procedures are effective in timely making known to them material information relating to the Company and the Company's consolidated subsidiaries required to be disclosed in the Company's reports filed or submitted under the Exchange Act. The Company has investments in certain unconsolidated entities. As the Company does not control these entities, its disclosure controls and procedures with respect to such entities are necessarily substantially more limited than those it maintains with respect to its consolidated subsidiaries. As discussed elsewhere in this Form 10-K, the Company began consolidating the financial results of AOLA effective March 31, 2004 pursuant to the requirements of FASB Interpretation No. 46, "Consolidation of Variable Interest Entities — an Interpretation of ARB No. 51," as revised ("FIN 46R"). Because the Company does not control AOLA, the Company's disclosure controls and procedures with respect to information regarding AOLA also are more limited than those for consolidated subsidiaries the Company controls. See "Management's Discussion and Analysis of Results of Operations and Financial Condition – Consolidation of Variable Interest Entities" for more information regarding the consolidation of the financial results of AOLA.

Management's Report on Internal Control Over Financial Reporting

Management's report and the report of the independent auditors thereon set forth at pages 209 and 211 through 212 are incorporated herein by reference.

Changes in Internal Control Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting during the quarter ended December 31, 2004 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

Item 9B. ***Other Information.***

Not applicable.

PART III

Items 10, 11, 12, 13 and 14. ***Directors and Executive Officers of the Registrant; Executive Compensation; Security Ownership of Certain Beneficial Owners and Management; Certain Relationships and Related Transactions; Principal Accounting Fees and Services.***

Information called for by Items 10, 11, 12, 13 and 14 of Part III is incorporated by reference from the Company's definitive Proxy Statement to be filed in connection with its 2005 Annual Meeting of Stockholders pursuant to Regulation 14A, except that (i) the information regarding the Company's executive officers called for by Item 401(b) of Regulation S-K has been included in Part I of this report; (ii) the information called for by Items 402(k) and 402(l) of Regulation S-K is not incorporated by reference; and (iii) the information regarding certain Company equity compensation plans called for by Item 201(d) of Regulation S-K is set forth below.

The Company has adopted a Code of Ethics for its Senior Executive and Senior Financial Officers. A copy of the Code is publicly available on the Company's website at www.timewarner.com/corporate_information. Amendments to the Code or any grant of a waiver from a provision of the Code requiring disclosure under applicable SEC rules will also be disclosed on the Company's website.

Equity Compensation Plan Information

The following table summarizes information as of December 31, 2004, about the Company's outstanding stock options and shares of Common Stock reserved for future issuance under the Company's equity compensation plans.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))[4]
	(a)	(b)	(c)
Equity compensation plans approved by security holders[1] ...	135,135,263	$31.68	181,089,137
Equity compensation plans not approved by security holders[2] ...	341,554,383	$31.04	0
Total[3]	476,689,646	$31.22	181,089,137

(1) Equity compensation plans approved by security holders are the (i) Time Warner Inc. 2003 Stock Incentive Plan, (ii) Time Warner Inc. 1999 Stock Plan, (iii) Time Warner Inc. 1999 Restricted Stock and Restricted Stock Unit Plan, (iv) Time Warner Inc. 1988 Restricted Stock and Restricted Stock Unit Plan for Non-Employee Directors, and (v) Time Warner Inc. Employee Stock Purchase Plan (column (c) includes 7,565,878 shares that were available for future issuance under this plan). The Time Warner Inc. 2003 Stock Incentive Plan was approved by the Company's stockholders in May 2003. The other plans or amendments to such plans were approved by the stockholders of either America Online or Historic TW in either 1998 or 1999. These other plans were assumed by the Company in connection with the America Online-Historic TW Merger, which was approved by the stockholders of both America Online and Historic TW on June 23, 2000.

(2) Equity compensation plans not approved by security holders consist of the AOL Time Warner Inc. 1994 Stock Option Plan, which expired in November 2003.

(3) Does not include options to purchase an aggregate of 142,308,826 shares of Common Stock (131,583,262 of which were awarded under plans that were approved by the stockholders of either America Online or Historic TW prior to the America Online-Historic TW Merger), at a weighted average exercise price of $27.68, granted under plans assumed in connection with transactions and under which no additional options may be granted.

(4) Includes securities available under the Time Warner Inc. 1988 Restricted Stock and Restricted Stock Unit Plan for Non-Employee Directors, which uses the formula of .003% of the shares of Common Stock outstanding on December 31 of the prior calendar year to determine the maximum amount of securities available for issuance each year under the plan (resulting in 13,449,514, shares available for issuance in 2005). Also includes securities available under the following plan that previously used a formula for determining the maximum amount of securities available for issuance based on the number of shares outstanding at December 31 of the prior year, but for which the maximum number of shares is not subject to further adjustment: (i) the Time Warner Inc. 1999 Restricted Stock and Restricted Stock Unit Plan, which provided for a maximum number of shares of Common Stock available for restricted stock awards of .08% of the shares of Common Stock outstanding on December 31 of the prior year. Of the shares available for future issuance under the Time Warner Inc. 1999 Stock Plan and the Time Warner Inc. 2003 Stock Incentive Plan, a maximum of 990,333 shares and 39,282,000 shares, respectively, may be awarded as restricted stock as of December 31, 2004.

The Time Warner Inc. 1999 Stock Plan (the "1999 Stock Plan") was approved by the stockholders of America Online in October 1999 and was assumed by the Company in connection with the America Online-Historic TW Merger in 2001. Under the 1999 Stock Plan, stock options (non-qualified and incentive), stock purchase rights, i.e., restricted stock, and restricted stock units can be granted to employees, directors and consultants of the Company and its consolidated subsidiaries. No incentive stock options have been awarded under the 1999 Stock Plan. The exercise price of a stock option under the 1999 Stock Plan cannot be less than the fair market value of the Common Stock on the date of grant. The stock options generally become exercisable, or vest, in installments of 25% over a four-year period, subject to acceleration upon the occurrence of certain events such as death or disability, and expire ten years from the grant date. No more than 5 million of the total 100 million shares of Common Stock that can be issued pursuant to the 1999 Stock Plan can be issued for awards of restricted stock and restricted stock units. Awards of restricted stock and restricted stock units vest in amounts and at times designated at the time of award, and generally have vested over a four- or five-year period. Awards of restricted stock and restricted stock units are subject to restrictions on transfer and forfeiture prior to vesting. The awards of stock options made to non-employee directors of the Company are made pursuant to the 1999 Stock Plan, which provides for an award of 8,000 stock options when a non-employee director is first elected to the Board of Directors and then annual awards of 8,000 stock options following the annual meeting of stockholders. Stock options awarded to non-employee directors vest in installments of 25% over a four-year period or earlier if the director does not stand for re-election or is not re-elected after being nominated.

The AOL Time Warner Inc. 1994 Stock Option Plan (the "1994 Plan") was assumed by the Company in connection with the America Online-Historic TW Merger. The 1994 Plan expired on November 18, 2003 and stock options may no longer be awarded under the 1994 Plan. Under the 1994 Plan, nonqualified stock options and related stock appreciation rights could be granted to employees (other than executive officers) of and consultants and advisors to the Company and certain of its subsidiaries. No stock appreciation rights are currently outstanding under the 1994 Plan. The exercise price of a stock option under the 1994 Plan could not be less than the fair market value of the Common Stock on the date of grant. The outstanding options under the 1994 Plan generally become exercisable in installments of one-third or one-quarter on each of the first three or four anniversaries, respectively, of the date of grant, subject to acceleration upon the occurrence of certain events, and expire ten years from the grant date.

The Time Warner Inc. 1999 Restricted Stock and Restricted Stock Unit Plan (the "1999 Restricted Stock Plan") was approved by the stockholders of Historic TW in May 1999 and was assumed by the Company in connection with the America Online-Historic TW Merger. The 1999 Restricted Stock Plan will terminate on May 19, 2009. Under the 1999 Restricted Stock Plan, awards of restricted stock and restricted stock units can be made to employees of the Company and its consolidated subsidiaries. Awards of restricted stock and restricted stock units vest in amounts and at times designated at the time of award, but at least 95% of the awards must vest at least three years after the date of award. Since 2004, most awards of restricted stock and restricted stock units have vested 50% on the third anniversary of the grant date and 50% on the fourth anniversary of the grant date. Awards of restricted stock and restricted stock units are subject to restrictions on transfer and forfeiture prior to vesting. As of December 31, 2004, 152,341 shares were available for issuance under the 1999 Restricted Stock Plan.

The Time Warner Inc. 1988 Restricted Stock and Restricted Stock Unit Plan for Non-Employee Directors (the "Directors' Restricted Stock Plan") was approved most recently in May 1999 by the stockholders of Historic TW and was assumed by the Company in connection with the America Online-Historic TW Merger. The Directors' Restricted Stock Plan will terminate on May 19, 2009. The Directors' Restricted Stock Plan provides for the award each year on the date of the annual stockholders meeting of either restricted stock or restricted stock units, as determined by the Board of Directors, to non-employee directors of the Company with value established by the Board of Directors. The awards of restricted stock and restricted stock units vest in equal annual installments on the first four anniversaries of the first day of the month in which the restricted stock or restricted stock units were awarded and in full if the director ends his or her service as a director due to (a) mandatory retirement, (b) failure to be re-elected after being nominated, (c) death or disability, (d) the occurrence of certain transactions involving a change in control of the Company and (e) with the approval of the Board of Directors on a case-by-case basis, under certain other designated circumstances. Restricted stock units also vest in full if a director retires from the Board of Directors after serving as a director for five years. If a non-employee director leaves the Board for any other reason, then his or her unvested restricted stock and restricted stock units are forfeited to the Company. The Board of Directors has determined that restricted stock units will be awarded in 2005.

The Time Warner Inc. Employee Stock Purchase Plan (the "ESPP") was approved most recently in October 1998 by the stockholders of America Online and was assumed by the Company in connection with the America Online-Historic TW Merger. Under the ESPP, employees of America Online and certain subsidiaries of America Online may purchase shares of the Company's Common Stock at a 15% discount from the closing price of the Common Stock at the beginning or end of a six-month participation period, whichever is lower. The purchases are made through payroll deductions during the participation period and are subject to annual limits.

PART IV

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

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

(i) The list of consolidated financial statements and schedules set forth in the accompanying Index to Consolidated Financial Statements and Other Financial Information at page 55 herein is incorporated herein by reference. Such consolidated financial statements and schedules are filed as part of this report.

(ii) All other financial statement schedules are omitted because the required information is not applicable, or because the information required is included in the consolidated financial statements and notes thereto.

(3) *Exhibits:*

The exhibits listed on the accompanying Exhibit Index are filed or incorporated by reference as part of this report and such Exhibit Index is incorporated herein by reference. Exhibits 10.1 through 10.42 listed on the accompanying Exhibit Index identify management contracts or compensatory plans or arrangements required to be filed as exhibits to this report, and such listing is incorporated herein by reference.

SIGNATURES

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

TIME WARNER INC.

By: /s/ WAYNE H. PACE

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

Date: March 11, 2005

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ RICHARD D. PARSONS **(Richard D. Parsons)**	Director, Chairman of the Board and Chief Executive Officer (principal executive officer)	March 11, 2005
/s/ WAYNE H. PACE **(Wayne H. Pace)**	Executive Vice President and Chief Financial Officer (principal financial officer)	March 11, 2005
/s/ JAMES W. BARGE **(James W. Barge)**	Sr. Vice President and Controller (principal accounting officer)	March 11, 2005
/s/ JAMES L. BARKSDALE **(James L. Barksdale)**	Director	March 11, 2005
/s/ STEPHEN F. BOLLENBACH **(Stephen F. Bollenbach)**	Director	March 11, 2005
/s/ STEPHEN M. CASE **(Stephen M. Case)**	Director	March 11, 2005

Signature	Title	Date
/s/ FRANK J. CAUFIELD **(Frank J. Caufield)**	Director	March 11, 2005
/s/ ROBERT C. CLARK **(Robert C. Clark)**	Director	March 11, 2005
/s/ MILES R. GILBURNE **(Miles R. Gilburne)**	Director	March 11, 2005
/s/ CARLA A. HILLS **(Carla A. Hills)**	Director	March 11, 2005
/s/ REUBEN MARK **(Reuben Mark)**	Director	March 11, 2005
/s/ MICHAEL A. MILES **(Michael A. Miles)**	Director	March 11, 2005
/s/ KENNETH J. NOVACK **(Kenneth J. Novack)**	Director	March 11, 2005
/s/ R.E. TURNER **(R.E. Turner)**	Director	March 11, 2005
/s/ FRANCIS T. VINCENT, JR. **(Francis T. Vincent, Jr.)**	Director	March 11, 2005

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

INTRODUCTION

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

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

- *Results of operations.* This section provides an analysis of the Company's results of operations for the three years ended December 31, 2004. This analysis is presented on both a consolidated and a business segment basis. In addition, a brief description is provided of significant transactions and events that impact the comparability of the results being analyzed.

- *Financial condition and liquidity.* This section provides an analysis of the Company's cash flows for the three years ended December 31, 2004, as well as a discussion of the Company's outstanding debt and commitments that existed as of December 31, 2004. Included in the discussion of outstanding debt is a discussion of the amount of financial capacity available to fund the Company's future commitments, as well as a discussion of other financing arrangements.

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

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

- *Risk factors and caution concerning forward-looking statements.* This section provides a description of risk factors that could adversely affect the operations, business or financial results of the Company or its business segments and 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.

Use of Operating Income (Loss) before Depreciation and Amortization and Free Cash Flow

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 costs of such tangible and intangible assets, the impact of related impairments, as well as asset sales through other financial measures, such as capital expenditures, investment spending and return on capital.

Free Cash Flow is cash provided by operations (as defined by U.S. generally accepted accounting principles) less cash provided by discontinued operations, capital expenditures and product development costs, principal payments on capital leases, and partnership distributions, if any. Free Cash Flow is considered to be an important indicator of the Company's liquidity, including its ability to reduce net debt, make strategic investments, pay dividends to common shareholders and repurchase stock.

Both Operating Income (Loss) before Depreciation and Amortization and Free Cash Flow should be considered in addition to, not as a substitute for, the Company's Operating Income (Loss), Net Income (Loss) and various cash flow measures (e.g., Cash Provided by Operations), as well as other measures of financial performance and liquidity reported in accordance with U.S. generally accepted accounting principles.

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 has produced and distributed films including *The Lord of the Rings* trilogy, the *Harry Potter* series, *Million Dollar Baby* and *The Polar Express* and television programs including *ER, Two and a Half Men* and *The West Wing.* As of February 1, 2005, the Company had approximately 85,000 employees worldwide. During 2004, the Company generated revenues of $42.089 billion (up 6% from $39.563 billion in 2003), Operating Income before Depreciation and Amortization of $9.372 billion (up 12% from $8.393 billion in 2003), Operating Income of $6.165 billion (up 17% from $5.254 billion in 2003), Net Income of $3.364 billion (up 27% from $2.639 billion in 2003), Cash Provided by Operations of $6.618 billion (up slightly from $6.601 billion in 2003) and Free Cash Flow of $3.280 billion (down 1% from $3.312 billion in 2003).

Time Warner Businesses

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

AOL. America Online, Inc. ("AOL" or "America Online") is a leader in interactive services, web brands, Internet technologies and e-commerce services, with 28.5 million total AOL brand subscribers in the U.S. and Europe at the end of 2004. In 2004, AOL had total revenues of $8.692 billion (21% of the Company's overall revenues), $1.772 billion in Operating Income before Depreciation and Amortization and $934 million in Operating Income. AOL generates its revenues primarily from subscription fees charged to subscribers and advertising services.

During the fourth quarter of 2004, America Online reorganized its operations into four business units: Access, Audience, Digital Services and International (refer to Part I, Business), to streamline management and more closely align these business units to the users that America Online serves. In connection with this reorganization, AOL effected a restructuring, which eliminated approximately 860 positions, to align the workforce with the current business outlook. The reorganization is intended to position AOL to implement its strategy of better balancing the subscription and advertising businesses. In other words, AOL plans to place more emphasis on generating higher margin advertising and search revenues, which the Company believes will continue to grow for the foreseeable future.

Over the past several years, the AOL Access business has experienced significant declines in U.S. subscribers and subscriber revenues, and these declines are expected to continue. Driving this decrease is the continued industry-wide maturing of premium dial-up services business, as consumers migrate to high-speed broadband and lower-cost dial-up services. AOL continues to develop, change, test and implement marketing strategies to attract and retain subscribers. For example, AOL recently launched AOL 9.0 Security

Edition, which includes enhanced security features and includes the *McAfee VirusScan Online* product, previously sold as a premium service, at no additional charge.

AOL's Audience business strategy relies on expanding its audience and increasing usage across all of its properties, including properties such as MapQuest, Moviefone and AOL Instant Messenger. AOL seeks to generate revenue from this increased traffic through the use of paid-search, branded advertising and increased utilization and optimization of AOL advertising inventory space. The acquisition of Advertising.com Inc., ("Advertising.com") in the third quarter of 2004, as discussed later, also provides incremental growth in Advertising revenues primarily through third-party performance-based advertising. A component of the Audience business strategy is the planned re-launch in 2005 of the publicly-available version of the AOL.com web portal that will include a limited portion of AOL's content that, today, is only available to AOL subscribers.

In the first quarter of 2005, AOL and Time Warner Cable Inc. announced a strategic agreement to develop a customized broadband offering for their current AOL and Road Runner subscribers as well as prospects across the Time Warner Cable coverage area. The Road Runner service will continue to be available on a stand-alone basis for those subscribers who elect not to take the new offering. This agreement will allow AOL to proactively migrate its subscribers to the customized broadband offering and also to share in future subscriber revenues generated. AOL anticipates some decline in near-term profits from this migration, but expects to experience an increase in the life of its revenue stream. Under the agreement, AOL will manage the advertising and search opportunities for both the new offering and the Road Runner portal, providing an increase in its audience size and the potential to earn from online advertising, search, commerce and premium services. Time Warner Cable will share in a portion of the Advertising revenues generated. The agreement should benefit Time Warner Cable in accelerating its acquisition of high-speed data subscribers and provide its high-speed data customers additional value through access to AOL's programming and features. The impact on Time Warner's consolidated financial results is not expected to be significant in 2005. AOL anticipates pursuing similar agreements with other entities offering broadband services.

AOL has taken steps over the past several years to align costs with the declining dial-up subscriber base. These efforts have resulted in reductions in the cost of operating AOL's network through improved pricing and decreased levels of service commitments. These factors are expected to result in continued declines in operating costs during 2005.

Consistent with AOL's domestic strategy, AOL's International business unit has focused on balancing its subscription and advertising businesses. Recently, the International business unit entered into a new, multi-year search arrangement that is expected to provide incremental Advertising revenues.

Cable. Time Warner's cable business, Time Warner Cable Inc. and its subsidiaries ("TWC Inc."), is the second-largest cable operator in the U.S. (in terms of subscribers served). TWC Inc. managed approximately 10.9 million basic cable subscribers (including approximately 1.6 million subscribers of unconsolidated investees) at the end of 2004, in highly clustered and upgraded systems in 27 states. TWC Inc. delivered $3.278 billion of Operating Income before Depreciation and Amortization, more than any of the Company's other reporting segments, and had revenues of $8.484 billion (20% of the Company's overall revenues) and $1.764 billion in Operating Income during 2004.

TWC Inc. offers three product lines — video, high-speed data and its newest service, Digital Phone. Video is TWC Inc.'s largest product line in terms of revenues generated; however, the growth of its customer base for video cable service is limited because the customer base has matured and industry-wide competition from direct-to-home satellite services has increased. Nevertheless, TWC Inc. is continuing to increase its video revenues through its offerings of advanced digital video services. Digital video, Video-on-Demand (VOD), Subscription-Video-on-Demand (SVOD) and Digital Video Recorders (DVR) are available in all of TWC Inc.'s 31 divisions. TWC Inc.'s digital video penetration provides a broad base of potential customers for these advanced services. Video programming costs represent a major component of TWC Inc.'s expenses and continue to rise across the sector, especially for sports programming.

High-speed data service has been one of TWC Inc.'s fastest-growing products over the past several years and is a key driver of its results. However, its rate of subscriber growth has begun to slow, reflecting increasing penetration rates and increased competition from digital subscriber lines (DSL).

TWC Inc.'s new voice product, Digital Phone, was launched in all of its divisions at December 31, 2004. Digital Phone enables TWC Inc. to offer its customers a combined, easy-to-use package of video, high-speed data and voice services and to compete effectively against similar bundled products that are available from its competitors. Included in Operating Income before Depreciation and Amortization during 2004 are approximately $45 million of losses associated with the roll-out of the Digital Phone service.

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

As noted above, TWC Inc. and AOL recently announced a strategic agreement to develop a customized broadband offering. This arrangement should benefit Time Warner Cable in accelerating its acquisition of high-speed data subscribers and provide its high-speed data customers additional value through access to AOL's programming and features. TWC Inc. will also share in a portion of the Advertising revenues generated.

Filmed Entertainment. Time Warner's Filmed Entertainment businesses, Warner Bros. Entertainment Group ("Warner Bros.") and New Line Cinema Corporation ("New Line"), generated revenues of $11.853 billion (26% of the Company's overall revenues), $1.474 billion in Operating Income before Depreciation and Amortization and $1.157 billion in Operating Income during 2004.

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

The sale of DVDs has been one of the largest drivers of the segment's profit growth over the last few years. Warner Bros.' library, consisting of more than 6,600 theatrical titles and 54,000 live-action and animated television titles, positions it to benefit from continuing growth in DVD hardware penetration. With DVD hardware penetration levels relatively low on a worldwide basis, the Company believes that a significant opportunity for DVD sales growth remains.

Warner Bros.' industry-leading television business has experienced growing revenues, including the successful releases of television series into the home video market. For the 2004-2005 television season, Warner Bros. has more current productions on the air than any other studio, with prime-time series on all six broadcast networks (including such hits as *Two and a Half Men, ER, Third Watch, The O.C., Cold Case, Smallville* and *The West Wing*).

Piracy, including physical piracy as well as illegal online file-sharing, continues to be a significant issue for the filmed entertainment industry. Piracy has expanded from music to movies and television programming due to advances in technology. The Company has taken a variety of actions to combat piracy over the last several years and will continue to do so, both individually and together with industry associations.

Networks. Time Warner's Networks group is composed of Turner Broadcasting System, Inc. ("Turner"), Home Box Office ("HBO") and The WB Television Network ("The WB Network"). The segment delivered revenues of $9.054 billion (20% of the Company's overall revenues), $2.694 billion in Operating Income before Depreciation and Amortization and $2.461 billion in Operating Income during 2004.

The Turner networks — including such recognized brands as TBS, TNT, CNN, Cartoon Network and CNN Headline News — are among the leaders in advertising-supported cable TV networks. For the third straight year, more prime-time viewers watched advertising-supported cable TV networks than the national broadcast networks. For 2004, TNT and TBS ranked first and second, respectively, among ad-supported cable networks in total day delivery of their key demographic, adults 18-49 and adults 25-54.

The Turner networks generate revenues principally from the sale of advertising time and monthly subscriber fees paid by cable system operators, satellite companies and other affiliates. Turner has benefited from strong ratings and a strong advertising market. Key contributors to Turner's success are its continued investments in high-quality programming focused on original movies, sports, network premieres, licensed and original series, news and animation, as well as brand awareness and operating efficiency. In 2004, Turner launched a rebranding of TBS under the "tbs very funny" slogan following an earlier, successful rebranding of TNT as "We Know Drama."

HBO operates the HBO and Cinemax multichannel pay television programming services, with the HBO service being 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 from the ancillary sales of its original programming, including such programs as *The Sopranos, Sex and the City, Six Feet Under* and *Band of Brothers.*

The WB Network is a broadcast television network whose target audience is the 12-34 age group demographic. The WB Network generates revenues almost exclusively from the sale of advertising time. Like many of its broadcast network competitors, The WB Network experienced a decline in its audience of young adults in the 2003-2004 television season and continues to be down in the 2004-2005 television season. Because this is The WB Network's target demographic, the loss had a proportionally larger effect on its overall audience delivery. Among other measures, The WB Network is now developing new programming to reach the higher end of its target demographic with shows that will increase viewership among adults 18-34.

Publishing. Time Warner's Publishing segment consists principally of magazine publishing through Time Inc. and book publishing through Time Warner Book Group Inc. and a number of direct-marketing and direct-selling businesses. The segment generated revenues of $5.565 billion (13% of the Company's overall revenues), $1.196 billion in Operating Income before Depreciation and Amortization and $934 million in Operating Income during 2004.

Time Inc. publishes over 130 magazines globally, including *People, Sports Illustrated, In Style, Southern Living, Time, Entertainment Weekly, Fortune, Real Simple, What's on TV* and *Cooking Light.* It generates revenues primarily from advertising, magazine subscription and newsstand sales, and drives growth through higher circulation and advertising on existing magazines, acquisitions and new magazine launches. Time Inc. owns IPC Media (the U.K.'s largest magazine company) and is the majority shareholder of magazine subscription marketer Synapse Group, Inc. In addition, Time Inc. is continuing to invest in new magazine launches, including *All You, Cottage Living* and *Nuts,* and has recently re-launched *Life* as a weekend magazine distributed in the U.S. in newspapers nationwide. In 2005, Time Inc. signed an agreement to acquire the remaining 51% stake it does not already own in Essence Communications Partners, the publisher of *Essence.* This transaction is expected to close in the first quarter of 2005. Time Inc.'s direct-selling division, Southern Living At Home, sells home decor products through approximately 35,000 independent consultants at parties hosted in people's homes throughout the United States.

Time Inc.'s book publishing operations are conducted primarily by Time Warner Book Group through its three major publishing houses, Warner Books, Little, Brown and Company, and Time Warner Book Group UK. During 2004, Time Warner Book Group placed a record 58 books on the *New York Times* bestseller lists, including the Publishers Weekly Book of the Year *America (The Book)* by Jon Stewart, *Your Best Life Now* by Joel Osteen, and *A Salty Piece of Land* by Jimmy Buffett, and new releases from many of its major recurring bestselling authors, including David Baldacci, Nelson DeMille, James Patterson and Nicholas Sparks.

Other Recent Developments

Update on Status of Government Investigations and Restatement of Financial Statements

As previously disclosed by the Company, the Securities and Exchange Commission ("SEC") and the U.S. Department of Justice ("DOJ") have been conducting investigations into the accounting and disclosure practices of the Company. Those investigations focused on transactions principally involving the Company's America Online segment that were entered into after July 1, 1999, including advertising arrangements, the methods used by the America Online segment to report its subscriber numbers and the accounting related to the Company's interest in AOL Europe prior to January 2002.

As announced on December 15, 2004, the Company and its subsidiary, AOL, have reached a definitive agreement with the DOJ that resolves the DOJ's investigation of the Company. The Company also announced that it has proposed a settlement to the staff of the SEC that the staff has agreed to recommend to the SEC Commissioners.

Under the terms of the settlement in connection with the DOJ investigation, the DOJ filed a criminal complaint against AOL for the conduct of certain employees in connection with securities fraud by PurchasePro.com, but the DOJ will defer prosecution of AOL. After two years, provided the Company fulfills its obligations under the agreement, the DOJ will dismiss the criminal complaint filed against AOL. In addition, the DOJ will not prosecute the Company or AOL for conduct relating to certain other transactions entered into by AOL or the Company from July 1, 1999, including transactions that were the subject of the DOJ or SEC investigations.

In connection with the settlement with the DOJ, in December 2004, the Company paid a penalty of $60 million and established a $150 million fund, which the Company may use to settle related securities litigation. The fund is reflected as restricted cash on the Company's accompanying consolidated balance sheet as of December 31, 2004. The Company's other obligations under the settlement agreement are to (a) accept responsibility for the conduct of certain AOL employees with respect to PurchasePro.com transactions; (b) cooperate fully with the DOJ or any other federal criminal law enforcement agency regarding the transactions covered by the settlement; and (c) retain and cooperate with an independent monitor, who will review the effectiveness of AOL's internal controls, including those related to the accounting for advertising and related transactions.

Under the settlement the SEC staff will recommend to the SEC Commissioners, Time Warner will agree, without admitting or denying the Commission's allegations, to be enjoined from future violations of certain provisions of the securities laws. Under the proposed settlement:

- The Company would pay a $300 million penalty, which the SEC staff will request be used for a Fair Fund, as authorized under the Sarbanes-Oxley Act;

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

- Consistent with its previous announcement, the Company would adjust its historical accounting for its investment in and consolidation of AOL Europe S.A. ("AOL Europe"); and

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

Final settlement is subject to both agreement on final documentation and approval by the SEC Commissioners. The Company will not be able to deduct the $300 million penalty to be paid under the proposed settlement for income tax purposes, be reimbursed or indemnified for such payment through insurance or any other source, or use such payment to setoff or reduce any award of compensatory damages to plaintiffs in related securities litigation pending against the Company.

In connection with the proposed settlement with the SEC, the financial results for each of the years ended December 31, 2000 through December 31, 2003 have been restated for the following:

- To adjust the accounting for transactions with certain counterparties resulting in the recognition of Advertising revenues of approximately $489 million in the aggregate, including the previously disclosed $400 million with Bertelsmann that the Company has reflected as a reduction in the purchase price of AOL Europe in 2002 rather than as Advertising revenues during 2001 and 2002.

- To adjust the accounting for $20 million of Advertising revenues that were recognized in 2001, but should have been recognized in 2002.

- To adjust the accounting for the Company's investment in AOL Europe to reflect the consolidation of AOL Europe in 2000. Previously, the Company began consolidating AOL Europe's operations in January 2002.

The accompanying financial information reflects the impact of the adjustments that were made in the restatement of the Company's consolidated financial statements.

The following tables reflect the impact of the restatement on the Company's consolidated financial statements for the years ended December 31, 2002, 2001 and 2000:

	Time Warner (as reported) (unaudited)	Impact of Restatement	Restated Time Warner
		(millions)	
2002:			
Income Statement:			
Revenues	$ 37,314	$ (254)	$ 37,060
Operating loss[a]	(38,688)	1,274	(37,414)
Loss before discontinued operations and cumulative effect of accounting change	(43,449)	1,479	(41,970)
Net loss[a]	(98,696)	1,479	(97,217)
Basic loss per common share before discontinued operations and cumulative effect of accounting change	$ (9.75)	$ 0.33	$ (9.42)
Diluted loss per common share before discontinued operations and cumulative effect of accounting change	$ (9.75)	$ 0.33	$ (9.42)
Basic net loss per common share	$ (22.15)	$ 0.33	$ (21.82)
Diluted net loss per common share	$ (22.15)	$ 0.33	$ (21.82)
Balance Sheet:			
Total assets	$115,518	$ (5)	$115,513
Total liabilities	62,701	(179)	62,522
Shareholders' equity	52,817	174	52,991
Cash Flow:			
Cash provided by operations	$ 7,032	$ (275)	$ 6,757
Cash used by investing activities	(10,460)	223	(10,237)
Cash provided by financing activities	4,439	—	4,439
Total change in cash	1,011	(52)	959

[a] There is a positive impact on the Operating Loss and Net Loss in 2002 due to a lower goodwill impairment charge at the AOL segment than originally reported. Specifically, the (1) incremental losses assumed by AOL related to the consolidation of AOL Europe beginning in 2000 and (2) the treatment of consideration received on certain other transactions as a reduction of the purchase price of AOL Europe as opposed to Advertising revenue reduce the goodwill recognized in connection with the Company's purchase of Bertelsmann's interest in AOL Europe in January 2002. There is a corresponding reduction in the impairment charge recognized thereon in the fourth quarter of 2002.

	Time Warner (as reported) (unaudited)	Impact of Restatement (unaudited)	Restated Time Warner (unaudited)
		(millions)	
2001:			
Income Statement:			
Revenues	$ 33,507	$ 589	$ 34,096
Operating income (loss)	500	(892)	(392)
Loss before discontinued operations and cumulative effect of accounting change	(4,221)	(926)	(5,147)
Net loss	(4,934)	(926)	(5,860)
Basic loss per common share before discontinued operations and cumulative effect of accounting change	$ (0.95)	$(0.21)	$ (1.16)
Diluted loss per common share before discontinued operations and cumulative effect of accounting change	$ (0.95)	$(0.21)	$ (1.16)
Basic net loss per common share	$ (1.11)	$(0.21)	$ (1.32)
Diluted net loss per common share	$ (1.11)	$(0.21)	$ (1.32)
Balance Sheet:			
Total assets	$208,563	$ 901	$209,464
Total liabilities	56,536	2,099	58,635
Shareholders' equity	152,027	(1,198)	150,829
Cash Flow:			
Cash provided by operations	$ 5,281	$ (800)	$ 4,481
Cash used by investing activities	(5,257)	108	(5,149)
Cash used by financing activities	(1,915)	594	(1,321)
Total change in cash	(1,891)	(98)	(1,989)

	Time Warner (as reported) (unaudited)	Impact of Restatement (unaudited)[b]	Restated Time Warner (unaudited)
		(millions)	
2000[a]:			
Income Statement:			
Revenues	$ 7,605	$ 515	$ 8,120
Operating income	1,766	(307)	1,459
Income before discontinued operations and cumulative effect of accounting change	1,121	(254)	867
Net income	1,121	(254)	867
Basic income per common share before discontinued operations and cumulative effect of accounting change	$ 0.48	$(0.11)	$ 0.37
Diluted income per common share before discontinued operations and cumulative effect of accounting change	$ 0.43	$(0.10)	$ 0.33
Basic net income per common share	$ 0.48	$(0.11)	$ 0.37
Diluted net income per common share	$ 0.43	$(0.10)	$ 0.33
Balance Sheet:			
Total assets	$10,778	$ 272	$11,050
Total liabilities	4,051	546	4,597
Shareholders' equity	6,727	(274)	6,453
Cash Flow:			
Cash provided by operations	$ 1,951	$ (226)	$ 1,725
Cash used by investing activities	(2,316)	79	(2,237)
Cash provided by financing activities	421	297	718
Total change in cash	56	150	206

[a] Because the America Online — Historic TW merger was not consummated until January 2001, the historical information for 2000 included herein reflects only the financial results of America Online. As a result, Time Warner's 2000 historical operating results and financial condition are not comparable to 2001 and 2002.

[b] The Company is required to consolidate AOL Europe for periods subsequent to the change in AOL Europe's governance rights in late March 2000. However, for purposes of convenience, and as permitted under the accounting rules, the Company has consolidated AOL Europe retroactive to January 1, 2000 and AOL began to recognize 100% of AOL Europe's losses effective March 31, 2000.

Additionally, for the year ended December 31, 2003, the results of operations reflect a reduction in the Company's consolidated revenues and Operating Income of approximately $2 million and $1 million, respectively. The impact on the consolidated Net Income was less than $1 million for the year ended December 31, 2003. There was no impact on the previously reported results of operations for the first three quarters of the year ended December 31, 2004. For additional information, see Note 1 to the accompanying consolidated financial statements.

As noted above, as part of the proposed settlement with the SEC, the Company has agreed to appoint an independent examiner, who — within 180 days after starting work — will review whether the Company's historical accounting for transactions with a limited number of specified counterparties, principally involving online advertising revenues, was in accordance with GAAP. Depending on the 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.

Agreements with Comcast Corporation

Comcast currently owns an effective interest of approximately 21% in TWC Inc.'s business — held through a 17.9% common stock interest in TWC Inc. and 4.7% limited partnership interest in Time Warner Entertainment Company, L.P. ("TWE").

On September 24, 2004, TWC Inc. entered into a Tolling and Optional Redemption Agreement (the "Agreement") with Comcast Corporation ("Comcast") and certain affiliates of Comcast, including the trust that holds shares of TWC Inc. on behalf of Comcast. Pursuant to the Agreement, Comcast was granted an option (the "Option"), which originally could be exercised between December 1, 2004 and April 1, 2005, to require TWC Inc. to redeem a portion of the TWC Inc. stock held by Comcast in exchange for a TWC Inc. subsidiary with cable systems serving approximately 90,000 basic subscribers as of December 31, 2004, plus approximately $750 million in cash. The Agreement was amended in February 2005 to extend the expiration date of the Option to 60 days following notice by either TWC Inc. or Comcast or, after April 1, 2005, immediately if Comcast irrevocably elects not to exercise the Option. Closing of the transactions contemplated by the Agreement is subject to the exercise of the Option, required governmental and regulatory approvals and other customary closing conditions. As of the date of this filing, Comcast has not exercised the Option.

If the Option is exercised, Comcast will reduce its effective interest in TWC Inc.'s business to approximately 17% — consisting of a 13.7% common stock interest in TWC Inc. and a 4.7% limited partnership interest in TWE. Other than as provided in the Agreement, Comcast cannot require TWC Inc. to purchase its interest in TWC Inc. Under the arrangements entered into by Comcast as part of the process of obtaining FCC approval of Comcast's acquisition of AT&T Broadband, Comcast is obligated to take steps to dispose of its entire interest in TWC Inc. and TWE in an orderly process by November 2007, and in any event by May 2008.

In connection with the restructuring of TWE completed in 2003 (the "TWE Restructuring"), Comcast received (1) customary registration rights relating to its 17.9% interest in the common stock of TWC Inc. and (2) the right, at any time following March 31, 2005, to require TWC Inc. or Time Warner to purchase all or a portion of Comcast's 4.7% limited partnership interest in TWE at an appraised fair market value. The purchase price payable by TWC Inc. or Time Warner as consideration for Comcast's limited partnership interest may be paid in cash, Time Warner or TWC Inc. common stock (if TWC Inc. common stock is then publicly traded) or a combination of cash and stock. Following March 31, 2005, Comcast also has the right to sell all or a portion of its interest in TWE to a third party, subject to rights of first refusal by the Company and TWC Inc.

The Agreement, as amended, also provides that Comcast will not exercise or pursue registration rights with respect to the TWC Inc. stock owned by it until the Option expires. This provision of the Agreement supersedes Comcast's request to TWC Inc. in December 2003 to register its TWC Inc. stock. For details related to the accounting for this transaction, see Note 6, "TWE and TWC Inc. Related Transactions."

In connection with the TWE Restructuring, Comcast also received Series A mandatorily convertible preferred stock of Time Warner that will convert automatically on March 31, 2005 into shares of Time Warner Common Stock having a value equal to $1.5 billion at the time of conversion, up to a maximum of 225,056,264 shares.

Google Inc.

In May 2004, America Online exercised a warrant for approximately $22 million and received approximately 7.4 million shares of Series D Preferred Stock of Google Inc. ("Google"). Each of these shares converted automatically into shares of Google's Class B Common Stock immediately prior to the closing of

Google's initial public offering on August 24, 2004. In connection with this offering, America Online converted 2,355,559 shares of its Google Class B Common Stock into an equal number of shares of Google's Class A Common Stock. Such Class A shares were sold in the offering for $195 million, net of the underwriters' discounts and commissions, and the Company recorded a gain of approximately $188 million, which is included in Other income (expense), net in the accompanying consolidated statement of operations. Following this transaction, America Online continues to hold 5,081,893 shares of Google's Class B Common Stock. Transfers of these shares are subject to applicable securities laws requiring that sales be made either pursuant to a registration statement or under exemptions from registration.

The Company does not consider its remaining interest in Google to be a strategic investment. As of December 31, 2004, the shares are recorded on the Company's consolidated balance sheet (classified as available-for-sale securities) at their fair value of approximately $980 million. There is a corresponding unrealized gain of approximately $579 million, net of deferred taxes of approximately $386 million, reflected in shareholders' equity. The fair value of the investment is calculated based on Google's stock price ($192.79 at December 31, 2004) times the number of Google shares owned by the Company.

Acquisition of Advertising.com

On August 2, 2004, America Online completed the acquisition of Advertising.com, Inc. for $445 million (net of cash acquired). Advertising.com purchases online advertising inventory from third-party websites and principally sells this inventory using performance-based advertising arrangements. From the time it was acquired through December 31, 2004, Advertising.com contributed Advertising revenues of $97 million from sales of advertising run on third-party websites.

Sale of Investment in Gateway

At December 31, 2003, AOL owned both preferred and common stock in Gateway, Inc. ("Gateway"). Specifically, AOL owned Gateway Series A and Series C preferred stock and 2.7 million shares of Gateway common stock (collectively, the "Gateway Securities"). The Series A preferred stock was subject to automatic conversion into approximately 22.2 million shares of Gateway common stock in December 2004. The Series C preferred stock was also redeemable, at AOL's option, in December 2004 for $200 million. Gateway had the option to pay the $200 million redemption price in cash, Gateway common stock (based on the average price of Gateway's common stock during a pricing period prior to the redemption date) or a combination thereof. AOL's ability to resell the Gateway Securities was limited by both contractual restrictions and applicable securities laws and regulations.

On December 22, 2004, AOL sold to Gateway all of the Gateway Securities for total consideration of approximately $316 million, consisting of approximately $280 million in cash and the offset of approximately $36 million of amounts owed to Gateway by AOL under certain existing customer acquisition agreements. The $316 million purchase price was based on a negotiated discount to Gateway's closing stock price of $5.54 on October 18, 2004 (the agreed reference date in the definitive transaction documents), which, after considering the aggregate impairment losses recognized by the Company on its investment in Gateway, resulted in the recognition of a net gain on the sale of approximately $44 million, which is included in Other income (expense), net in the accompanying consolidated statement of operations. AOL has recognized marketing expense in respect of the amounts offset under the customer acquisition agreements with Gateway. Concurrently with the agreement to sell the Gateway Securities, AOL and Gateway agreed to settle existing commercial disputes, resulting in AOL separately paying Gateway approximately $3 million in cash.

Urban Cable Works of Philadelphia, L.P.

Urban Cable Works of Philadelphia, L.P. ("Urban Cable") is an unconsolidated joint venture of TWC Inc., with approximately 50,000 basic subscribers at December 31, 2004, that operates cable television systems in Philadelphia, Pennsylvania. Urban Cable is 40% owned by TWC Inc. and 60% owned by an investment group led by Inner City Broadcasting ("Inner City"). Under a management agreement, TWC Inc. is responsible for the day-to-day management of Urban Cable. During 2004, TWC Inc. and Inner City settled certain disputes regarding the joint venture for $34 million in cash.

TWC Inc. has also agreed to purchase, subject to receipt of applicable regulatory approvals, all of Inner City's interests in the Urban Cable venture for approximately $53 million in cash. In addition, upon closing, TWC Inc. will eliminate in consolidation $67 million of debt and interest owed to it by Urban Cable and will assume $53 million of Urban Cable's third-party debt. On March 3, 2005, the City Council of Philadelphia denied TWC Inc.'s request for approval of this transaction. TWC Inc. believes the denial was invalid, but is unable to predict when the transaction may be completed. For the year ended December 31, 2004, Urban Cable's revenues and Operating Income were $47 million and $3 million, respectively.

Sale of VIVA Media AG and VIVA Plus

In August 2004, Turner completed the previously announced sale of its 30.6% ownership stake in VIVA Media AG ("VIVA") and its 49% stake in VIVA Plus to Viacom Inc. for approximately 109 million Euros (approximately $134 million). VIVA primarily owns a music television channel in Germany and also operates a portfolio of music channels in other European countries, as well as Brainpool TV GmbH, a major independent television producer in Germany. VIVA Plus is a smaller music television channel that operates in Germany. The Company accounted for these assets as equity investments prior to the sale. The Company recorded a gain from the sale of approximately $113 million as a component of Other income (expense), net, in the accompanying 2004 consolidated statement of operations.

Consolidation of Warner Village Cinemas S.P.A.

Warner Village Cinemas S.P.A. ("Warner Village") is a joint-venture arrangement that operates cinemas in Italy. Prior to December 2004, this entity was owned 45% by Warner Bros., 45% by Village Cinemas International Pty. Ltd. ("Village Cinemas") and 10% by a third-party investor. The 10% owner was bought out by Warner Bros. and Village Cinemas in December 2004. As previously announced, in April 2004, Warner Bros. and Village Cinemas agreed that: (i) Warner Bros. would control the voting rights associated with Village Cinemas' interest and (ii) beginning in March 2007 and continuing for one year, Village Cinemas can require that both Warner Bros. and Village Cinemas place their collective interests for sale and, to the extent that a bona fide offer is received, can require Warner Bros. to acquire the Village Cinemas interest at that value in the event that Warner Bros. elects not to proceed with such sale. If such right is not exercised by Village Cinemas, the voting rights associated with its interest will revert to Village Cinemas in March 2008.

As a result of controlling Village Cinemas' voting interest, Warner Bros. began consolidating the results of Warner Village in the second quarter of 2004. As permitted by U.S. generally accepted accounting principles, Warner Village results have been consolidated retroactive to the beginning of the year. For the year ended December 31, 2004, Warner Village revenues were $101 million and its Operating Income was $3 million.

Discontinued Operations Presentation of Music Segment

On March 1, 2004, the Company completed the sale of the Warner Music Group's ("WMG") recorded music and music publishing operations to a private investment group for approximately $2.6 billion in cash and an option to re-acquire a minority interest in the operations sold. In addition, on October 24, 2003, the Company completed the sale of WMG's CD and DVD manufacturing, printing, packaging and physical distribution operations ("Warner Manufacturing") to Cinram International Inc. for approximately $1.05 billion in cash (Note 4).

With the completion of these transactions, the Company disposed of its entire Music segment. Accordingly, the Company has presented the financial condition and results of operations of the Music segment as discontinued operations for all periods presented.

Sale of the Winter Sports Teams

On March 31, 2004, the Company completed the sale of the Turner winter sports teams (the Atlanta Thrashers, an NHL team, and the Atlanta Hawks, an NBA team) and the entity holding the operating rights to Philips Arena, an Atlanta sports and entertainment venue, to Atlanta Spirit LLC ("Atlanta Spirit"). In addition to the $219 million of impairment charges recognized in 2003, the Company recorded an approximate $7 million loss on the closing of the sale in the first quarter of 2004. As of December 31, 2004, Turner owns an approximate 10% interest in Atlanta Spirit and accounts for its interest in the limited liability company under the equity method of accounting.

RESULTS OF OPERATIONS

Transactions and Accounting Principles Affecting Comparability of Results of Operations

The comparability of the Company's results of operations, financial position and cash flows has been affected by certain new accounting principles adopted by the Company and certain significant transactions occurring during each period, as discussed further below.

New Accounting Principles To Be Adopted

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board ("FASB") issued FASB Statement 123 (Revised), "Share-Based Payment" ("FAS 123R"). FAS 123R requires all companies to measure compensation costs for all share-based payments (including employee stock options) at fair value and recognize such costs in the statement of operations. FAS 123R is effective for public companies for periods beginning after June 15, 2005. The Company will continue to account for stock-based compensation using the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") until adoption of FAS 123R on July 1, 2005. In accordance with APB 25 and related interpretations, compensation expense for stock options is generally recognized in income based on the excess, if any, of the quoted market price of the stock at the grant date of the award or other measurement date over the amount an employee must pay to acquire the stock. The compensation costs related to stock options recognized by the Company pursuant to APB 25 were minimal. As a result, the application of the provisions of FAS 123R will have a significant impact on Operating Income before Depreciation and Amortization, Operating Income, net income and earnings per share. See Note 1 for the pro forma impact if compensation costs for the Company's stock option plans had been determined based on the fair value method set forth in FAS 123.

Recently Adopted New Accounting Principles

Consolidation of Variable Interest Entities

Pursuant to the provisions of FASB Interpretation No. 46, "Consolidation of Variable Interest Entities — an Interpretation of ARB No. 51," (as revised, "FIN 46R"), the Company began consolidating the operations of America Online Latin America, Inc. ("AOLA") as of March 31, 2004. AOLA is a publicly traded entity whose significant shareholders include the Company, AOL, the Cisneros Group (a private investment company) and Banco Itau (a leading Brazilian bank). AOLA provides online services principally to customers in Brazil, Mexico, Puerto Rico and Argentina. The Company has no obligation to provide additional funding for AOLA's operations, and the creditors of AOLA have no recourse to the Company.

In accordance with the transition provisions of FIN 46R, the assets and liabilities of AOLA were recorded in the Company's consolidated balance sheet as of March 31, 2004, in the amounts at which they would have been carried if FIN 46R had been effective when the Company first met the conditions to be considered the primary beneficiary of AOLA. Upon consolidating the balance sheet of AOLA, the Company recorded incremental assets of approximately $85 million and liabilities of $29 million, with the difference of $56 million recognized as the pretax cumulative effect of an accounting change ($34 million on an after-tax basis). Prior periods have not been restated. The Company consolidated the operating results of AOLA's operations commencing April 1, 2004. In order to provide the time necessary to consolidate and evaluate the AOLA financial information, the AOLA financial statements are consolidated by the Company on a one-quarter time lag. For the year ended December 31, 2004, the Company recognized revenues of $40 million and an Operating Loss of $20 million associated with AOLA.

Significant Transactions and Other Items Affecting Comparability

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

	Year Ended December 31,		
	2004	2003	2002 (restated)
		(millions)	
Merger and restructuring costs	$ (50)	$(109)	$ (327)
Legal reserves related to government investigations	(510)	—	—
Asset impairments	(10)	(318)	(42,511)
Net gain on disposal of assets	21	14	6
Impact on Operating Income	(549)	(413)	(42,832)
Microsoft Settlement	—	760	—
Investment gains	453	797	124
Gain on WMG option	50	—	—
Loss on investments, net	(29)	(204)	(2,199)
Impact on other income (expense), net	474	1,353	(2,075)
Pretax impact	(75)	940	(44,907)
Income tax impact	(82)	(394)	958
After-tax impact	$(157)	$ 546	$(43,949)

Merger and Restructuring Costs

Merger and restructuring costs consist of charges related to mergers, employee terminations and exit activities. During the year ended December 31, 2004, the Company incurred restructuring costs at AOL related to various employee terminations of $55 million, which were partially offset by a $5 million reduction in restructuring costs, reflecting changes in estimates of previously established restructuring accruals. During the year ended December 31, 2003, the Company incurred restructuring costs related to various employee and contractual lease terminations of $109 million, including $52 million at AOL, $15 million at Cable,

$21 million at Networks and $21 million at Publishing. During the year ended December 31, 2002, the Company incurred restructuring costs of $327 million, including $266 million at AOL, $15 million at Cable and $46 million at Corporate. These costs are included in Merger and restructuring costs in the accompanying consolidated statement of operations and are discussed in more detail in Note 3 to the accompanying consolidated financial statements.

Legal Reserves Related to the Government Investigations

As previously discussed, during 2004, the Company (a) incurred a $210 million charge in connection with the definitive agreement with the DOJ that resolves the DOJ's investigation of the Company and (b) established a $300 million reserve in connection with the proposed settlement with the SEC, which the SEC staff will request be used for a Fair Fund, as authorized under the Sarbanes-Oxley Act. The $210 million DOJ settlement amount consists of a $60 million penalty to the DOJ and the establishment of a $150 million fund that the Company may use to settle any related shareholder or securities litigation.

Asset Impairments

During 2004, the Company recognized a $10 million impairment charge related to a building at the AOL segment that is held for sale. During 2003, the Company's results included $318 million of noncash impairment charges, including $219 million related to intangible assets of the winter sports teams at the Networks segment and $99 million at the Publishing segment related to goodwill and intangible assets of the Time Warner Book Group. These impairment amounts are included in Operating income (loss) in the accompanying consolidated statement of operations (Note 2).

In the fourth quarter of each year, the Company performs its annual impairment review for goodwill and intangible assets. The 2004 and 2003 annual impairment reviews for goodwill and intangible assets did not result in any impairment charges being recorded. The 2002 annual impairment review resulted in a noncash charge of $42.511 billion, which was recorded as a component of Operating income (loss) in the accompanying consolidated statement of operations. The $42.511 billion included charges to reduce the carrying value of goodwill at the AOL segment ($31.961 billion) and the Cable segment ($10.550 billion) (Note 2).

Net Gain on Disposal of Assets

For the year ended December 31, 2004, the Company recognized a $13 million gain related to the sale of AOL Japan and a $7 million gain related to the sale of Netscape Security Solutions at the AOL segment, an $8 million gain at the Publishing segment related to the sale of a building and an approximate $7 million loss (after taking into consideration the $219 million of impairment charges described above) on the closing of the sale of the winter sports teams at the Networks segment. These amounts are reflected as components of Operating income (loss) in the accompanying consolidated statement of operations.

During the year ended December 31, 2003, the Company recognized a $43 million gain on the sale of its interest in U.K. cinemas, which previously had been consolidated by the Filmed Entertainment segment, partially offset by a loss of $29 million on the sale of Time Life at the Publishing segment. During the year ended December 31, 2002, the Company recognized a $6 million gain on the sale of certain consolidated cable television systems at TWE. These gains are included in Operating income (loss) in the accompanying consolidated statement of operations.

Microsoft Settlement

As more fully described in Note 8 to the consolidated financial statements, in the second quarter of 2003 the Company recognized a gain of approximately $760 million as a result of the settlement with Microsoft

Corporation of then-pending litigation between Microsoft and Netscape Communications Corporation (the "Microsoft Settlement"). The gain is included in Other income (expense), net, in the accompanying 2003 consolidated statement of operations.

Investment Gains

For the year ended December 31, 2004, the Company recognized $453 million of gains from the sale of investments, including a $188 million gain related to the sale of a portion of the Company's interest in Google, a $113 million gain related to the sale of the Company's interest in VIVA and VIVA Plus and a $44 million gain on the sale of the Company's interest in Gateway (Note 7).

For the year ended December 31, 2003, the Company recognized $797 million of gains from the sale of investments, including a $513 million gain from the sale of the Company's interest in Comedy Central, a $52 million gain from the sale of the Company's interest in chinadotcom, a $50 million gain from the sale of the Company's interest in Hughes Electronics Corp. ("Hughes") and gains of $66 million on the sale of the Company's equity interests in international cinemas not previously consolidated (Note 7).

For the year ended December 31, 2002, the Company recognized investment gains of $124 million, including a $59 million gain from the sale of a portion of the Company's interest in The Columbia House Company Partnerships and a $31 million gain on the redemption of approximately 1.6 million shares of preferred stock of TiVo Inc. (Note 7).

These gains are included as a component of Other income (expense), net, in the accompanying consolidated statement of operations.

Gain on WMG Option

For the year ended December 31, 2004, the Company recorded a $50 million fair value adjustment related to the Company's option in WMG (Note 4). This gain is included as a component of Other income (expense), net in the accompanying consolidated statement of operations.

Loss on Investments, Net

For the year ended December 31, 2004, noncash charges to reflect other-than-temporary declines in the Company's investments were $29 million. These amounts consisted of $15 million to reduce the carrying value of certain investments that experienced other-than-temporary declines in market value and $14 million of losses related to market fluctuations in equity derivative instruments.

For the year ended December 31, 2003, noncash charges to reflect other-than-temporary declines in the Company's investments were $204 million. These amounts consisted of $212 million to reduce the carrying value of certain investments that experienced other-than-temporary declines in market value, offset in part by $8 million of gains related to market fluctuations in equity derivative instruments. Included in the 2003 charges were a writedown of $77 million related to the Company's equity interest in AOL Japan and a $71 million writedown related to the Company's equity interest in n-tv KG ("NTV-Germany"), a German news broadcaster (Note 7).

For the year ended December 31, 2002, noncash charges to reflect other-than-temporary declines in the Company's investments were $2.199 billion. These amounts consisted of $2.212 billion to reduce the carrying value of certain investments that experienced other-than-temporary declines in market value, offset in part by $13 million of gains related to market fluctuations in equity derivative instruments. Included in the $2.212 billion charge relating to other-than-temporary declines in value were noncash charges to reduce the carrying value of the Company's investments in Time Warner Telecom Inc. ("Time Warner Telecom") by

$796 million, Hughes by $505 million, Gateway by $140 million, AOLA by $131 million and certain unconsolidated cable television system joint ventures by $420 million (Note 7).

These writedowns are included as a component of Other income (expense), net in the accompanying consolidated statement of operations.

2004 vs. 2003

Consolidated Results

Revenues. Consolidated revenues increased 6% to $42.089 billion in 2004 from $39.563 billion in 2003. As shown below, these increases were led by growth in Subscription, Advertising and Content revenues, offset, in part, by declines in Other revenues:

	Year Ended December 31,		
	2004	2003 (restated)	% Change
	(millions)		
Subscription	$21,605	$20,448	6%
Advertising	6,955	6,180	13%
Content	12,350	11,446	8%
Other	1,179	1,489	(21)%
Total revenues	$42,089	$39,563	6%

The increase in Subscription revenues primarily related to the Cable and Networks segments, and, to a lesser extent, the Publishing segment. This increase was offset partially by a decline at AOL. The increase at Cable was principally due to the continued penetration of new services (primarily high-speed data and advanced digital video services) and video rate increases. The increase at the Networks segment was due to higher subscription rates and an increase in the number of subscribers at both Turner and HBO. The increase at the Publishing segment was due to a decrease in subscription allowances (which are netted against revenue) and the favorable effects of foreign currency exchange rates. The AOL segment declined primarily as a result of lower domestic subscribers and related Subscription revenues, partially offset by growth in international subscription revenues due primarily to the favorable effects of foreign currency exchange rates.

The increase in Advertising revenues was primarily due to growth at the Publishing, Networks and AOL segments. The increase at the Publishing segment was due to the strength of magazine advertising and the favorable effects of foreign currency exchange rates. The increase at the Networks segment was driven by higher CPMs (advertising cost per one thousand viewers) and sellouts at Turner's entertainment networks. The increase at AOL was due primarily to growth in paid-search advertising and revenues associated with the acquisition of Advertising.com.

The increase in Content revenues was principally due to growth at the Filmed Entertainment segment related to both television and theatrical product. The increase in television product revenues was attributable to an increase in worldwide license fees and an increase in home video sales. Revenue from theatrical product increased primarily as a result of higher television license fees and, to a lesser extent, higher home video sales and worldwide theatrical film revenues.

The decline in Other revenues was primarily attributable to the December 31, 2003 sale of Time Life, a direct-marketing business formerly a part of the Publishing segment. Time Life contributed $312 million to Other revenues in 2003.

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

Costs of Revenues. For 2004 and 2003, costs of revenues totaled $24.449 billion and $23.422 billion, respectively, and as a percentage of revenues were 58% and 59%, respectively. The improvement in costs of revenues as a percentage of revenues related primarily to improved margins at the AOL, Networks and Filmed Entertainment segments, as discussed in detail in "Business Segment Results."

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased 5% to $10.300 billion in 2004 from $9.834 billion in 2003 primarily reflecting increases at all segments, including higher advertising and marketing expenses. The segment variations are discussed in detail in "Business Segment Results."

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

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

	Year Ended December 31,		
	2004	2003 (restated) (millions)	% Change
Operating Income before Depreciation and Amortization	$ 9,372	$ 8,393	12%
Depreciation	(2,581)	(2,499)	3%
Amortization	(626)	(640)	(2)%
Operating Income	6,165	5,254	17%
Interest expense, net	(1,533)	(1,734)	(12)%
Other income, net	521	1,210	(57)%
Minority interest expense, net	(246)	(214)	15%
Income before income taxes, discontinued operations and cumulative effect of accounting change	4,907	4,516	9%
Income tax provision	(1,698)	(1,370)	24%
Income before discontinued operations and cumulative effect of accounting change	3,209	3,146	2%
Discontinued operations, net of tax	121	(495)	NM
Cumulative effect of accounting change, net of tax	34	(12)	NM
Net income	$ 3,364	$ 2,639	27%

Operating Income before Depreciation and Amortization. Time Warner's Operating Income before Depreciation and Amortization increased 12% to $9.372 billion in 2004 from $8.393 billion in 2003 principally as a result of solid growth at all business segments, partially offset by increased expenses at Corporate. The segment variations are discussed in detail under "Business Segment Results."

Corporate Operating Loss before Depreciation and Amortization. Time Warner's Corporate Operating Loss before Depreciation and Amortization was $1.020 billion for 2004 compared to $424 million for 2003.

As previously discussed, during 2004 the Company (a) incurred a $210 million charge in connection with the definitive agreement with the DOJ that resolves the DOJ's investigation of the Company and (b) established a $300 million reserve in connection with the proposed settlement with the SEC, which the SEC staff will request be used for a Fair Fund, as authorized under the Sarbanes-Oxley Act. The $210 million

DOJ settlement amount consists of a $60 million penalty paid to the DOJ and the establishment of a $150 million fund that the Company may use to settle any related shareholder or securities litigation.

Also included in Corporate Operating Loss before Depreciation and Amortization are legal and other professional fees related to the SEC and DOJ investigations into the Company's accounting and disclosure practices and the defense of various shareholder lawsuits ($26 million and $56 million in 2004 and 2003, respectively). It is not yet possible to predict the outcome of these lawsuits, and costs are expected to continue to be incurred in future periods.

Included in the 2004 amounts are $53 million of costs associated with the relocation from the Company's former corporate headquarters. Of the $53 million charge, approximately $26 million relates to a noncash write-off of the fair value lease adjustment, which was established in purchase accounting at the time of the merger of America Online and Time Warner Inc., now known as Historic TW Inc. ("Historic TW").

Excluding the items previously discussed, Corporate Operating Loss before Depreciation and Amortization increased primarily as a result of higher severance costs and insurance premiums and a $29 million adjustment to increase self insurance liabilities, partially related to prior periods.

Depreciation Expense. Depreciation expense increased to $2.581 billion in 2004 from $2.499 billion in 2003. The increase in depreciation primarily related to the Cable segment and, to a lesser extent, growth at all other segments except AOL. The growth in depreciation expense at Cable reflects higher levels of spending related to the roll-out of digital services and increased spending on customer premise equipment that is depreciated over a significantly shorter useful life compared to the mix of assets previously purchased. In 2004 and 2003, AOL benefited from an approximate $13 million and $60 million decrease, respectively, to reduce excess depreciation inadvertently recorded at AOL over several prior years. Management does not believe that the understatement of prior years results were material to any of the applicable year's financial statements. Similarly, management does not believe that the adjustments made are material to either the 2004 or 2003 results. Excluding these decreases, depreciation expense at the AOL segment declined due to a reduction in network assets.

Amortization Expense. Amortization expense decreased to $626 million in 2004 from $640 million in 2003. The decrease relates primarily to a decline in amortization at the Publishing segment as a result of certain intangibles with short useful lives, such as customer lists, becoming fully amortized, partially offset by an increase in the amortization associated with customer-related intangible assets at the Cable segment, which were established with the purchase price allocation associated with the TWE Restructuring. The purchase price allocation was finalized on March 31, 2004.

Operating Income. Time Warner's Operating Income increased to $6.165 billion in 2004 from $5.254 billion in 2003, reflecting the changes in business segment Operating Income before Depreciation and Amortization, partially offset by the increase in depreciation expense, as discussed above.

Interest Expense, Net. Interest expense, net, decreased to $1.533 billion in 2004 from $1.734 billion in 2003 due primarily to lower average net debt levels.

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

	Year Ended December 31,	
	2004	2003
	(millions)	
Investment gains	$453	$ 797
Gain on WMG option	50	—
Loss on investments	(29)	(204)
Microsoft Settlement	—	760
Income (losses) from equity investees	35	(97)
Other	12	(46)
Other income, net	$521	$1,210

The Microsoft Settlement, changes in investment gains, the gain on the WMG option and the declines in the losses on writedown of investments are discussed above in detail under "Significant Transactions and Other Items Affecting Comparability." Excluding the impact of these items, Other income, net, improved in 2004 as compared to the prior year, primarily from an increase in income from equity method investees. This increase was principally due to the impact from the consolidation of AOLA in 2004. Prior to the consolidation in 2003, AOLA losses were recognized as losses from equity investees.

Minority Interest Expense. Time Warner had $246 million of minority interest expense in 2004 compared to $214 million in 2003. The increase relates primarily to larger profits recorded by TWC Inc., in which Comcast has a minority interest.

Income Tax Provision. Income tax expense from continuing operations was $1.698 billion in 2004, compared to $1.370 billion in 2003. The Company's effective tax rate for continuing operations was 35% and 30% in 2004 and 2003, respectively. The increase in the effective tax rate results primarily from a decrease in tax benefits realized on capital losses (from $450 million to $110 million) and the impact of legal reserves recognized in 2004 related to the government investigations (as discussed under "Significant Transactions and Other Items Affecting Comparability"), most of which ultimately may not be deductible for income tax purposes. The increase in the effective tax rate was partially offset by the release of certain tax reserves and related interest which includes amounts recognized from the finalization of prior tax filings as well as additional benefits associated with certain foreign source income.

U.S. federal tax attribute carryforwards at December 31, 2004, consist primarily of $6.9 billion of net operating losses, $607 million of capital losses and $166 million of alternative minimum tax credits. The utilization of these carryforwards as an available offset to future taxable income is subject to limitations under U.S. federal income tax laws. If the net operating losses are not utilized, they expire in varying amounts, starting in 2018 and continuing through 2021. The capital losses expire in 2008 and the alternative minimum tax credits do not expire (Note 11).

Income before Discontinued Operations and Cumulative Effect of Accounting Change. Income before discontinued operations and cumulative effect of accounting change was $3.209 billion in 2004 compared to $3.146 billion in 2003. Basic and diluted net income per share before discontinued operations and cumulative effect of accounting change were $0.70 and $0.68, respectively, in 2004 compared to $0.70 and $0.68 in 2003, respectively. In addition, excluding the items previously discussed under "Significant Transactions and Other Items Affecting Comparability" of $157 million of expense and $546 million of income in 2004 and 2003, respectively, income before discontinued operations and cumulative effect of accounting change increased by $766 million. This increase reflects primarily the after-tax effect of the increase in Operating Income and lower interest expense.

Discontinued Operations, Net of Tax. The 2004 and 2003 results include the impact of the treatment of the Music segment as a discontinued operation. Included in the 2004 results are a pretax loss of $2 million and a related tax benefit of $123 million. The loss and the corresponding taxes relate primarily to adjustments to the initial estimates of the assets sold to, and liabilities assumed by, the acquirers in such transactions and to the resolution of various tax matters surrounding the music business dispositions.

Included in the 2003 results are a pretax gain of approximately $560 million for the sale of Warner Manufacturing, a $1.1 billion pretax impairment charge taken to reduce the carrying value of the net assets of WMG, a $27 million pretax loss from the music operations and $72 million of income tax benefits.

Cumulative Effect of Accounting Change, Net of Tax. As previously discussed, the Company recorded an approximate $34 million benefit, net of tax, as a cumulative effect of accounting change upon the consolidation of AOLA in 2004 in accordance with FIN 46R. In addition, during 2003 the Company recorded an approximate $12 million charge, net of tax, as the cumulative effect of the adoption of FIN 46.

Net Income and Net Income Per Common Share. Net income was $3.364 billion in 2004 compared to $2.639 billion in 2003. Basic and diluted net income per common share were $0.74 and $0.72 in 2004 compared to $0.59 and $0.57 in 2003, respectively. Net income includes the items discussed above under "Significant Transactions and Other Items Affecting Comparability," discontinued operations, net of tax, and cumulative effect of accounting change.

Business Segment Results

AOL. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the AOL segment for the years ended December 31, 2004 and 2003 are as follows:

	Year Ended December 31,		
	2004	2003 (restated) (millions)	% Change
Revenues:			
Subscription	$ 7,477	$ 7,593	(2)%
Advertising	1,005	785	28%
Other	210	220	(5)%
Total revenues	8,692	8,598	1%
Costs of revenues[a]	(4,186)	(4,499)	(7)%
Selling, general and administrative[a]	(2,694)	(2,542)	6%
Gain on disposal of consolidated businesses	20	—	NM
Asset impairments	(10)	—	NM
Restructuring charges	(50)	(52)	(4)%
Operating Income before Depreciation and Amortization	1,772	1,505	18%
Depreciation	(662)	(668)	(1)%
Amortization	(176)	(175)	1%
Operating Income	$ 934	$ 662	41%

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

The reduction in Subscription revenues primarily reflects a decrease in domestic Subscription revenues (from $6.095 billion in 2003 to $5.725 billion in 2004), offset in part by an increase in Subscription revenues at

AOL Europe (from $1.498 billion in 2003 to $1.677 billion in 2004). AOL's domestic Subscription revenues declined due primarily to a decrease in the number of domestic AOL brand subscribers and related revenues, partially offset by an increase in premium service revenue. AOL Europe's Subscription revenues benefited from the favorable impact of foreign currency exchange rates ($156 million) and growth in bundled broadband subscribers. These increases more than offset an increase in value-added taxes ("VAT") (which is netted against revenue) due to a change in European tax law that took effect July 1, 2003. In addition, total Subscription revenues benefited from the consolidation of AOLA effective March 31, 2004 ($37 million), and AOL Japan ($37 million), which was consolidated effective January 1, 2004, but then sold on July 1, 2004.

Through September 30, 2004, AOL classified its domestic AOL brand subscribers as narrowband or broadband subscribers based on the price plan marketed by AOL and selected by subscribers. This price plan classification did not necessarily reflect a subscriber's speed of connection (e.g., high-speed or dial-up), nor did this classification necessarily reflect a member's usage pattern. In America Online's restructuring in the fourth quarter of 2004, the broadband and narrowband access businesses were combined into one Access business. Because it determined that the classification between narrowband and broadband subscribers no longer provided as meaningful information in describing AOL's subscriber base, AOL undertook a review of possible methods to provide subscriber information. As a result of this review, the discussion of subscribers has been updated to focus on the total AOL brand subscriber base, with additional information provided on subscribers with price plans above and below $15 per month. Information is also provided regarding the related average subscription revenue per subscriber ("ARPU") for price plans above and below $15, which ARPU corresponds to the price plan and level of service selected by the customer.

The number of AOL brand domestic and European subscribers is as follows at December 31, 2004, September 30, 2004 and December 31, 2003 (millions):

	December 31, 2004	September 30, 2004	December 31, 2003
Subscriber category:			
AOL brand domestic[1]			
$15 and over	17.5	18.1	19.9
Under $15	4.7	4.6	4.4
Total AOL brand domestic	22.2	22.7	24.3
AOL Europe	6.3	6.3	6.4

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

The ARPU for each significant category of subscribers, calculated as total subscription revenue for the category divided by the average subscribers in the category for the applicable year, is as follows:

	Year Ended December 31, 2004	2003
Subscriber category:		
AOL brand domestic		
$15 and over	$20.97	$20.25
Under $15	13.07	12.11
Total AOL brand domestic	19.44	18.98
AOL Europe	21.48	19.03

Domestic subscribers to the AOL brand service include subscribers during introductory free-trial periods and subscribers at no or reduced monthly fees through member service and retention programs. Total AOL brand domestic subscribers include free-trial and retention members of approximately 13% at December 31, 2004 and 17% at December 31, 2003. Domestic subscribers to the AOL brand service also include subscriptions sold at a discount to employees and customers of selected America Online strategic partners. Domestic AOL brand subscribers also include subscribers to America Online's bundled broadband service, which combines the AOL service with high-speed Internet access provided by third-party broadband Internet access providers such as cable companies and telephone companies. AOL did not actively market the bundled broadband service domestically during 2004.

The largest component of the AOL brand domestic $15 and over price plans is the $23.90 price plan, which provides unlimited access to the AOL service using America Online's dial-up network and unlimited usage of the AOL service through any other Internet connection. The largest component of the AOL brand domestic under $15 price plans is the $14.95 per month price plan, which is primarily marketed as a bring your own access ("BYOA") plan, which includes unlimited usage of the AOL service through an Internet connection not provided by America Online, such as a high-speed broadband Internet connection via cable or DSL. This BYOA price plan also includes a limited number of hours per month of dial-up telephone access in the U.S. to the AOL service using America Online's dial-up network. America Online continues to develop, test, change and implement price plans, service offerings and payment methods to attract and retain members to its AOL brand interactive service and, therefore, the composition of AOL's subscriber base may change over time.

The decline in AOL brand subscribers on plans priced $15 and over per month resulted from a number of factors, principally the continued maturing of dial-up services and subscribers adopting other dial-up and high-speed services, and a reduction in direct marketing response rates over the prior period. Further, during the year, subscribers migrated from the premium priced unlimited dial-up plans, including the $23.90 plan, to lower priced limited dial-up plans, such as the $14.95 plan. The decline in AOL brand subscribers overall and in the $15 and over per month price plans is expected to continue into the foreseeable future.

Growth in AOL brand subscribers on plans below $15 per month was driven principally by the migration of subscribers from plans $15 and over per month, and to a lesser extent by new subscribers on the $14.95 BYOA plan. America Online believes that subscribers on plans priced below $15 per month will continue to grow sequentially and will grow as a percentage of total membership. Subscribers to the AOL/TWC Inc. bundled broadband offering will be included within the price plans below $15 per month category.

Within the $15 and over per month category, the increase in ARPU over the prior year was due primarily to an increase in the percentage of total subscribers who generate revenue. Also contributing to the increase in ARPU was an increase in premium services revenues from subscribers in this category. Premium services revenues included in ARPU for the year ended December 31, 2004 and 2003 were $92 million and $37 million, respectively. ARPU was unfavorably impacted by the mix of subscriber price plans, as subscribers on bundled broadband plans became a smaller portion of the total membership in the $15 and over category.

ARPU for subscribers in the below $15 per month category increased primarily due to growth in subscribers to the $14.95 price plan year over year, which resulted in a favorable impact as the portion of these subscribers grew in relation to the total membership in the below $15 per month category. Also contributing to the increase in ARPU was an increase in premium services revenues from subscribers in this category. In the below $15 per month category, premium services revenues included in ARPU for the years ended December 31, 2004 and 2003 were $24 million and $8 million, respectively.

AOL Europe offers a variety of price plans, including bundled broadband, unlimited access to the AOL service using America Online's dial-up network and limited access plans, which are generally billed based on actual usage. AOL Europe continues to actively market bundled broadband plans, as AOL Europe's subscribers have been migrating from dial-up plans to bundled broadband plans, and this trend is expected to continue.

ARPU for AOL Europe for the first three quarters of 2004 has been revised to $21.72 from $22.06, $20.84 from $21.38, and $21.19 from $21.46 for the 2004 quarters ending March 31, June 30 and September 30, respectively, to exclude amounts of non-AOL brand revenues inadvertently included in the historical amounts. The ARPU for European subscribers increased primarily because of the positive effect of changes in foreign currency exchange rates related to the strengthening of the Euro and British Pound relative to the U.S. Dollar, as well as a change in the mix of price plans, with bundled broadband subscribers growing as a percentage of total subscribers. The total number of AOL brand subscribers reflects a year-over-year increase in subscribers in the U.K., offset by declines in France and Germany.

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

The increase in Advertising revenues primarily reflects an increase from domestic paid-search advertising contracts (from approximately $200 million in 2003 to $302 million in 2004), $97 million generated by Advertising.com from sales of advertising run on third-party websites and a $33 million increase at AOL Europe, including foreign exchange gains. These increases were partially offset by a decrease in intercompany sales of advertising to other business segments of Time Warner in 2004, as compared to 2003 (from $40 million in 2003 to $11 million in 2004). AOL expects Advertising revenues to continue to increase during 2005 due to expected growth in both traditional online and paid-search advertising, as well as Advertising.com's performance-based advertising. Paid-search advertising revenues for AOL Europe are also expected to increase in 2005 as the result of a multi-year paid-search deal executed in the fourth quarter of 2004.

Other revenues primarily include software licensing revenue, revenue from providing the Cable segment access to the AOL Transit Data Network for high-speed access to the Internet and merchandising revenue. Other revenues decreased due primarily to AOL's decision in the first quarter of 2003 to reduce the promotion of its merchandise business (i.e., reducing pop-up advertisements) to improve the member experience, partially offset by higher software licensing revenues.

Costs of revenues decreased 7% and, as a percentage of revenues, decreased to 48% in 2004 from 52% in 2003. The declines related primarily to lower network-related expenses, which decreased 27% to $1.777 billion in 2004 from $2.446 billion in 2003. The decline in network-related expenses was principally attributable to improved pricing and decreased levels of service commitments as well as increased amounts of network assets under capital leases (which are included within depreciation expense) versus operating leases. These factors are expected to result in continued declines in network expenses during 2005. These declines were partially offset by an increase in other costs of service, which included higher domestic salary and consulting costs as well as higher broadband and member service costs at AOL Europe. In addition, there were incremental costs associated with the acquisition of Advertising.com and the consolidation of AOLA and AOL Japan during 2004 (AOL Japan was subsequently sold, effective July 1, 2004).

The increase in selling, general and administrative expenses is primarily related to an increase in marketing costs, additional costs resulting from the acquisition of Advertising.com and higher costs associated with the consolidation of AOLA and the consolidation of AOL Japan for the first half of 2004. The increase in marketing costs resulted from higher spending on member acquisition activities, partially offset by a decline in brand advertising. The increase in marketing expense was partially offset by an approximate $25 million adjustment to reduce excess marketing accruals made in prior years, primarily related to AOL Europe. Management does not believe that the understatement of prior years' results was material to any of the years' financial statements. Similarly, management does not believe that the adjustment made is material to the current-year results. The overall increase in marketing costs was also partially offset by the change in the treatment of intercompany advertising barter transactions (refer to the 2003 versus 2002 AOL results below).

As previously discussed under "Significant Transactions and Other Items Affecting Comparability," 2004 results included a $55 million restructuring charge partially offset by a $5 million reversal of previously-established restructuring accruals, reflecting changes in estimates, a $13 million gain on the sale of AOL Japan, a $7 million gain on the sale of Netscape Security Solutions and a $10 million impairment charge related to a building that is held for sale. Included in 2003 results were $52 million of restructuring charges.

The increases in Operating Income before Depreciation and Amortization and Operating Income are due primarily to a modest increase in overall revenues and lower costs of revenues, offset in part by higher selling, general and administrative expenses.

AOL's 2004 fourth-quarter results also reflect a benefit related to AOL's reversal of a liability of approximately $56 million related to the November 2003 expiration of the federal moratorium on Internet sales taxes. This liability had previously been accrued during the period from November 2003 through September 30, 2004 (of which $47 million was accrued in 2004). In the fourth quarter of 2004, the U.S. government enacted the Internet Tax Nondiscrimination Act, which retroactively reinstated the federal moratorium on Internet sales taxes to November 2003 and extended the federal moratorium on Internet sales taxes through 2007. As a result of the retroactive application of the legislation, AOL was no longer subject to the sales tax exposure for which it had previously accrued.

Cable. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Cable segment for the years ended December 31, 2004 and 2003 are as follows:

	Year Ended December 31,		
	2004	2003	% Change
		(millions)	
Revenues:			
Subscription	$ 7,969	$ 7,233	10%
Advertising	515	466	11%
Total revenues	8,484	7,699	10%
Costs of revenues[a]	(3,723)	(3,343)	11%
Selling, general and administrative[a]	(1,483)	(1,349)	10%
Restructuring charges	—	(15)	NM
Operating Income before Depreciation and Amortization	3,278	2,992	10%
Depreciation	(1,438)	(1,403)	2%
Amortization	(76)	(58)	31%
Operating Income	$ 1,764	$ 1,531	15%

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

Subscription revenues increased due to the continued penetration of new services (primarily high-speed data and advanced digital video services) and video rate increases. High-speed data subscription revenues increased to $1.760 billion for 2004 from $1.422 billion in 2003. The Company anticipates that revenues in 2005 will be positively impacted by revenues associated with its high-speed data and Digital Phone services.

Basic cable subscribers include all subscribers receiving cable service. Digital video subscribers reflect subscribers on any level of service received via digital technology. High-speed data subscribers include subscribers of TWC Inc.'s Road Runner Internet service, as well as other Internet services offered by TWC

Inc. At December 31, 2004, as compared to December 31, 2003, basic cable subscribers declined by 0.3% and totaled 10.884 million (including 1.569 million subscribers of unconsolidated investees, which are managed by TWC Inc.), digital video subscribers increased by 11% to 4.806 million (including 747,000 subscribers of unconsolidated investees, which are managed by TWC Inc.), residential high-speed data subscribers increased by 21% to 3.913 million (including 551,000 subscribers of unconsolidated investees, which are managed by TWC Inc.) and commercial high-speed data subscribers increased by 35% to 173,000 (including 22,000 subscribers of unconsolidated investees, which are managed by TWC Inc.). Digital Phone subscribers totaled 220,000 (including 38,000 subscribers of unconsolidated investees, which are managed by TWC Inc.).

The increase in Advertising revenues was attributable to an increase in both the rates and volume of advertising spots sold.

Costs of revenues increased 11% and, as a percentage of revenues, were 44% for 2004 compared to 43% for 2003. The increase in costs of revenues is primarily related to increases in video programming costs and higher employee costs. Video programming costs increased 12% to $1.865 billion in 2004 due primarily to contractual rate increases across TWC Inc.'s programming line-up (including sports programming). Video programming costs are expected to increase in 2005 at a rate in line with the rate of increase experienced during 2004, reflecting the expansion of service offerings and contractual rate increases across TWC Inc.'s programming line-up (including sports programming). Employee costs increased primarily due to merit increases and higher headcount resulting from the roll-out of new services. High-speed data connectivity costs were relatively flat resulting in a decline on a per subscriber basis.

The increase in selling, general and administrative expenses is primarily the result of higher marketing costs and $34 million incurred in connection with the previously discussed Urban Cable dispute, which was settled in 2004. As a percentage of revenue, selling, general and administrative expenses were constant at approximately 17.5%.

Operating Income before Depreciation and Amortization increased principally as a result of revenue gains, offset in part by higher costs of revenues and selling, general and administrative expenses. As previously discussed in "Significant Transactions and Other Items Affecting Comparability," 2003 results also included $15 million of restructuring charges.

Included in Operating Income before Depreciation and Amortization during 2004 are approximately $45 million of losses associated with the roll-out of the Digital Phone service. At December 31, 2004, Digital Phone service was launched in all of TWC Inc.'s divisions.

Operating Income increased due primarily to the increase in Operating Income before Depreciation and Amortization described above, offset in part by an increase in depreciation and amortization expense. Depreciation expense increased $35 million due primarily to the increased investment in customer premise equipment in recent years, which generally has a significantly shorter useful life compared to the mix of assets previously purchased. Amortization expense increased $18 million, primarily as a result of a full year of amortization of customer-related intangibles in 2004 compared to nine months of amortization in 2003. These assets were established in connection with the TWE Restructuring.

Filmed Entertainment. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Filmed Entertainment segment for the years ended December 31, 2004 and 2003 are as follows:

	Year Ended December 31, 2004	2003 (millions)	% Change
Revenues:			
Advertising	$ 10	$ 6	67%
Content	11,628	10,800	8%
Other	215	161	34%
Total revenues	11,853	10,967	8%
Costs of revenues[a]	(8,941)	(8,430)	6%
Selling, general and administrative[a]	(1,438)	(1,225)	17%
Gain on disposal of consolidated businesses	—	43	NM
Operating Income before Depreciation and Amortization	1,474	1,355	9%
Depreciation	(104)	(86)	21%
Amortization	(213)	(206)	3%
Operating Income	$ 1,157	$ 1,063	9%

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

Content revenues increased during 2004 primarily due to a $631 million and $175 million improvement in revenues from television and theatrical product, respectively. The increase in television product revenues was attributable to a $431 million increase in worldwide license fees and a $200 million increase in home video sales. Revenue from theatrical product included a $106 million increase in television license fees, a $43 million increase in home video sales and a $26 million increase in worldwide theatrical film revenues.

The increase in worldwide license fees from television product was primarily attributable to the third-cycle syndication continuance license arrangements for *Seinfeld,* partially offset by reduced revenues stemming from the conclusion of *Friends* at the end of the 2003-2004 broadcast season. The growth in home video sales of television product was attributable to an increased number of titles released and now sold in this format, including such properties as *Friends, Babylon 5* and *Smallville.*

The increase in television license fees from theatrical product was due primarily to the network television availability of *The Lord of the Rings: The Fellowship of the Ring* to Turner and The WB Network and from the network television availability of *Harry Potter and the Sorcerer's Stone.* Home video sales from theatrical product increased primarily due to a strong release slate at New Line, including *The Lord of the Rings: The Return of the King, Elf, Freddy vs. Jason* and *The Texas Chainsaw Massacre.* The increase in worldwide theatrical film revenues was attributable primarily to the international success of *Harry Potter and the Prisoner of Azkaban, The Last Samurai* and *Troy* and from international overages associated with *The Lord of the Rings: The Return of the King.* This increase was partially offset by a decline in domestic theatrical revenues primarily resulting from difficult comparisons at New Line to the prior year, which included *The Lord of the Rings: The Return of the King* and *Elf.*

Other revenues increased primarily due to the consolidation of the results of Warner Village in 2004, as previously discussed, which contributed $95 million of Other revenues during 2004. The Company's U.K. cinema interests, which were sold in the second quarter of 2003, contributed Other revenues of $51 million during 2003.

The increase in costs of revenues resulted from higher film costs ($5.870 billion in 2004 compared to $5.358 billion in 2003), primarily resulting from the quantity and mix of product released and increased production of new episodic television series (new series are generally produced at a cost in excess of their network license fees, with such excess costs expensed as incurred). Included in film costs are theatrical valuation adjustments, which declined from $245 million in 2003 to $215 million in 2004. Marketing and distribution costs increased slightly due to the quantity and mix of films released during these years. Costs of revenues as a percentage of revenues decreased to 75% for 2004 from 77% for 2003.

Selling, general and administrative expenses increased due to additional distribution fees associated with the off-network television syndication of *Seinfeld,* costs resulting from the consolidation of Warner Village in 2004, additional headcount and merit increases and increased rent expense, partially offset by a reduction in employee incentive compensation.

As previously discussed in "Significant Transactions and Other Items Affecting Comparability," the Company recorded a $43 million gain on the sale of its interest in U.K. cinemas, which previously had been consolidated, during the second quarter of 2003.

Operating Income before Depreciation and Amortization and Operating Income increased due to an increase in revenues, which was partially offset by increases in costs of revenue, selling, general and administrative expenses and the absence of the gain on disposal of a consolidated business, as discussed above.

The Company anticipates that both Operating Income before Depreciation and Amortization and Operating Income will decline in 2005 in comparison to 2004 due primarily to difficult comparisons to 2004 theatrical results, which included significant contributions from *The Lord of the Rings: The Return of the King* and *Elf,* and television results, which included the third-cycle syndication continuance license arrangements for *Seinfeld.*

Networks. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Networks segment for the years ended December 31, 2004 and 2003 are as follows:

	Year Ended December 31,		
	2004	2003	% Change
		(millions)	
Revenues:			
Subscription	$5,058	$4,588	10%
Advertising	2,895	2,675	8%
Content	973	981	(1)%
Other	128	190	(33)%
Total revenues	9,054	8,434	7%
Costs of revenues[a]	(4,600)	(4,499)	2%
Selling, general and administrative[a]	(1,753)	(1,668)	5%
Impairment of intangible assets	—	(219)	NM
Loss on sale of assets	(7)	—	NM
Restructuring charges	—	(21)	NM
Operating Income before Depreciation and Amortization	2,694	2,027	33%
Depreciation	(212)	(192)	10%
Amortization	(21)	(26)	(19)%
Operating Income	$2,461	$1,809	36%

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

The increase in Subscription revenues was due primarily to higher subscription rates and an increase in the number of subscribers at both Turner and HBO. In addition, 2004 and 2003 each include a benefit (approximately $50 million and $45 million, respectively) related to the favorable resolution of certain contractual agreements, which resulted in previously deferred revenue being recognized when the fees became fixed and determinable.

The increase in Advertising revenues was driven primarily by higher CPMs and sellouts at Turner's entertainment networks.

The slight decrease in Content revenues was primarily due to the success of HBO's first-quarter 2003 home video release of *My Big Fat Greek Wedding* and the absence of Content revenues from the winter sports teams after the first quarter of 2004, partially offset by higher 2004 ancillary sales of HBO's original programming and higher license fees from *Everybody Loves Raymond.*

Other revenues declined primarily due to the sale of the winter sports teams in the first quarter of 2004.

Costs of revenues increased 2%. This increase was primarily due to an increase in programming costs, which grew to $3.225 billion for 2004 from $3.021 billion for 2003. The increase in programming costs is primarily due to higher costs for sports rights, network premieres, licensed series and original series at Turner, and higher theatrical film and original series costs at HBO. Costs of revenues for 2004 benefited from the sale of the winter sports teams in the first quarter of 2004 and a reduction in player payroll at the Atlanta Braves. Costs of revenues as a percentage of revenues were 51% and 53% in 2004 and 2003, respectively.

The increase in selling, general and administrative expenses primarily related to higher marketing and promotion costs at Turner and higher general and administrative costs across the networks. These increases were partially offset by a $110 million decrease in bad debt expense that was primarily related to the first and second quarter 2004 reversals of approximately $75 million of bad debt reserves at Turner and HBO on receivables from Adelphia Communications Corporation ("Adelphia"), a major cable operator that declared bankruptcy in 2002, and higher second quarter 2003 bad debt charges incurred at Turner related to certain cable operators. During 2004, the Company sold a portion of its Adelphia receivables to a third-party investor and also collected a portion of its remaining receivables from Adelphia.

As discussed in "Significant Transactions and Other Items Affecting Comparability," the 2004 results include an approximate $7 million loss on the sale of the winter sports teams. The 2003 results include a $219 million impairment charge related to the writedown of intangible assets of the winter sports teams and $21 million of restructuring costs at Turner.

Operating Income before Depreciation and Amortization and Operating Income improved during 2004 due to an increase in revenues and the absence of the 2003 impairment and restructuring charges, partially offset by increases in costs of revenues and selling, general and administrative expenses, as described above.

The sale of the winter sports teams was completed on March 31, 2004. The winter sports teams contributed revenues of $66 million and an Operating Loss of $8 million during 2004. For 2003, the winter sports teams contributed approximately $160 million of revenues and an Operating Loss of $37 million.

The Company anticipates that the rate of growth in both Operating Income before Depreciation and Amortization and Operating Income during 2005 will be lower than that experienced during 2004. The lower expected rate of growth is due partially to the absence of the benefit of the approximate $75 million reversal of bad debt reserves on receivables from Adelphia, the approximate $50 million benefit from the favorable resolution of certain contractual agreements in 2004 and the impacts of growth trends across 2003, 2004 and 2005 from the sale of the winter sports teams.

Publishing. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Publishing segment for the years ended December 31, 2004 and 2003 are as follows:

	Year Ended December 31,		
	2004	2003	% Change
		(millions)	
Revenues:			
Subscription	$1,615	$1,533	5%
Advertising	2,692	2,459	9%
Content	544	522	4%
Other	714	1,019	(30)%
Total revenues	5,565	5,533	1%
Costs of revenues[a]	(2,282)	(2,288)	—
Selling, general and administrative[a]	(2,095)	(2,141)	(2)%
Impairment of goodwill and intangible assets	—	(99)	NM
Gain (loss) on sale of assets	8	(29)	NM
Merger and restructuring charges	—	(21)	NM
Operating Income before Depreciation and Amortization	1,196	955	25%
Depreciation	(122)	(116)	5%
Amortization	(140)	(175)	(20)%
Operating Income	$ 934	$ 664	41%

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

Subscription revenues increased primarily due to a decrease in subscription allowances (which are netted against revenue), due in part to timing, and the favorable effects of foreign currency exchange rates.

Advertising revenues benefited from strength in print advertising, including growth at *Real Simple, Time, In Style, Sports Illustrated, Fortune* and *Entertainment Weekly*, among others. The favorable effects of foreign currency exchange rates and new magazine launches also contributed to growth in Advertising revenues.

Content revenues increased due to several strong titles at Time Warner Book Group. This increase was partially offset by the absence of revenues from Time Life, which was sold at the end of 2003. During 2003, Time Life contributed $40 million of Content revenues.

Other revenues declined primarily due to the sale of Time Life at the end of 2003, which contributed $312 million of Other revenues during 2003.

Costs of revenues for 2003 included $164 million of costs associated with Time Life. Excluding Time Life, costs of revenues increased 7% and, as a percentage of revenues, were 41% for both 2004 and 2003. Costs of revenues for the magazine publishing business include manufacturing (paper, printing and distribution) and editorial-related costs, which together increased 8% to $1.747 billion due primarily to growth in advertising page volume, magazine launch-related costs and the effects of foreign currency exchange rates.

Selling, general and administrative expenses included $251 million of costs associated with Time Life during 2003. Excluding Time Life, selling, general and administrative expenses increased 11%, driven by higher advertising and marketing expense, due primarily to an increase in consumer promotion costs, incremental magazine launch-related costs and costs associated with the coverage and sponsorship of the 2004 Summer Olympics.

As previously discussed in "Significant Transactions and Other Items Affecting Comparability," 2004 results reflect an $8 million gain on the sale of a building and 2003 results include a $99 million impairment charge related to goodwill and intangible assets at the Time Warner Book Group, a $29 million loss on sale of Time Life and $21 million of restructuring costs.

Excluding the 2004 first quarter gain on the sale of a building, the 2003 impairment charges of goodwill and intangible assets, the losses at Time Life, the loss on the sale of Time Life and restructuring charges in 2003, Operating Income before Depreciation and Amortization increased $21 million, and Operating Income increased $40 million, reflecting an increase in overall revenues, partially offset by higher costs of revenues and selling, general and administrative expenses, including $44 million of incremental start-up operating losses associated with the launch of new magazines. Operating Income also benefited from a decline in amortization as a result of certain short-lived intangibles, such as customer lists, becoming fully amortized.

2003 vs. 2002

Consolidated Results

Revenues. Consolidated revenues increased 7% to $39.563 billion in 2003 from $37.060 billion in 2002. As shown below, these increases were led by growth in Subscription, Advertising and Content revenues, offset in part by a decline in Other revenues:

	Year Ended December 31,		
	2003	2002	% Change
	(restated; millions)		
Subscription	$20,448	$18,959	8%
Advertising	6,180	6,045	2%
Content	11,446	10,216	12%
Other	1,489	1,840	(19)%
Total revenues	$39,563	$37,060	7%

The increase in Subscription revenues was driven principally by increases at the Cable segment due primarily to the continued deployment of new services and higher rates, at the AOL segment primarily related to the favorable changes in foreign currency exchange rates and increases in subscriber rates outside the U.S., at the Networks segment primarily driven by higher subscription rates at both Turner and HBO and an increase in the number of subscribers at Turner, and at the Publishing segment due to lower subscription agent commissions (which are netted against revenue) and the favorable effects of foreign currency translation.

Advertising revenues increased due to growth at the Networks segment resulting from improved CPMs and ratings that benefited Turner's domestic entertainment networks and The WB Network, partially offset by declines at the AOL segment, due principally to the decline in the current benefit from prior-period contract sales, and the Cable segment, due to a decrease in program vendor advertising.

The increase in Content revenues related primarily to the Filmed Entertainment segment, due to the worldwide box office success of *The Matrix* and *The Lord of the Rings* franchises, higher worldwide DVD revenues and higher television network license fees, and at the Networks segment, due to HBO's first quarter 2003 home video release of *My Big Fat Greek Wedding* and, to a lesser extent, higher ancillary sales of HBO programming and licensing and syndication revenue associated with *Everybody Loves Raymond*.

The decline in Other revenues was due primarily to the AOL segment's decision to reduce the promotion of its merchandise business (i.e., reducing pop-up advertisements) to improve the member experience. Other revenues were also reduced, due to the sale of the Company's interest in the consolidated U.K. cinemas at the Filmed Entertainment segment in the second quarter of 2003.

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

Cost of Revenues. For the years ended December 31, 2003 and 2002, cost of revenues as a percentage of revenues was 59% and 60% in 2003 and 2002, respectively. Increases in the percentage at Cable (higher programming and depreciation costs) were offset by decreases at AOL (lower network costs) and Filmed Entertainment (overall higher-margin films in 2003).

Selling, General and Administrative Expenses. Selling, general and administrative costs as a percentage of revenues increased from 24% for the year ended December 31, 2002 to 25% for the year ended December 31, 2003. These increases were driven primarily by AOL and Cable, which had higher personnel and marketing costs associated with the roll-out of new products and services.

Reconciliation of Operating Income (Loss) before Depreciation and Amortization to Operating Income and Net Income (Loss).

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

	Year Ended December 31,		
	2003	2002	% Change
	(restated; millions)		
Operating Income (Loss) before Depreciation and Amortization	$ 8,393	$(34,651)	NM
Depreciation	(2,499)	(2,206)	13%
Amortization	(640)	(557)	15%
Operating Income (Loss)	5,254	(37,414)	NM
Interest expense, net	(1,734)	(1,624)	7%
Other income (expense), net	1,210	(2,341)	NM
Minority interest expense	(214)	(278)	(23)%
Income (loss) before income taxes, discontinued operations and cumulative effect of accounting change	4,516	(41,657)	NM
Income tax provision	(1,370)	(313)	338%
Income (loss) before discontinued operations and cumulative effect of accounting change	3,146	(41,970)	NM
Discontinued operations	(495)	(1,012)	(51)%
Cumulative effect of accounting change	(12)	(54,235)	NM
Net income (loss)	$ 2,639	$(97,217)	NM

Operating Income (Loss) before Depreciation and Amortization. Operating Income (Loss) before Depreciation and Amortization improved to $8.393 billion in 2003 from a loss of $34.651 billion in 2002.

Included in these results were several items affecting comparability, including impairments of goodwill and intangible assets, net gains on the disposition of consolidated businesses and restructuring costs, as discussed in "Significant Transactions and Other Items Affecting Comparability" above. Excluding these items from both periods, Operating Income (Loss) before Depreciation and Amortization in 2003 increased (from $8.181 billion to $8.806 billion) as a result of improvements at the Cable, Filmed Entertainment, Networks and AOL segments, offset in part by a decline at the Publishing segment. The segment results are discussed below in detail in "Business Segment Results." Also impacting Operating Income (Loss) before Depreciation and Amortization is an increase in the Corporate Operating Loss before Depreciation and Amortization.

Corporate Operating Loss before Depreciation and Amortization. Time Warner's Corporate Operating Loss before Depreciation and Amortization increased to $424 million in 2003 from $398 million in 2002. Included in these amounts are legal and other professional fees related to the SEC and DOJ investigations into the Company's accounting and disclosure practices and the defense of various shareholder lawsuits ($56 million incurred in 2003 compared to $28 million in 2002). 2002 also included $46 million of restructuring charges, which primarily related to severance costs. In addition, 2003 includes higher compensation costs primarily related to incentive compensation plans.

Depreciation Expense. Depreciation expense increased to $2.499 billion in 2003 from $2.206 billion in 2002, principally due to increases at the Cable and AOL segments. For Cable, as a result of an increase in the amount of capital spending on customer premise equipment in recent years, a larger portion of the Cable segment's property, plant and equipment consisted of assets with shorter useful lives in 2003 than in 2002. Additionally, the Cable division completed the upgrades of its cable systems in mid-2002. Depreciation expense related to these shorter-lived assets, coupled with incremental depreciation expense on the upgraded cable systems, resulted in the increase in overall depreciation expense.

For the AOL segment, the higher expense was due to an increase in network assets acquired under capital leases, offset by an approximate $60 million decrease in depreciation in the fourth quarter of 2003, to reduce excess depreciation inadvertently recorded at AOL over several years prior to 2003. This adjustment is reflected as a reduction of depreciation expense recorded in "selling, general and administrative" expenses (approximately $30 million) and "cost of revenues" (approximately $30 million) in the accompanying consolidated statement of operations. Management does not believe that the understatement of prior years' results was material to any of the applicable year's financial statements. Similarly, management does not believe that the adjustment made is material to the 2003 results.

Amortization Expense. Amortization expense increased to $640 million in 2003 from $557 million in 2002. The increase relates principally to an increase in the carrying values and related amortization of film library assets at Filmed Entertainment and customer-related intangible assets at Cable as a result of the TWE Restructuring.

Operating Income (Loss). Time Warner's Operating Income (Loss) increased from a loss of $37.414 billion in 2002 to income of $5.254 billion in 2003. This reflects the increase in business segment Operating Income (Loss) before Depreciation and Amortization, partially offset by an increase in depreciation and amortization expense.

Interest Expense, Net. Interest expense, net, increased to $1.734 billion in 2003 from $1.624 billion in 2002, due primarily to a change in the mix of debt from lower rate short-term floating rate debt to higher rate long-term fixed-rate debt, as well as lower interest income resulting from the conversion of Hughes preferred stock to common stock during 2002. This was offset in part by lower average rates in 2003 on floating rate debt.

Other Income (Expense), Net. Other income (expense), net, detail is shown in the table below:

	Year Ended December 31, 2003	2002 (restated)
	(millions)	
Investment gains	$ 797	$ 124
Loss on writedown of investments	(204)	(2,199)
Microsoft Settlement	760	—
Losses from equity investees	(97)	(312)
Other	(46)	46
Other income (expense), net	$1,210	$(2,341)

The changes in investment gains, loss on writedown of investments and the Microsoft Settlement are discussed above in detail under "Significant Transactions and Other Items Affecting Comparability." Excluding the impact of the items discussed above, Other income (expense), net, improved in 2003 as compared to the prior year, primarily from a reduction of losses from equity method investees.

Minority Interest Expense. Time Warner had $214 million of minority interest expense in 2003 compared to $278 million in 2002. The decrease in minority interest expense was primarily related to the elimination of the minority interest in AOL Europe as a result of the Company's purchase of the remaining preferred securities and payment of accrued dividends in April 2003.

Income Tax Provision. The Company had income tax expense of $1.370 billion in 2003, compared to $313 million in 2002. The Company's pretax income (loss) before discontinued operations and cumulative effect of accounting change was income of $4.516 billion in 2003, compared to a loss of $41.657 billion in 2002. Applying the 35% U.S. Federal statutory rate to pretax income (loss) would result in income tax expense of $1.581 billion in 2003 and a benefit of $14.580 billion in 2002. The Company's actual income tax expense (benefit) differs from these amounts as a result of several factors, including non-temporary differences (i.e., certain financial statement expenses that are not deductible for income tax purposes), foreign income taxed at different rates, state and local income taxes and the recognition in the fourth quarter of 2003 of a $450 million tax benefit on capital losses. The most significant non-temporary difference in 2002 relates to approximately $42.5 billion of non-deductible losses on the writedown of goodwill (Note 11).

Income (Loss) before Discontinued Operations and Cumulative Effect of Accounting Change. Income (loss) before discontinued operations and cumulative effect of accounting change was $3.146 billion in 2003 compared to a loss of $41.970 billion in 2002. Basic and diluted net income (loss) per share before discontinued operations and cumulative effect of accounting change were income of $0.70 and $0.68, respectively, in 2003 compared to basic and diluted net loss per share of $9.42 in 2002. In addition, excluding the items discussed under "Significant Transactions and Other Items Affecting Comparability" of $546 million of income in 2003 and $43.949 billion of losses in 2002, Income (Loss) before Discontinued Operations and Cumulative Effect of Accounting Change increased by $621 million. Of the increase, $450 million was from the income tax benefit from capital losses. The remainder reflects a slight increase in Operating Income and a decrease in losses from equity method investees.

Discontinued Operations, Net of Tax. The 2003 and 2002 results include the impact of the treatment of the Music segment as discontinued operations. In addition, 2002 reflects the deconsolidation of a portion of the TWE-Advance/Newhouse Partnership ("TWE-A/N") (Note 6). Included in the 2003 discontinued operations for the Music segment is a pretax gain of approximately $560 million for the sale of Warner Manufacturing, a $1.1 billion pretax impairment charge taken to reduce the carrying value of the net assets of the recorded music and music publishing businesses, a $27 million pretax loss from the operations of the Music business and $72 million of income tax benefits (Note 4). The 2002 amounts include pretax income of $101 million from the operations of the Music business, impairments of the Music segment's goodwill of $646 million, brands and trademarks of $853 million and $273 million of income tax benefit related to Music. Additionally, 2002 amounts include $113 million of net income from the operations of TWE-A/N.

Cumulative Effect of Accounting Change. As previously discussed, the Company recorded an approximate $12 million charge, net of tax, as a cumulative effect of accounting change upon adoption of FIN 46 in 2003. During 2002, the Company recorded a $54.235 billion cumulative effect charge upon adoption of SFAS 142. Included in this charge was $4.796 billion related to the Music segment.

Net Income (Loss) and Net Income (Loss) Per Common Share. Net income was $2.639 billion in 2003, compared to a net loss of $97.217 billion in 2002. Basic net income per common share was $0.59 and diluted net income per share was $0.57 in 2003, compared to basic and diluted net loss per common share of $21.82 in 2002. Net Income (Loss) includes the items discussed under "Significant Transactions and Other Items Affecting Comparability," discontinued operations, net of tax, and the cumulative effect of accounting change discussed above.

Business Segment Results

AOL. Revenues, Operating Income (Loss) before Depreciation and Amortization and Operating Income (Loss) of the AOL segment for the years ended December 31, 2003 and 2002 are as follows:

	Year Ended December 31,		
	2003	2002	% Change
	(restated; millions)		
Revenues:			
Subscription	$ 7,593	$ 7,216	5%
Advertising	785	1,082	(27)%
Other	220	562	(61)%
Total revenues	8,598	8,860	(3)%
Costs of revenues[a]	(4,499)	(5,081)	(11)%
Selling, general and administrative[a]	(2,542)	(2,235)	14%
Goodwill impairment charge	—	(31,961)	NM
Restructuring charges	(52)	(266)	(80)%
Operating Income (Loss) before Depreciation and Amortization	1,505	(30,683)	NM
Depreciation	(668)	(624)	7%
Amortization	(175)	(161)	9%
Operating Income (Loss)	$ 662	$(31,468)	NM

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

The growth in Subscription revenues at AOL was primarily attributable to an increase in Subscription revenues at AOL Europe (from $1.153 billion to $1.498 billion). The growth in AOL Europe's Subscription revenues resulted from a $240 million favorable impact of foreign currency exchange rates and higher pricing that more than offset an increase in VAT (which is netted against revenue) due to a change in European tax law that took effect July 1, 2003. AOL's domestic Subscription revenues grew $32 million (from $6.063 billion to $6.095 billion) in 2003 compared to 2002. The expansion of domestic broadband subscribers and increased premium services revenue accounted for the increase. These gains were offset in part by year-over-year declines in revenues related to declines in domestic AOL narrowband subscribers.

The number of AOL brand subscribers in the U.S. was approximately 24.3 million at December 31, 2003, compared to approximately 26.5 million at December 31, 2002, and 24.7 million at September 30, 2003 (total AOL brand subscribers included subscribers receiving the service under various unlimited usage price plans, limited usage price plans, BYOA plans, Original Equipment Manufacturers ("OEMs") bundled plans, and bulk subscriptions sold at a discount rate to AOL's selected strategic partners, as well as members receiving the AOL service during introductory free-trial periods and members who are receiving the AOL service at no or reduced costs through member service and retention programs). The sequential quarterly decline in domestic AOL brand subscribers resulted from a number of factors, including continued subscriber cancellations and terminations, a reduction in direct marketing response rates, the continued maturing of narrowband services, subscribers adopting other narrowband and broadband services, and a reassessment of various marketing programs, partially offset by growth in broadband subscribers.

The year-over-year decline in subscribers also reflects the continued maturing of narrowband services described above and the Company's identification of and removal from the subscriber base of members failing to complete appropriately the registration and payment authorization process and members who were prevented from using the service due to online conduct violations (e.g., spamming, inappropriate language) and who did not properly address the violation.

AOL brand subscribers are classified based on price plans, rather than the speed of a member's connection. The majority of AOL's domestic subscribers are on unlimited usage pricing plans. Additionally, AOL has entered into certain bundling programs with OEMs that generally do not result in Subscription revenues during introductory periods, and previously had sold bulk subscriptions at a discounted rate to AOL's selected strategic partners for distribution to their employees. The following table summarizes the percentage of AOL's domestic members on each type of price plan:

	Year Ended December 31,			
	Percentage of Total Subs		ARPU	
	2003	2002	2003	2002
Unlimited[a]	78%	81%	$20.38	$19.47
Lower-priced plans[b]	18%	13%	$11.15	$11.03
OEM bundled	4%	6%	—	—
Total	100%	100%	$18.98	$18.31

[a] Includes 10% in both 2003 and 2002 under various free-trial and retention programs.
[b] Includes 2% in 2003 and 1% in 2002 under various free-trial and retention programs. These plans include BYOA plans, limited usage plans and bulk programs with strategic partners.

ARPU, defined as total AOL brand domestic Subscription revenue divided by the average subscribers for the period, for 2003 increased 4% to $18.98 as compared to $18.31 in 2002. The change in domestic subscription ARPU primarily related to the termination of non-paying members. In addition, ARPU was impacted by changes in the mix of narrowband and broadband product, customer pricing plans, the level of service provided (full connectivity versus BYOA) and by changes in the terms of AOL's relationships with its broadband cable, DSL and satellite partners.

The number of AOL brand subscribers in Europe was 6.4 million at December 31, 2003, and the average monthly Subscription revenue per European subscriber for 2003 was $19.03. This compares to AOL brand subscribers in Europe of 6.4 million and 6.3 million at December 31, 2002, and September 30, 2003, respectively, and an average monthly Subscription revenue per European subscriber for 2002 of $14.88. The average monthly Subscription revenue per European subscriber in 2003 was impacted primarily by the positive effects of changes in foreign currency exchange rates related to the strengthening of the Euro and British Pound relative to the U.S. Dollar and price increases implemented in the second quarter of 2003 and in mid-2002 in various European countries offering the AOL service. The growth in the number of AOL brand subscribers in Europe was essentially flat in 2003, as growth in U.K. subscribers was offset by subscriber declines in Germany and France.

The decline in Advertising revenues is principally due to a $338 million reduction in revenues from domestic contractual commitments received in prior periods (from $655 million to $317 million) and continued softness in AOL online advertising sales. Of the $655 million of Advertising revenue from contractual commitments for 2002, $15 million was recognized as the result of terminations. There were no terminations in 2003 that resulted in additional revenues. The decline in Advertising revenues also reflects a decrease in the intercompany sales of advertising to other business segments of Time Warner in 2003 as compared to 2002 (from $178 million to $40 million). This reduction also reflects a change in the treatment of intercompany advertising barter transactions. During the second quarter of 2003, there was a change in the application of AOL's policy for intercompany advertising barter transactions, which reduced both the amount of intercompany advertising revenues and advertising expenses by $51 million for the year. This change, however, had no impact on the AOL segment's Operating Income (Loss) or its Operating Income (Loss) before Depreciation and Amortization. In addition, because intercompany transactions are eliminated on a consolidated basis, this change in policy did not impact the Company's consolidated results of operations. The decline in Advertising revenues was partially offset by increased revenues from certain transaction-based advertising contracts (from $35 million in 2002 to approximately $200 million in 2003) related to paid-search categories.

Of the $785 million of Advertising revenues for 2003, $317 million was generated from the five most significant advertisers. Similarly, of the $1.082 billion of Advertising revenues for 2002, $213 million related to the five most significant advertisers.

Domestic advertising commitments for future periods declined to $204 million as of December 31, 2003, as compared to $514 million as of December 31, 2002. In addition to the prior period commitments recognized in revenue, the remaining commitments were reduced by $196 million and $261 million for 2003 and 2002, respectively, without any revenue being recognized, to reflect a decline in future consideration to be received related to the termination or restructuring of various contracts. Included in the $204 million of advertising commitments for future periods as of December 31, 2003 is $120 million for the five largest advertising commitments. Similarly, the $514 million of advertising commitments for future periods as of December 31, 2002 includes $217 million for the five largest commitments.

Other revenues include merchandising revenue and revenue from providing the Cable segment access to the AOL Transit Data Network for high-speed access to the Internet. The decrease in Other revenues for 2003 was due primarily to the Company's decision to reduce the promotion of its merchandise business (i.e., reducing pop-up advertisements) to improve the member experience.

Operating Income (Loss) before Depreciation and Amortization in 2002 included a $31.961 billion impairment charge taken to reduce the carrying value of goodwill. Excluding this impairment charge, Operating Income before Depreciation and Amortization increased by $227 million in 2003. The increase is due primarily to lower costs of revenue and lower merger and restructuring costs, offset in part by lower Advertising revenues, as discussed above, and higher selling, general and administrative expenses. The 11% decline in cost of revenues primarily related to lower domestic network and merchandise expenses. Network-related expenses decreased 14% to $2.446 billion in 2003, principally attributable to improved pricing and decreased levels of service commitments entered into during 2003, as well as the increased utilization of network assets under capital leases. Merger and restructuring costs declined in 2003 to $52 million as compared to $266 million in 2002 (Note 3). The 14% increase in selling, general and administrative expenses primarily related to higher marketing costs, consulting costs, commissions, and personnel costs associated with the roll-out of new services, as well as higher legal and insurance costs.

Excluding the $31.961 billion impairment in 2002, Operating Income (Loss) increased in 2003 due to an increase in Operating Income before Depreciation and Amortization, as discussed above, partially offset by an increase in depreciation and amortization expense. The increase in depreciation expense primarily related to an increase in network assets acquired under capital leases. This was partially offset by an adjustment of approximately $60 million in the fourth quarter of 2003 to reduce excess depreciation inadvertently recorded at AOL over several years prior to 2003. Management does not believe that the understatement of prior years' results was material to any of the given years' financial statements. Similarly, management does not believe that the adjustment made is material to the 2003 results. The increase in amortization expense is primarily related to a reduction in useful lives of certain intangible assets that would cease to be used in early 2004.

Cable. Revenues, Operating Income (Loss) before Depreciation and Amortization and Operating Income (Loss) of the Cable segment for the years ended December 31, 2003 and 2002 are as follows:

	Year Ended December 31,		
	2003	2002	% Change
		(millions)	
Revenues:			
Subscription	$ 7,233	$ 6,374	13%
Advertising	466	661	(30)%
Total revenues	7,699	7,035	9%
Costs of revenues[a]	(3,343)	(3,033)	10%
Selling, general and administrative[a]	(1,349)	(1,242)	9%
Goodwill impairment charge	—	(10,550)	NM
Restructuring charges	(15)	(15)	—
Gain on disposal of consolidated businesses	—	6	NM
Operating Income (Loss) before Depreciation and Amortization	2,992	(7,799)	NM
Depreciation	(1,403)	(1,206)	16%
Amortization	(58)	(7)	NM
Operating Income (Loss)	$ 1,531	$ (9,012)	NM

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

The increase in Subscription revenues for 2003 was due to the growth in high-speed data subscribers, higher basic cable rates and an increase in digital video subscribers. High-speed data revenues increased from $1.009 billion in 2002 to $1.422 billion in 2003.

Basic cable subscribers include all subscribers receiving basic cable service. Digital video subscribers reflect subscribers on any level of service received via digital technology. High-speed data subscribers include subscribers to TWC Inc.'s Road Runner service, as well as other Internet services offered by TWC Inc. For the period from December 31, 2002 to December 31, 2003, residential high-speed data subscribers increased by 33% to 3.228 million (including 443,000 million subscribers of unconsolidated investees, which are managed by TWC Inc.), commercial high-speed data subscribers increased by 54% to 128,000 (including 13,000 subscribers of unconsolidated investees, which are managed by TWC Inc.), digital video subscribers increased by 16% to 4.349 million (including 696,000 million subscribers of unconsolidated investees, which are managed by TWC Inc.) and basic cable subscribers increased 0.1% to 10.919 million (including 1.572 million subscribers of unconsolidated investees, which are managed by TWC Inc.).

The decrease in Advertising revenues was primarily related to a decrease in advertising purchased by programming vendors to promote their channels, including new channel launches (from $124 million to $12 million) and a decrease in the intercompany sale of advertising to other business segments of Time Warner (from $125 million to $11 million). This was offset in part by an 8%, or $31 million, increase in general third-party advertising sales.

Operating Income (Loss) before Depreciation and Amortization for 2002 included a $10.550 billion impairment charge to reduce the carrying value of goodwill and a $6 million gain on the sale of certain consolidated cable systems. Excluding the impairment charge and gain, Operating Income before Depreciation and Amortization in 2003 increased by $247 million, principally as a result of the Subscription revenue gains described above, offset in part by higher costs of revenue and selling, general and administrative expenses. The increase in costs of revenue was primarily related to increases in video programming costs, offset in part by reduced high-speed data network expenses. Video programming costs increased 15% to $1.661 billion in 2003, principally attributable to contractual rate increases across the Company's programming lineup (including sports programming). The increase in selling, general and administrative expenses was primarily related to higher employee-related costs, due in part to the roll-out of new services and, to a lesser extent, higher pension expenses.

Excluding the $10.550 billion impairment, Operating Income increased in 2003 due primarily to the increase in Operating Income before Depreciation and Amortization described above, offset in part by an increase in depreciation and amortization expense. As a result of an increase in the amount of capital spending on customer premise equipment in recent years, a larger proportion of the Cable segment's property, plant and equipment consisted of assets with shorter useful lives in 2003 than in 2002. Additionally, the Cable division completed the upgrades of its cable systems in mid-2002. Depreciation expense related to these shorter-lived assets, coupled with incremental depreciation expense on the upgraded cable systems, has resulted in the increase in overall depreciation expense. Amortization expense increased $51 million, primarily as a result of amortization of subscriber lists that were established in connection with the TWE Restructuring.

Filmed Entertainment. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Filmed Entertainment segment for the years ended December 31, 2003 and 2002 are as follows:

	Year Ended December 31,		
	2003	2002	% Change
		(millions)	
Revenues:			
Advertising	$ 6	$ 10	(40)%
Content	10,800	9,824	10%
Other	161	206	(22)%
Total revenues	10,967	10,040	9%
Costs of revenues[a]	(8,430)	(7,891)	7%
Selling, general and administrative[a]	(1,225)	(1,051)	17%
Gain on disposal of consolidated businesses	43	—	NM
Operating Income before Depreciation and Amortization	1,355	1,098	23%
Depreciation	(86)	(79)	9%
Amortization	(206)	(191)	8%
Operating Income	$ 1,063	$ 828	28%

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

For 2003, Content revenues increased as a result of improvements from theatrical and television product. Increases in revenue from theatrical product included higher worldwide theatrical film rentals ($109 million), higher worldwide home video sales ($174 million) and higher television license fees ($118 million). Increases in revenue from television product is attributable to higher worldwide license fees ($288 million) and improved home video sales ($251 million). The increase in worldwide theatrical film rentals was primarily driven by the success of *Harry Potter and the Chamber of Secrets, The Matrix Reloaded, The Lord of the Rings: The Fellowship of the Ring* and *The Lord of the Rings: The Two Towers*. The increase in worldwide home video sales reflects increased DVD unit sales for both feature films and episodic television series, offset in part by lower VHS revenues. The growth in DVD revenues is attributable to a combination of the popularity of the Company's film and television releases as well as the expanding worldwide DVD player base. The increase in television revenues is primarily attributable to improved network license fees from several returning series, as well as a higher number of new episodes produced and delivered in 2003 versus 2002. In addition, revenues were negatively impacted by a $40 million reserve established during the fourth quarter in connection with an international VAT tax matter (which is netted against revenue).

Other revenues consist primarily of comic-book publishing sales and revenues from the portion of the Company's U.K. cinema operations consolidated for financial reporting purposes. Other revenues declined as a result of the sale of the Company's U.K. cinema interests in the second quarter of 2003. This operation contributed $51 million of Other revenues in 2003, compared to $108 million in 2002.

Operating Income before Depreciation and Amortization reflects improved contributions from theatrical product, which were offset in part by lower gross profits from television product stemming from an increase in the production of new episodic series (new series are generally produced at a cost in excess of their network license fees). Specifically, Operating Income before Depreciation and Amortization includes increased Content revenues, which was partially offset by decreases in Other revenues discussed above, increases in costs of revenue and selling, general and administrative expenses. The increase in costs of revenue is primarily related to increased film and exploitation costs and by increased television production costs as discussed above.

The increase in selling, general and administrative expenses is primarily related to third party distribution fees associated with higher revenue, general cost increases (including annual salary increases), additional headcount and approximately $45 million of additional accruals for employee incentive compensation. In addition, Operating Income before Depreciation and Amortization includes a $43 million gain related to the sale of the Company's interest in consolidated U.K. cinemas in 2003.

The increase in Operating Income was due primarily to the aforementioned changes in Operating Income before Depreciation and Amortization, offset in part by higher depreciation expense due to asset additions to property and equipment, as well as higher amortization expense relating to a step-up in the valuation of the Warner Bros. film library assets, which were established in connection with the TWE Restructuring.

Networks. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Networks segment for the years ended December 31, 2003 and 2002 are as follows:

	Year Ended December 31,		
	2003	2002	% Change
		(millions)	
Revenues:			
Subscription	$ 4,588	$ 4,310	6%
Advertising	2,675	2,423	10%
Content	981	736	33%
Other	190	186	2%
Total revenues	8,434	7,655	10%
Costs of revenues[(a)]	(4,499)	(4,057)	11%
Selling, general and administrative[(a)]	(1,668)	(1,566)	7%
Impairment of intangible assets	(219)	—	NM
Restructuring charges	(21)	—	NM
Operating Income before Depreciation and Amortization	2,027	2,032	—
Depreciation	(192)	(172)	12%
Amortization	(26)	(21)	24%
Operating Income	$ 1,809	$ 1,839	(2)%

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

The increase in Subscription revenues was due primarily to higher subscription rates at both the cable networks of Turner and at HBO and an increase in the number of subscribers at Turner. In addition, as a result of the resolution of certain contractual agreements, certain previously deferred revenues were recognized when the fees became fixed and determinable. As a result, approximately $45 million of revenue that had been deferred was recognized in the third quarter of 2003.

The increase in Advertising revenues was driven by higher CPMs, sellouts and ratings at Turner's entertainment networks, reflecting improvement in the cable television advertising market, and, at The WB Network, from higher advertising rates and the impact of an expanded Sunday night schedule that began in September 2002.

The increase in Content revenues was primarily due to the success of HBO's first quarter 2003 home video release of *My Big Fat Greek Wedding* and, to a lesser extent, higher ancillary sales of HBO programming and higher licensing and syndication revenue associated with *Everybody Loves Raymond*.

Operating Income before Depreciation and Amortization for 2003 includes the previously discussed $219 million of impairment charges at Turner related to the writedown of intangible assets of the winter sports teams. Excluding this impairment charge, Operating Income before Depreciation and Amortization improved due to the increase in total revenues described above, offset in part by an increase in costs of revenue and selling, general and administrative expenses. The 11% increase in costs of revenue is primarily due to increases in programming costs and higher distribution costs related to the increase in HBO's Content revenues. Partially offsetting the higher programming costs was a $45 million deferral of programming costs associated with future revenues from syndication and home video distribution of original programming. The 7% increase in selling, general and administrative expenses is primarily related to higher employee costs at Turner and HBO due to business growth, and an increase in marketing costs. 2002 also included a benefit from the finalization of certain licensing agreements at HBO. In addition, 2003 included $13 million of restructuring costs related to a lease termination and a sublease associated with the planned move of Turner's New York-based advertising sales department to the Time Warner Center and an additional $8 million of restructuring costs related to various employee and contractual terminations. Both years reflect bad debt reserves on receivables from Adelphia, which declared bankruptcy in 2002.

Excluding the impairment charge, Operating Income increased primarily due to the changes in Operating Income before Depreciation and Amortization noted above, partially offset by an increase in depreciation expense related to fixed asset additions, primarily at Turner.

The winter sports teams, which were sold in the first quarter of 2004, contributed approximately $160 million and $152 million of revenues in 2003 and 2002, respectively. Operating Losses were $37 million and $45 million in 2003 and 2002, respectively.

Publishing. Revenues, Operating Income before Depreciation and Amortization and Operating Income of the Publishing segment for the years ended December 31, 2003 and 2002 are as follows:

	Year Ended December 31,		
	2003	2002	% Change
		(millions)	
Revenues:			
Subscription	$ 1,533	$ 1,484	3%
Advertising	2,459	2,422	2%
Content	522	513	2%
Other	1,019	1,003	2%
Total revenues	5,533	5,422	2%
Costs of revenues[a]	(2,288)	(2,233)	2%
Selling, general and administrative[a]	(2,141)	(2,034)	5%
Impairment of goodwill and intangible assets	(99)	—	NM
Loss on sale of assets	(29)	—	NM
Merger and restructuring charges	(21)	—	NM
Operating Income before Depreciation and Amortization	955	1,155	(17)%
Depreciation	(116)	(97)	20%
Amortization	(175)	(177)	(1)%
Operating Income	$ 664	$ 881	(25)%

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