subscriber relationships • Launch & grow the ICQ, Digital Cities and other brands	• New wired and wireless broadband access to Internet • Free ISPs in Europe, South America • Microsoft
Cable Systems	• The largest U.S. MSO • Extensive presence in large markets • Modern, upgraded systems	• Customer service reputation • Convoluted structure in TWX/TWE partnerships	• Rapid penetration of high-speed data market, particularly with Road Runner/MediaOne Express merger completed • Digital cable (Athena) launch • Possible affiliation with AT&T	• Overbuilders in various markets • Over-regulation of high-speed data services • Failure to take advantage of window of opportunity for new services through technological delays, faulty execution
Basic Cable Networks	• Near-ubiquitous carriage • Strong brand name in entertainment, sports and news • Ratings • Strong management (Terry McGuirk and Ted Turner) • Access to Warner/Turner program libraries • Sports entertainment	• Some broad-based networks do not travel well internationally • Difficulties in integrating with Time Inc. culture to leverage new network, Internet opportunities	• International expansion • New network launches • Continued inroads against broadcast TV	• Competition from emerging niche entertainment networks • News network competition (CNBC, MSNBC, Fox News) • Escalating programming costs • CNNfn and CNN/SI could remain money drainers
Filmed Entertainment	• History • Big-name production deals and other relationships • Multiple back-end distribution channels in cable, broadcast, home video, etc. • Largest filmed entertainment library in the world	• Box office momentum just picking up • Management changes • Declining new network prime-time TV programming success ratio	• Favorable year-over-year comparisons • More disciplined operations management • Continued development of international markets • Promising off-network syndication product in pipeline	• Continued slump • Escalating production costs • Declining demand for U.S. TV programming in international markets
Publishing	• Strong brands • Demographic coverage • Customer database • Excellent special issue and cross-promotion abilities	• Economically sensitive	• Launch of new titles • Leverage content for Internet business	
Recorded Music	• Strong artists portfolio • Publishing • Catalog	• Weak in some major international markets • Declining U.S. market share	• Exploitation of electronic distribution methods • Continued development of international market • Direct marketing	• A stronger Universal Music Group • Slow Asian economic recovery • Continued oversupply • Plans to cut artist roster may cause company to miss the next "big" act • Internet piracy
Pay Cable Networks (HBO)	• Strongest brand in pay cable • Growing international brand • Excellent original programming	• Churn remains at 50%+, causing need to invest marketing dollars in chasing old subscribers	• Off-network syndication of new programming • PPV business for 2000 and beyond	• Overexposure of motion picture product, diminishing the value of pay TV window
The WB Network	• Ratings momentum • Identifiable demographic focus • Tight management team	• U.S. population coverage low versus Big Four • No station ownership • Economically sensitive	• Expand into other programming forms, upgrade others • Attractive new creative talent • Increase ad rates • Exploit relationship with WB	• Continued network viewer loss to cable • Higher programming costs • Need to maintain popular programming momentum
TW Digital	• Excellent TW brands in news, sports, lifestyles	• Lack of coherent Internet development approach historically	• Leverage broad content and brands	• Cannibalization of offline TWX audience

Source: Credit Lyonnais Securities (USA) Inc.

Exhibit 21: AOL Time Warner Operating Segment Synopsis

Division	% of Total 2000PF Rev*	% of Total 2000PF EBITDA*	Description	2000 EBITDA ($ mm)	2001 EBITDA ($ mm)	2000E–2005E EBITDA CAGR
Cable TV Systems	14.7%	28.3%	The best large cluster group in the United States. TW Cable should benefit from high demand for new products and services (assuming the pending joint venture with AT&T) due to high per-capita and disposable income as well as large amounts of telecommunications traffic in its markets. Expect further clustering via swaps and a resolution of TWE to enhance the company's position. AT&T's 33% of Cablevision could go to Warner as part of the unwinding. Solid long-term growth prospects.	2,843	3,353	12.5%
America Online	13.7%	22.2%	AOL provides Internet access through AOL (20.5 million subscribers globally, including 3.1 million AOL subscribers in Europe), the value-oriented CompuServe 2000 and CompuServe Classic (2.5 million subscribers), the free Netscape in the UK and the Gateway.net service (740,000 subscribers). AOL derives revenues from two major sources: (1) subscriber fees ranging from $21.95 for the traditional AOL dial-up service to nothing for Netscape, accounting for 66% of revenues in 2Q00, or a running 12-month $4.27 billion; and (2) advertising and e-commerce, accounting for 27% of revenues in 2Q00, or a running 12-month $1.75 billion. The company also derives revenues from the Netscape-Sun Microsystems alliance, which provides enterprise solutions to business customers.	2,233	3,403	31.2%
Basic Cable Networks	11.1%	13.3%	Turner networks are benefiting from (1) new programs creating higher rating and ad rates; (2) viewership growth through capture of the previous TV window for films; (3) creation of new networks from previously amortized programming; (4) emerging EBITDA from less developed networks domestically and internationally.	1,336	1,587	14.2%
Publishing	12.0%	8.8%	Cross promotion, special issues, successful new launches, and a fairly consistent ad climate position at Time for ongoing low double-digit EBITDA growth. Growing EBITDA profitability of *Entertainment Weekly*, *InStyle* and new magazines aids growth. Fulfillment and databases of BOMC and Time-Life Books could emerge as important e-commerce assets.	895	1,294	25.4%
Filmed Entertainment	20.9%	9.6%	The filmed entertainment segment revolves around Warner Brothers' filmed entertainment, home video and TV program production operations. Warner's filmed entertainment operations have been a model of consistency in an inconsistent and oftentimes economically unsound business. Film will be driven by off-network syndication profits, international syndication, and cost-cutting under new management.	963	1,232	12.2%
Warner EMI	20.5%	12.4%	Single-digit grower needs to buttress domestic and international operations; could be a major Internet beneficiary, assuming encryption is successful; large free cash generating business. We could be facing a transition period to new management and a sharp refocus on international operations under Ames.	1,247	1,632	15.5%
HBO	5.7%	6.5%	The world's top pay channel/brand, HBO benefits from the growth of DBS, emerging profitability internationally, and strong original programming. Solid mid-teens EBITDA grower. Must return to edgy films in the face of growing original telefilm competition from Showtime and the basic cable networks.	652	871	21.7%
WB Network	1.1%	NM	WB Network, with its focus on teen viewers, has been the only one of the six networks to consistently gain audience share with its popular hour-long programming; expansion to six nights brings new opportunities and risks. The network must maintain its programming edge to maintain vital momentum. Large revenue and cash flow upsides, as indicated by 50% increase in 1999-2000 prime-time upfront to about $450 million.	(79)	(44)	$322 mm positive swing
TW Digital	0.1%	NM	The newly created Time Warner Digital needs to coalesce TW's Internet activities forging links between the Warner Brothers, Time and Turner businesses. Extraordinary potential assuming the Internet emerges as an entertainment medium. Look for strong performance from CDNow and Road Runner.	(22)	(35)	$199 mm positive swing

Source: Credit Lyonnais Securities (USA) Inc.