The 3% increase in Subscription revenues was due to $36 million of favorable effects of foreign exchange rates and a $49 million reduction in subscription agents' commissions, which are netted against revenue, partially offset by lower subscription revenue per subscriber.

The 2% increase in Advertising revenues reflects easier comparisons to 2002 during the early part of the year, resulting from the aftermath of the events of September 11, 2001, offset in part by a soft print advertising market in the latter part of 2003.

The increase in Other revenues resulted from increases at Southern Living At Home, a division that sells merchandise via in-home parties, and Synapse, a direct subscription marketing company. These gains were partially offset by a $52 million decrease at Time Life.

The decrease in Operating Income before Depreciation and Amortization includes the previously discussed $99 million impairment charge related to the goodwill and intangible assets of the Time Warner Book Group. It also includes an $84 million decline at Time Life (a $72 million loss in 2003 versus income of $12 million in 2002) and an increase in pension-related expenses of $44 million. These items were partially offset by an overall increase in revenue. Restructuring charges of $21 million were also recorded in 2003, including $9 million for Time Life workforce reductions. As previously discussed, in December 2003, the Company sold Time Life and recorded a loss on disposal of $29 million. Operating expenses for the magazine publishing business include manufacturing (paper, printing and distribution) and editorial-related costs, which together increased 2% to $1.627 billion due primarily to the effects of foreign exchange rates.

The decrease in Operating Income was due primarily to lower Operating Income before Depreciation and Amortization, as discussed above, and higher depreciation expense, primarily related to increased capitalized software and building improvements. Time Life contributed $82 million of Operating Losses in 2003 and Operating Income of $6 million in 2002.

FINANCIAL CONDITION AND LIQUIDITY

Current Financial Condition

At December 31, 2004, Time Warner had $22.375 billion of debt, $6.139 billion of cash and equivalents (net debt of $16.236 billion, defined as total debt less cash and equivalents) and $60.771 billion of shareholders' equity, compared to $25.745 billion of debt, $3.040 billion of cash and equivalents (net debt of $22.705 billion) and $56.213 billion of shareholders' equity at December 31, 2003.

As discussed in more detail below, management believes that Time Warner's cash provided by operations, cash and equivalents, borrowing capacity under its committed credit facilities and availability under its commercial paper programs are sufficient to fund its capital and liquidity needs for the foreseeable future.

Debt Reduction Program

In January 2003, the Company announced its intention to reduce its overall level of indebtedness. Specifically, the Company indicated its intention was to reduce consolidated net debt to approximately $20 billion by the end of 2004.

The following table shows the change in net debt from December 31, 2003 to December 31, 2004 (millions):

Net debt at December 31, 2003	$22,705
Free Cash Flow[a]	(3,280)
Acquisition of Advertising.com	445
Acquisition of additional interest in Synapse Group Inc.	120
Net proceeds from sale of WMG[b]	(2,501)
Proceeds from sale of a portion of the Company's investment in Google	(195)
Proceeds from sale of the Company's investment in Gateway	(280)
Proceeds from sale of the Company's investment in VIVA and VIVA Plus	(134)
Other	(644)
Net debt at December 31, 2004(c)	$16,236

[a] See Free Cash Flow discussion under "Cash Flows" below for a reconciliation of the Company's Free Cash Flow to cash provided by operations ($6.618 billion in 2004).

[b] Represents $2.6 billion of proceeds received from the sale of WMG less certain working capital adjustments.

[c] Included in the net debt balance is approximately $299 million, which represents the net unamortized fair value adjustment recognized as a result of the merger of America Online and Historic TW.

With the receipt of the proceeds upon the closing of the sale of the Company's recorded music and music publishing businesses in the first quarter of 2004, as well as the generation of significant Free Cash Flow, the Company achieved its previously announced net debt reduction target in the first quarter, almost a full year ahead of schedule.

The Company employs a disciplined approach to capital management, including investment opportunities and the potential return of capital to shareholders. Depending upon the timing and magnitude of such transactions, the Company's net debt may continue to decline due to the prospective generation of Free Cash Flow.

The Company has submitted a joint bid with Comcast for the acquisition of Adelphia. If successful, the Company's net debt would increase.

Cash Flows

Cash and equivalents increased to $6.139 billion as of December 31, 2004, from $3.040 billion as of December 31, 2003. Components of this change are discussed in more detail in the pages that follow.

Operating Activities

Sources of cash provided by operations are as follows:

	Year Ended December 31,		
	2004	2003 (restated)	2002 (restated)
		(millions)	
Operating Income (Loss) before Depreciation and Amortization	$ 9,372	$ 8,393	$(34,651)
Noncash asset impairments	10	318	42,511
Noncash legal reserves related to government investigations	300	—	—
Net interest payments[a]	(1,578)	(1,633)	(1,548)
Net income taxes paid[b]	(382)	(489)	(246)
Adjustments relating to discontinued operations[c]	123	350	639
Merger and restructuring payments[d]	(90)	(293)	(512)
Domestic pension plan contributions	(358)	(648)	(119)
Microsoft Settlement	—	750	—
Cash paid for litigation settlements	—	(391)	—
All other, net, including working capital changes	(779)	244	683
Cash provided by operations	$ 6,618	$ 6,601	$ 6,757

(a) Includes interest income received of $94 million, $61 million and $93 million in 2004, 2003 and 2002, respectively.

(b) Includes income tax refunds received of $107 million, $15 million and $49 million in 2004, 2003 and 2002, respectively.

(c) Includes net income (loss) from discontinued operations of $121 million, ($495) million and ($1.012) billion in 2004, 2003 and 2002, respectively. Amounts also include working capital related adjustments associated with discontinued operations of $2 million, $845 million and $1.651 billion in 2004, 2003 and 2002, respectively.

(d) Includes payments for merger and restructuring costs, as well as payment for certain other merger-related liabilities.

Cash provided by operations increased to $6.618 billion in 2004 compared to $6.601 billion in 2003. The increase in cash provided by operations is related primarily to an increase in Operating Income before Depreciation and Amortization and lower domestic qualified pension plan contributions, tax, interest and merger and restructuring payments. These increases were partially offset by a reduction in cash provided by working capital, a reduction in cash relating to discontinued operations and the absence of net cash received from litigation settlements in 2004. The changes in working capital are subject to wide fluctuations based on the timing of cash transactions related to production schedules, the acquisition of programming, collection of accounts receivables and sales proceeds and similar items. The change in working capital between periods included higher production and programming spending and the timing of accounts payable and accrual payments.

Cash provided by operations decreased to $6.601 billion for 2003, compared to $6.757 billion in 2002. The decline in cash provided by operations is related primarily to higher net interest and tax payments, lower cash generated from discontinued operations, higher domestic pension contributions and decreased contributions from working capital primarily related to higher production spending at Warner Bros. These factors causing declines were offset in part by an increase in Operating Income before Depreciation and Amortization (excluding noncash impairment charges of intangible assets), a decrease in cash paid for restructuring and merger liabilities and $359 million of net cash received in connection with litigation settlements.

Investing Activities

Sources of cash provided (used) by investing activities are as follows:

	Year Ended December 31, 2004	2003	2002 (restated)
		(millions)	
Investment and acquisitions, net of cash acquired:			
Synapse[a]	$ (120)	$ (40)	$ —
Advertising.com	(445)	—	—
The WB Network	—	(128)	—
Consolidation of AOLA[b]	33	—	—
AOL Europe	—	—	(6,475)
All other, principally funding of joint ventures	(345)	(402)	(919)
Investments and acquisitions, net from discontinued operations	—	(52)	(162)
Capital expenditures and product development costs from continuing operations	(3,024)	(2,761)	(2,843)
Capital expenditures and product development costs from discontinued operations	—	(126)	(386)
Proceeds from sale of the Company's investment in Hughes	—	783	—
Proceeds from the sale of a portion of the Company's investment in Google	195	—	—
Proceeds from the sale of the Company's investment in Gateway	280	—	—
Proceeds from the sale of other available-for-sale securities	57	296	187
Net proceeds from the sale of WMG[c]	2,501	—	—
Proceeds from the sale of the Company's investment in VIVA and VIVA Plus	134	—	—
Proceeds from sale of the Company's investment in Comedy Central	—	1,225	—
Proceeds from sale of Warner Manufacturing	—	1,050	—
All other investment proceeds	231	232	361
Cash provided (used) by investing activities	$ (503)	$ 77	$(10,237)

[a] Represents purchase of additional interest in Synapse Group Inc.
[b] Represents cash balance of AOLA upon consolidation.
[c] Represents $2.6 billion of proceeds received from the sale of WMG less certain working capital adjustments.

Cash used by investing activities was $503 million in 2004 compared to cash provided by investing activities of $77 million in 2003. The decrease in cash provided (used) by investing activities is due to lower proceeds from sale of investments, an increase in capital expenditures and product development costs and an increase in investments and acquisitions during 2004. Capital expenditures increased across all business segments and included capital expenditures related to the Company's new corporate headquarters and the construction of a building by IPC Media.

Cash provided by investing activities was $77 million in 2003, compared to cash used by investing activities of $10.237 billion in 2002. The increase in cash provided by investing activities is due primarily to the lower level of cash used for investments and acquisitions than in 2002, when the Company spent $6.475 billion in connection with the acquisition of Bertelsmann's interest in AOL Europe. In addition, as noted above, 2003 had higher investment proceeds from the sale of non-strategic assets. Capital expenditures and product development costs from continuing operations were essentially flat.

As previously discussed under "Other Recent Developments," Comcast has been granted an option, which generally can be exercised until 60 days following delivery of a termination notice from either TWC Inc. or Comcast, to require TWC Inc. to redeem a portion of the TWC Inc. stock held by Comcast in exchange for certain cable systems and approximately $750 million in cash.

Financing Activities

Sources of cash provided (used) by financing activities are as follows:

	Year Ended December 31,		
	2004	2003	2002
		(millions)	
Borrowings	$ 1,631	$ 2,492	$ 23,535
Debt repayments	(4,834)	(7,230)	(18,984)
Redemption of mandatorily redeemable preferred securities of a subsidiary	—	(813)	(255)
Current period repurchases of common stock	—	—	(102)
Partnership distributions	—	—	(11)
Principal payments on capital leases	(191)	(178)	(61)
Proceeds from exercise of stock options	353	372	297
Other financing activities	25	(11)	20
Cash provided (used) by financing activities	$(3,016)	$(5,368)	$ 4,439

Cash used by financing activities was $3.016 billion in 2004 compared to $5.368 billion in 2003. The decrease in cash used by financing activities was due principally to lower incremental debt repayments in 2004 and the absence of the 2003 redemption of mandatorily redeemable preferred securities of a subsidiary.

Cash used by financing activities was $5.368 billion in 2003 compared to cash provided by financing activities of $4.439 billion in 2002. The increase in cash used by financing activities was due principally to incremental debt repayments in 2003. These were pursuant to the Company's debt reduction plan. This is in contrast to incremental borrowings in 2002 that were used to finance the acquisition of Bertelsmann's interest in AOL Europe.

Free Cash Flow

Free Cash Flow is cash provided (used) 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. Free Cash Flow should be considered in addition to, and not as a substitute for, the Company's various cash flow measures (e.g., Cash Provided by Operations) reported in accordance with U.S. generally accepted accounting principles.

The following table provides a reconciliation from the Company's cash provided by operations to Free Cash Flow.

	Year Ended December 31,		
	2004	2003	2002 (restated)
		(millions)	
Cash provided by operations	$ 6,618	$ 6,601	$ 6,757
Capital expenditures and product development costs	(3,024)	(2,887)	(3,229)
Partnership distributions	—	—	(11)
Principal payments on capital leases	(191)	(178)	(61)
Free Cash Flow including discontinued operations	3,403	3,536	3,456
Less: Free Cash Flow from discontinued operations	(123)	(224)	(242)
Free Cash Flow	$ 3,280	$ 3,312	$ 3,214

Capital Expenditures and Product Development Costs

Time Warner's total capital expenditures and product development costs were $3.024 billion in 2004 compared to $2.887 billion in 2003 and $3.229 billion in 2002. Capital expenditures and product development costs from continuing operations were $2.761 billion in 2003 and $2.843 billion in 2002. Capital expenditures and product development costs from continuing operations principally relate to the Company's Cable segment, which had capital expenditures from continuing operations of $1.712 billion in 2004, $1.637 billion in 2003 and $1.813 billion in 2002.

The Cable segment's capital expenditures from continuing operations comprise the following categories:

	Year Ended December 31,		
	2004	2003	2002
		(millions)	
Cable Segment Capital Expenditures			
Customer premise equipment	$ 719	$ 715	$ 813
Scaleable infrastructure	205	173	188
Line extensions	239	214	192
Upgrade/rebuild	139	175	224
Support capital	410	360	396
Total capital expenditures	$1,712	$1,637	$1,813

Time Warner's Cable segment generally capitalizes expenditures for tangible fixed assets having a useful life greater than one year. Capitalized costs typically include direct material, direct labor, overhead and interest. Sales and marketing costs, as well as the costs of repairing or maintaining existing fixed assets, are expensed as incurred. Types of capitalized expenditures at the Cable segment include plant upgrades, drops (i.e., initial customer installations), converters (i.e., analog and digital boxes that convert transmitted signals to analog and/or digital TV signal) and cable modems used in the delivery of high-speed data and Digital Phone services. With respect to customer premise equipment, including converters and cable modems, the Cable segment capitalizes direct installation charges only upon the initial deployment of such assets. All costs incurred in subsequent disconnects and reconnects are expensed as incurred. Depreciation on these assets is generally provided using the straight-line method over their estimated useful life. For converters and modems, such life is 3-5 years and for plant upgrades, such useful life is 3-16 years.

Outstanding Debt and Other Financing Arrangements

Outstanding Debt and Available Committed Financial Capacity

At December 31, 2004, Time Warner had total committed capacity, defined as maximum available borrowings under various existing debt arrangements and cash and short term investments, of $37.991 billion. Of this committed capacity, $15.265 billion was available to fund future obligations and $22.375 billion was outstanding as debt (refer to Note 10 to the accompanying consolidated financial statements for more details on outstanding debt). At December 31, 2004, total committed capacity, unused capacity and outstanding debt were as follows:

	Committed Capacity	Letters of Credit[a]	Unused Committed Capacity	Outstanding Debt[c]
		(millions)		
Cash and equivalents	$ 6,139	$ —	$ 6,139	$ —
Bank credit agreement and commercial paper programs	11,000	351	9,126	1,523
Fixed-rate public debt[b]	20,393	—	—	20,393
Other fixed-rate obligations	459	—	—	459
Total	$37,991	$351	$15,265	$22,375

[a] Represents the portion of committed capacity reserved for outstanding and undrawn letters of credit.
[b] Includes debt due within one year of $1.672 billion, which primarily relates to $1.5 billion of bonds that mature in 2005.
[c] Represents principal amounts adjusted for fair value adjustments, premiums and discounts.

Time Warner Credit Agreement

Time Warner has a $7.0 billion senior unsecured five-year revolving credit facility with a maturity date of June 30, 2009 (the "TW Facility"). The permitted borrowers under the TW Facility are Time Warner and Time Warner Finance Ireland (the "Borrowers"). The obligations of both Time Warner and Time Warner Finance Ireland are directly or indirectly guaranteed by America Online, Historic TW, Turner and Time Warner Companies, Inc. The obligations of Time Warner Finance Ireland are also guaranteed by Time Warner.

Borrowings under the TW Facility bear interest at a rate determined by the credit rating of Time Warner, which rate is currently LIBOR plus 0.39%. In addition, the Borrowers are required to pay a facility fee on the aggregate commitments under the TW Facility at a rate determined by the credit rating of Time Warner, which rate is currently 0.11% per annum. The Borrowers also incur an additional usage fee of 0.10% per annum on the outstanding loans and other extensions of credit under the TW Facility if and when such amounts exceed 50% of the aggregate commitments thereunder.

The TW Facility provides same-day funding and multi-currency capability, and a portion of the commitment, not to exceed $500 million at any time, may be used for the issuance of letters of credit. The TW Facility contains a maximum leverage ratio covenant of 4.5 times consolidated EBITDA of Time Warner and an interest coverage covenant of 2.0 times consolidated cash interest expense of Time Warner. Each of these terms, ratios and related financial metrics is defined in the agreement. At December 31, 2004, the Company was in compliance with all of these covenants, with a leverage ratio and interest coverage ratio, as calculated in accordance with the agreement, of approximately 1.8 times and 5.5 times, respectively. The TW Facility does not contain any credit ratings-based defaults or covenants, or any ongoing covenant or representations specifically relating to a material adverse change in Time Warner's financial condition or results of operations. Borrowings may be used for general corporate purposes, and unused credit is available to support borrowings under commercial paper programs. As of December 31, 2004, there were no loans outstanding and $351 million in outstanding face amount of letters of credit were issued under the TW Facility.

TWC Inc. and TWE Credit Agreement

TWC Inc. and TWE have a $4.0 billion senior unsecured five-year revolving credit facility with a maturity date of November 23, 2009 (the "Cable Facility"). TWC Inc. and TWE have cross-guaranteed their respective obligations under the Cable Facility, and Warner Communications Inc. and American Television and Communications Corporation (both indirect wholly-owned subsidiaries of Time Warner but not subsidiaries of TWC Inc.) have each guaranteed a pro-rata portion of TWE's obligations under the Cable Facility (including TWE's obligations under its guarantee of TWC Inc.'s obligations). There are generally no restrictions on the ability of Warner Communications Inc. and American Television and Communications Corporation to transfer material assets (other than their interests in TWC Inc. or TWE) to parties that are not guarantors.

Borrowings under the Cable Facility bear interest at a rate based on the credit rating of TWC Inc., which rate is currently LIBOR plus 0.39%. In addition, the borrowers are required to pay a facility fee on the aggregate commitments under the Cable Facility at a rate determined by the credit rating of TWC Inc., which rate is currently 0.11% per annum. The borrowers also incur an additional usage fee of 0.10% per annum on the outstanding loans and other extensions of credit under the Cable Facility if and when such amounts exceed 50% of the aggregate commitments thereunder.

The Cable Facility provides same-day funding capability and a portion of the commitment, not to exceed $300 million at any time, may be used for the issuance of letters of credit. The Cable Facility contains a maximum leverage ratio covenant of 5.0 times consolidated EBITDA of TWC Inc. and an interest coverage covenant of 2.0 times consolidated cash interest expense of TWC Inc. Each of these terms, ratios and related financial metrics is defined in the agreement. At December 31, 2004, TWC Inc. was in compliance with all of these covenants with a leverage ratio and interest coverage ratio, as calculated in accordance with the agreement, of approximately 1.4 times and 6.7 times, respectively. The Cable Facility does not contain any credit ratings-based defaults or covenants, or any ongoing covenant or representations specifically relating to a material adverse change in the financial condition or results of operations of Time Warner, TWC Inc. or TWE. Borrowings may be used for general corporate purposes and unused credit is available to support borrowings under commercial paper programs. As of December 31, 2004, there were no loans or letters of credit outstanding, and approximately $1.523 billion of commercial paper was supported by the Cable Facility.

Commercial Paper Programs

Time Warner maintains a $5.0 billion unsecured commercial paper program. Included as part of the $5.0 billion commercial paper program is a $2.0 billion European commercial paper program under which Time Warner and Time Warner Finance Ireland can issue European commercial paper. The obligations of both Time Warner and Time Warner Finance Ireland are directly and indirectly guaranteed by America Online, Historic TW, Turner and Time Warner Companies, Inc. The obligations of Time Warner Finance Ireland are also guaranteed by Time Warner. Proceeds from the commercial paper program may be used for general corporate purposes, including investments, repayment of debt and acquisitions. Commercial paper borrowings at Time Warner and Time Warner Finance Ireland are supported by the unused committed capacity of the $7.0 billion TW Facility. As of December 31, 2004, there was no commercial paper outstanding under the Time Warner commercial paper programs.

In the second quarter of 2004, TWC Inc. established a $2.0 billion unsecured commercial paper program. TWE continues to maintain its own $1.5 billion unsecured commercial paper program, although the combined total of the unsecured notes outstanding at any time under these commercial paper programs (the "Notes") may not exceed $3.0 billion. Commercial paper borrowings at TWC Inc. and TWE are supported by the unused committed capacity of the $4.0 billion Cable Facility. TWC Inc. is a guarantor of Notes issued by TWE, and TWE is a guarantor of Notes issued by TWC Inc. In addition, Warner Communications Inc. and American Television and Communications Corporation (each indirect wholly-owned subsidiaries of the Company, but not subsidiaries of TWC Inc. or TWE) have each guaranteed a pro-rata portion of the obligations under the Notes, although there are generally no restrictions on the ability of Warner Communications Inc. and American Television and Communications Corporation to transfer material assets (other than their interests in TWC Inc. or TWE) to parties that are not guarantors. The Notes rank pari passu with TWC Inc.'s and TWE's other unsecured senior indebtedness. As of December 31, 2004, there were approximately $1.523 billion of Notes outstanding under the TWC Inc. and TWE commercial paper programs.

Other Financing Arrangements

From time to time, the Company enters into various other financing arrangements that provide for the accelerated receipt of cash on certain accounts receivable and film backlog licensing contracts. The Company employs these arrangements because they provide a cost-efficient form of financing, as well as an added level of diversification of funding sources. The Company is able to realize cost efficiencies under these arrangements since the assets securing the financing are held by a legally separate, bankruptcy-remote entity and provide direct security for the funding being provided. These arrangements do not contain any rating-based defaults or covenants. For more details, see Note 10 to the accompanying consolidated financial statements.

The following table summarizes the Company's other financing arrangements at December 31, 2004:

	Committed Capacity[a]	Unused Capacity (millions)	Outstanding Utilization
Accounts receivable securitization facilities	$ 805	$ 97	$ 708
Backlog securitization facility[b]	500	52	448
Total other financing arrangements	$1,305	$149	$1,156

[a] Ability to use accounts receivable securitization facilities and backlog securitization facility depends on availability of qualified assets.
[b] The outstanding utilization on the backlog securitization facility is classified as deferred revenue on the accompanying consolidated balance sheet.

Film Sale-Leaseback Arrangements

From time to time the Company has entered into arrangements where certain film assets are sold to third-party investors that generate tax benefits to the investors that are not otherwise available to the Company. The forms of these transactions differ, but it is generally that of a sale-leaseback arrangement with a third-party special purpose entity ("SPE"). Such SPEs are capitalized with approximately $3.7 billion of debt and equity from the third-party investors. The Company does not guarantee and is not otherwise responsible for the equity and debt in these SPEs and does not participate in the profits or losses of these SPEs but does have a performance guarantee to produce such films. Accordingly, the Company does not consolidate these SPEs. Instead, the Company accounts for these arrangements based on their substance. That is, the net benefit paid to the Company from these transactions is recorded as a reduction of film costs. These transactions resulted in reductions of film costs totaling $177 million, $80 million and $60 million for the years ended December 31, 2004, 2003 and 2002, respectively.

Once executed, the sale-leaseback arrangement obligates the Company to deliver a completed film to the SPE. As of December 31, 2004, the Company is obligated (based on current production budgets) to spend approximately $440 million to complete films covered by these arrangements.

Covenants and Rating Triggers

Each of the Company's bank credit agreements, public debt and financing arrangements with SPEs contain customary covenants. A breach of such covenants in the bank credit agreements that continues beyond any grace period constitutes a default, which can limit the Company's ability to borrow and can give rise to a right of the lenders to terminate the applicable facility and/or require immediate payment of any outstanding debt. A breach of such covenants in the public debt beyond any grace period constitutes a default which can require immediate payment of the outstanding debt. A breach of such covenants in the financing arrangements with SPEs that continues beyond any grace period can constitute a termination event, which can limit the facility as a future source of liquidity; however, there would be no claims on the Company for the receivables or backlog contracts previously sold. Additionally, in the event that the Company's credit ratings decrease, the cost of maintaining the bank credit agreements and facilities and of borrowing increases and, conversely, if the ratings improve, such costs decrease. There are no rating-based defaults or covenants in the credit agreements, public debt or financing arrangements with SPEs.

As of December 31, 2004, and through the date of this filing, the Company was in compliance with all covenants. Management does not foresee that the Company will have any difficulty in the foreseeable future complying with the existing covenants.

Contractual and Other Obligations

Contractual Obligations

In addition to the previously discussed financing arrangements, the Company has obligations under certain contractual arrangements to make future payments for goods and services. These contractual obligations secure the future rights to various assets and services to be used in the normal course of operations. For example, the Company is contractually committed to make certain minimum lease payments for the use of property under operating lease agreements. In accordance with applicable accounting rules, the future rights and obligations pertaining to firm commitments, such as operating lease obligations and certain purchase obligations under contracts, are not reflected as assets or liabilities on the accompanying consolidated balance sheet.

The following table summarizes the Company's aggregate contractual obligations at December 31, 2004, and the estimated timing and effect that such obligations are expected to have on the Company's liquidity and cash flow in future periods.

Contractual Obligations[1]	Total	2005	2006-2007	2008-2009	2010 and thereafter
			(millions)		
Outstanding debt obligations (Note 10)	$22,144	$1,557	$3,172	$2,388	$15,027
Capital lease obligations (Note 10)	213	125	75	3	10
Operating lease obligations (Note 18)	4,844	588	1,071	939	2,246
Purchase obligations	9,991	3,973	3,959	1,295	764
Total contractual obligations and outstanding debt	$37,192	$6,243	$8,277	$4,625	$18,047

[1] The table does not include the effects of certain put/call or other buy-out arrangements involving certain of the Company's investees, which are discussed in more detail in the pages that follow.

The following is a description of the Company's material contractual obligations at December 31, 2004:

- Outstanding debt obligations — represents the principal amounts due on outstanding debt obligations, current and long-term, as of December 31, 2004. Amounts do not include any fair value adjustments, bond premiums, discounts or interest payments.

- Capital lease obligations — represents the minimum capital lease payments under noncancelable leases, primarily for network equipment at the AOL segment financed under capital leases.

- Operating lease obligations — represents the minimum lease rental payments under noncancelable leases, primarily for the Company's real estate and operating equipment in various locations around the world.

- Purchase obligations — As it is used herein, a purchase obligation "represents an agreement to purchase goods or services that is enforceable and legally binding on the Company and that specifies all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction." The Company expects to receive consideration (i.e., products or services) for these purchase obligations. The purchase obligation amounts do not represent the entire anticipated purchases in the future, but represent only those items for which the Company is contractually obligated. Additionally, the Company also purchases products and services as needed, with no firm commitment. For this reason, the amounts presented in the table will not provide a reliable indicator of the Company's expected future cash outflows on a stand-alone basis. For purposes of identifying and accumulating purchase obligations, the Company has included all material contracts meeting the definition of a purchase obligation (e.g., legally binding for a fixed or minimum amount or quantity). For those contracts involving a fixed or minimum quantity, but variable pricing, the Company has estimated the contractual obligation based on its best estimate of pricing that will be in effect at the time the obligation is incurred. Additionally, the Company has included only the obligation governed by those contracts that existed at December 31, 2004, and did not assume renewal or replacement of the contract at the end of its term. If a contract includes a penalty for non-renewal, the Company has included that penalty, assuming it will be paid in the period after the contract term expires. If Time Warner can unilaterally terminate an agreement simply by providing a certain number of days notice or by paying a termination fee, the Company has included the amount of the termination fee or the amount that would be paid over the "notice period." Contracts that can be unilaterally terminated without incurring a penalty have not been included. The following table summarizes the

Company's purchase obligations at December 31, 2004, and the estimated timing and effect that such obligations are expected to have on the Company's liquidity and cash flow in future periods:

Purchase Obligations	Total	2005	2006-2007	2008-2009	2010 and thereafter
			(millions)		
Network programming obligations[1]	$4,275	$1,250	$1,754	$ 838	$433
Narrowband and broadband network obligations[2]	988	596	373	3	16
Creative talent and employment agreements[3]	1,890	869	786	223	12
Obligations to purchase paper and to use certain printing facilities for the production of magazines and books	812	323	424	65	—
Obligations to certain investee companies[4]	96	22	74	—	—
Advertising, marketing and sponsorship obligations[5]	466	345	97	24	—
Obligations to purchase information technology licenses and services	504	254	102	62	86
Other, primarily general and administrative obligations[6]	960	314	349	80	217
Total purchase obligations	$9,991	$3,973	$3,959	$1,295	$764

(1) The Networks segment enters into contracts to license sports programming to carry on its television networks. The amounts in the table above represent minimum payment obligations to sports leagues (e.g., NBA, NASCAR and MLB) to air the programming over the contract period. The Networks segment also enters into licensing agreements with certain movie studios to acquire the rights to air movies that the movie studios release theatrically ("Studio Movie Deals"). The pricing structures in these contracts differ in that certain agreements can require a fixed amount per movie while others will be based on a percentage of the movie's box office receipts (with license fees generally capped at specified amounts), or a combination of both. The amounts included herein represent obligations for movies that have been released theatrically as of December 31, 2004 and are calculated using the actual or estimated box office performance or fixed amounts, as applicable.

(2) Narrowband and broadband network obligations relate primarily to minimum purchase commitments that AOL has with various narrowband and broadband network providers.

(3) The Company's commitments under creative talent and employment agreements include obligations to executives, actors, producers, authors, sports personnel and other talent under contractual arrangements, including union contracts.

(4) Obligations to certain investee companies represent obligations to purchase additional interests in a subsidiary of the Publishing segment and fund investees within the AOL and Filmed Entertainment segments.

(5) Advertising, marketing and sponsorship obligations include minimum guaranteed royalty and marketing payments to vendors and content providers, primarily of the AOL and Filmed Entertainment segments.

(6) Other includes obligations to purchase general and administrative items such as legal, security, janitorial, office equipment, support and maintenance services, office supplies, obligations related to the Company's postretirement and unfunded defined benefit pension plans, as well as construction commitments primarily for the Publishing and Filmed Entertainment segments.

Most of the Company's other long-term liabilities reflected on the accompanying consolidated balance sheet have been incorporated in the estimated timing of cash payments provided in the summary of contractual obligations, the most significant of which is an approximate $885 million liability for film licensing obligations. However, certain long-term liabilities have been excluded from the summary because there are no cash outflows associated with them (e.g., deferred revenue and mandatorily convertible preferred stock) or because cash outflows associated with certain other noncurrent liabilities are uncertain (e.g., deferred taxes, minority interests, participations and royalties, deferred compensation and other miscellaneous items). Contractual capital commitments are also included in the preceding table, but these commitments represent a small part of the Company's expected capital spending in 2005 and beyond. Additionally, minimum pension funding requirements have not been presented, as such amounts have not been determined beyond 2005. The

Company does not have a required minimum pension contribution obligation for its defined benefit pension plans in 2005.

Other Contractual Obligations

In addition to the contractual obligations previously discussed, certain other contractual commitments of the Company entail variable or undeterminable quantities and/or prices and, thus, do not meet the definition of a purchase obligation. As certain of these commitments are significant to our business, the Company has summarized these arrangements below. Given the variability in the terms of these arrangements, significant estimates were involved in the determination of these obligations. Actual amounts, once known, could differ significantly from these estimates.

Other Contractual Commitments	Total	2005	2006-2007	2008-2009	2010 and thereafter
			(millions)		
Cable and Network programming and DVD manufacturing obligations	$16,589	$3,226	$5,786	$4,570	$3,007

The Company's other contractual commitments at December 31, 2004 primarily consist of Cable programming arrangements, future film licensing obligations and DVD manufacturing obligations. Cable programming arrangements represent contracts that the Company's Cable segment has with cable television networks to provide programming service to its subscribers. Typically, these arrangements provide that the Company purchase cable television programming for a certain number of subscribers provided that the Company is providing cable services to such number of subscribers. There is generally no obligation to purchase these services if the Company is not providing cable services. The obligation included in the above table represents estimates of future cable programming costs based on subscriber levels at December 31, 2004, and current contractual per subscriber rates. Network programming obligations represent Studio Movie Deal commitments to acquire the right to air movies that will be released in the future (i.e., after December 31, 2004). These arrangements do not meet the definition of a purchase obligation since there are neither fixed nor minimum quantities under the arrangement. The amounts included herein have been estimated giving consideration to historical box office performance and studio release trends. DVD manufacturing obligations relate to a six-year agreement at the Filmed Entertainment segment with a third-party manufacturer to purchase the Company's DVD requirements. This arrangement does not meet the definition of a purchase obligation since there are neither fixed nor minimum quantities under the arrangement. Amounts were estimated using current DVD manufacturing volumes and pricing per manufactured DVD for each year of the agreement.

The Company expects to fund its operating commitments and obligations with cash flow from operations generated in the normal course of business.

Contingent Commitments

The Company also has certain contractual arrangements that would require the Company to make payments or provide funding if certain circumstances occur ("contingent commitments"). For example, the Company has guaranteed certain lease obligations of joint-venture investees. In this circumstance, the Company would be required to make payments due under the lease to the lessor in the event of default by the joint-venture investee. The Company does not expect that these contingent commitments will result in any material amounts being paid by the Company in the foreseeable future.

The following table summarizes separately the Company's contingent commitments at December 31, 2004. The table identifies when the maximum contingent commitments will expire and does not mean that the Company expects to incur an obligation to make any payments during that timeframe.

Nature of Contingent Commitments	Total	2005	2006-2007	2008-2009	2010 and thereafter
			(millions)		
Guarantees	$2,327	$ 95	$185	$204	$1,843
Letters of credit and other contingent commitments	531	394	6	1	130
Total contingent commitments	$2,858	$489	$191	$205	$1,973

The following is a description of the Company's contingent commitments at December 31, 2004:

- Guarantees include guarantees the Company has provided on certain lease and operating commitments entered into by (a) entities formerly owned by the Company, as described below, and (b) joint ventures in which the Company is or was a venture partner.

  In connection with the Company's former investment in the Six Flags theme parks located in Georgia and Texas ("Six Flags Georgia" and "Six Flags Texas," respectively, and collectively, the "Parks"), the Company agreed to guarantee (the "Six Flags Guarantee") certain obligations relating to the partnerships that hold the Parks (the "Partnerships"). The Six Flags Guarantee principally covers the following obligations (the "Guaranteed Obligations"): (a) the obligation to make a minimum amount of annual distributions to the limited partners of the Partnerships; (b) the obligation to make a minimum amount of capital expenditures each year; (c) the requirement that an annual offer to purchase be made in respect of 5% of the limited partnership units of the Partnerships (plus any such units not purchased in any prior year) based on an aggregate price for all limited partnership units at the higher of (i) $250 million in the case of Six Flags Georgia or $374.8 million in the case of Six Flags Texas and (ii) a multiple of EBITDA and (d) either (i) the purchase of all of the outstanding limited partnership units upon the earlier of the occurrence of certain specified events or the end of the term of each of the Partnerships in 2027 (Six Flags Georgia) and 2028 (Six Flags Texas) (the "End of Term Purchase") or (ii) the obligation to cause each of the Partnerships to have no indebtedness and to meet certain other financial tests as of the end of the term of the Partnership. The aggregate purchase price in respect of all of the limited partnership units for the End of Term Purchase is equal to $250 million in the case of Six Flags Georgia and $374.8 million in the case of Six Flags Texas (in each case, subject to a consumer price index based adjustment calculated annually from 1998 in respect of Six Flags Georgia and 1999 in respect of Six Flags Texas). Such aggregate amount will be reduced in respect of limited partnership units previously purchased.

  In connection with the 1998 sale of Six Flags Entertainment Corporation to Premier Parks Inc. ("Premier"), Premier and the Company, among others, entered into a Subordinated Indemnity Agreement pursuant to which Premier agreed to guarantee the performance of the Guaranteed Obligations when due and to indemnify the Company, among others, in the event that the Guaranteed Obligations are not performed and the Six Flags Guarantee is called upon. Premier's obligations to the Company are secured by its interest in all limited partnership units that are purchased by Premier.

  To date, no payments have been made by the Company pursuant to the Six Flags Guarantee.

- Generally, letters of credit and surety bonds support performance and payments for a wide range of global contingent and firm obligations including insurance, litigation appeals, import of finished goods, real estate leases, cable installations and other operational needs. The Cable segment has obtained letters of credit for several of its joint ventures. Should these joint ventures default on their obligations supported by the letters of credit, the Cable segment would be obligated to pay these costs to the extent of the letters of credit.

Except as otherwise discussed above and below, Time Warner does not guarantee the debt of any its investments accounted for using the equity method of accounting.

Selected Investment Information

Cable Joint Ventures

On May 1, 2004, the Company completed the restructuring of two joint ventures that it manages, Kansas City Cable Partners ("KCCP"), previously a 50-50 joint venture between Comcast and TWE serving approximately 295,000 basic video subscribers as of December 31, 2004, and Texas Cable Partners, L.P. ("TCP"), previously a 50-50 joint venture between Comcast and the TWE-Advance/Newhouse Partnership ("TWE-A/N") serving approximately 1.224 million basic video subscribers as of December 31, 2004. Prior to the restructuring, the Company accounted for its investment in these joint ventures using the equity method. Under the restructuring, KCCP was merged into TCP, which was renamed "Texas and Kansas City Cable Partners, L.P." Following the restructuring, the combined partnership was owned 50% by Comcast and 50% collectively by TWE and TWE-A/N. Since the net assets of the combined partnership were owned 50% by Time Warner Cable and 50% by Comcast both before and after the restructuring and there were no changes in the rights or economic interests of either party, the Company viewed the transaction as a non-substantive reorganization to be accounted for at book value, similar to the transfer of assets under common control. In February 2005, TWE's interest in the combined partnership was contributed to TWE-A/N in exchange for preferred equity in TWE-A/N. TWC Inc. continues to account for its investment in the restructured joint venture using the equity method. Beginning any time after June 1, 2006, either TWC Inc. or Comcast can trigger a dissolution of the partnership. If a dissolution is triggered, the non-triggering party has the right to choose and take full ownership of one of two pools of the combined partnership's systems — one pool consisting of the Houston systems and the other consisting of the Kansas City and southwest Texas systems — with an arrangement to distribute the partnership's debt between the two pools. The party triggering the dissolution would own the remaining pool of systems and any debt associated with that pool.

In 2004, TWE-A/N (which owns the Company's equity stake in Texas and Kansas City Cable Partners, L.P.) agreed to extend its commitment to provide a ratable share (i.e., 50%) of any funding required to maintain certain Texas systems (i.e., Houston and southwest Texas systems) in compliance with their financial covenants under the bank credit facilities (which facilities are otherwise nonrecourse to the Company, its other subsidiaries or to the Kansas City systems). Funding made with respect to this funding agreement is contributed to the Texas systems in the form of partner subordinated loans. The aggregate amount of subordinated debt provided by TWE-A/N in 2004 with respect to its obligations under the funding agreement was $33 million. TWE-A/N's ultimate liability in respect of the funding agreement is dependent upon the financial results of the Texas systems.

The existing bank credit facilities of the Texas systems and the Kansas City systems (approximately $805 million in aggregate principal outstanding as of December 31, 2004 for the Texas systems and $400 million in aggregate principal outstanding as of December 31, 2004 for the Kansas City systems) mature at the earlier of June 30, 2007, for the Texas systems and March 31, 2007 for the Kansas City systems or the refinancing thereof pursuant to the dissolution of the partnership.

As previously discussed under "Other Recent Developments," 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. TWC Inc. is continuing to work with the local franchise authority to gain approval of its purchase of Urban Cable and management is currently unable to predict the timing of such approval. For the year ended December 31, 2004, Urban Cable's revenues and Operating Income were approximately $47 million and $3 million, respectively.

Court TV Joint Venture

The Company and Liberty Media ("Liberty") each have a 50% interest in Court TV. Beginning January 2006, Liberty may give written notice to Time Warner requiring Time Warner to purchase all of Liberty's interest in Court TV (the "Liberty Put"). In addition, as of the same date, Time Warner may, by notice to Liberty, require Liberty to sell all of its interest in Court TV to Time Warner (the "Time Warner Call"). The price to be paid upon exercise of either the Liberty Put or the Time Warner Call will be an amount equal to one-half of the fair market value of Court TV, determined by an appraisal. The consideration is required to be paid in cash if the Liberty Put is exercised. If the Time Warner Call is exercised, the consideration is also payable in cash only if Liberty determines that the transaction cannot be structured as a tax efficient transaction, or if Time Warner determines that a tax efficient transaction may either violate applicable law or cause a breach or default under any other agreement affecting Time Warner. For the year ended December 31, 2004, Court TV's Operating Income was approximately $36 million.

Bookspan Joint Venture

The Company and Bertelsmann each have a 50% interest in the Bookspan joint venture, which operates the U.S. book clubs of Book-of-the-Month Club, Inc., and Doubleday Direct, Inc. Under the General Partnership Agreement, beginning on June 30, 2005, and then on January 1 of each subsequent year, either Bertelsmann or the Company may elect to terminate the partnership by giving notice during 60-day termination periods. If such an election is made, a confidential bid process will take place, pursuant to which the highest bidder will purchase the other party's entire venture interest. The Company is unable to predict whether this bid process will occur or the amount that may be paid out or received under it. For the year ended December 31, 2004, the Bookspan joint venture had Operating Income of approximately $26 million.

Backlog

Backlog represents the amount of future revenue not yet recorded from cash contracts for the licensing of theatrical and television product for pay cable, basic cable, network and syndicated television exhibition. Backlog was approximately $3.7 billion and $3.9 billion at December 31, 2004 and December 31, 2003, respectively. Included in these amounts is licensing of film product from the Filmed Entertainment segment to the Networks segment of $514 million and $740 million at December 31, 2004 and December 31, 2003, respectively.

Because backlog generally relates to contracts for the licensing of theatrical and television product which have already been produced, the recognition of revenue for such completed product is principally dependent upon the commencement of the availability period for telecast under the terms of the related licensing agreement. Cash licensing fees are collected periodically over the term of the related licensing agreements or, as referenced above and discussed in more detail in Note 10 to the accompanying consolidated financial statements, on an accelerated basis using a $500 million securitization facility. The portion of backlog for which cash has not already been received has significant value as a source of future funding. Of the approximately $3.7 billion of backlog relating to the Filmed Entertainment segment as of December 31, 2004, Time Warner has recorded $437 million of deferred revenue on the accompanying consolidated balance sheet, representing cash received through the utilization of the backlog securitization facility. The backlog excludes filmed entertainment advertising barter contracts, which are also expected to result in the future realization of revenues and cash through the sale of advertising spots received under such contracts.

MARKET RISK MANAGEMENT

Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest rates, foreign currency exchange rates and changes in the market value of financial instruments.

Interest Rate Risk

Time Warner has issued variable-rate debt that, at December 31, 2004, had an outstanding balance of $1.523 billion. Based on Time Warner's variable-rate obligations outstanding at December 31, 2004, each 25 basis point increase or decrease in the level of interest rates would, respectively, increase or decrease Time Warner's annual interest expense and related cash payments by approximately $4 million. Such potential increases or decreases are based on certain simplifying assumptions, including a constant level of variable-rate debt for all maturities and an immediate, across-the-board increase or decrease in the level of interest rates with no other subsequent changes for the remainder of the period. Conversely, since almost all of the Company's cash balance of approximately $6.139 billion is invested in variable-rate interest earning assets, the Company would also earn more (less) interest income due to such an increase (decrease) in interest rates.

Time Warner has entered into fixed-rate debt that, at December 31, 2004, had an outstanding balance of $20.393 billion and a fair value of $23.400 billion. Based on Time Warner's fixed-rate debt obligations outstanding at December 31, 2004, a 25 basis point increase or decrease in the level of interest rates would, respectively, decrease or increase the fair value of the fixed-rate debt by approximately $449 million. Such potential increases or decreases are based on certain simplifying assumptions, including a constant level and rate of fixed-rate debt and an immediate across-the-board increase or decrease in the level of interest rates with no other subsequent changes for the remainder of the period.

From time to time, the Company uses interest rate swaps to hedge the fair value of its fixed-rate obligations. Under the interest rate swap contract, the Company agrees to receive a fixed-rate payment (in most cases equal to the stated coupon rate of the bond being hedged) for a floating-rate payment. The net payment on the swap is exchanged at a specified interval that usually coincides with the bonds underlying coupon payment on the agreed upon notional amount.

At December 31, 2004, interest rate swaps with a notional amount of $200 million were outstanding. These swaps mature in June 2005 and are designated as hedging the fair value of certain of the Company's fixed-rate debt. The swaps effectively convert the fixed-rate debt to variable-rate instruments indexed to LIBOR. These swaps have been designated as a fair value hedge of the changes in fair value of the Company's fixed-rate debt, attributable to changes in benchmark interest rates. As key terms of the swap match the debt they are intended to hedge, changes in the fair value of the swap are substantially offset in the consolidated statement of operations by changes in the fair value of the hedged item. The fair value of these swaps at December 31, 2004 was not material.

The Company monitors its positions with, and the credit quality of, the financial institutions, which are party to any of its financial transactions. Credit risk related to interest rate swaps is considered low because swaps are entered into with strong, creditworthy counterparties and are limited to the net interest payments receivable, if any, for the remaining life of the swap.

Foreign Currency Risk

Time Warner uses foreign exchange contracts primarily to hedge the risk that unremitted or future royalties and license fees owed to Time Warner domestic companies for the sale or anticipated sale of U.S. copyrighted products abroad may be adversely affected by changes in foreign currency exchange rates. Similarly, the Company enters into foreign exchange contracts to hedge certain film production costs abroad as well as other transactions, assets and liabilities denominated in a foreign currency. As part of its overall strategy to manage the level of exposure to the risk of foreign currency exchange rate fluctuations, primarily exposure to changes in the value of the British pound and the Euro. Time Warner hedges a portion of its foreign currency exposures anticipated over an eighteen-month period beginning in January of each year (the "hedging period"). The hedging period for royalties and license fees covers revenues expected to be recognized over the ensuing fiscal year; however, there is often a lag between the time that revenue is recognized and the transfer of foreign denominated cash revenues back into U.S. dollars. Therefore, the hedging period covers an eighteen-month period. To hedge this exposure, Time Warner uses foreign exchange contracts that generally have maturities of three months to eighteen months providing continuing coverage throughout the hedging period. At December 31, 2004, Time Warner had effectively hedged approximately 70% of the estimated net foreign currency exposures that relate principally to anticipated cash flows for royalties and license fees to be remitted to the U.S. over the ensuing hedging period.

At December 31, 2004, Time Warner had contracts for the sale of $3.375 billion and the purchase of $1.714 billion of foreign currencies at fixed rates, including net contracts for the sale of $496 million of the British pound and $825 million of the Euro. At December 31, 2003, Time Warner had contracts for the sale of $3.544 billion and the purchase of $1.934 billion of foreign currencies at fixed rates, including net contracts for the sale of $692 million of the British pound and $633 million of the Euro.

Based on the foreign exchange contracts outstanding at December 31, 2004, each 10% devaluation of the U.S. dollar as compared to the level of foreign exchange rates for currencies under contract at December 31, 2004 would result in approximately $166 million of net unrealized losses. Conversely, a 10% appreciation of the U.S. dollar would result in approximately $166 million of net unrealized gains. For a hedge of forecasted royalty or license fees denominated in a foreign currency, consistent with the nature of the economic hedge provided by such foreign exchange contracts, such unrealized gains or losses largely would be offset by corresponding decreases or increases, respectively, in the dollar value of future foreign currency royalty and license fee payments that would be received in cash within the hedging period from the sale of U.S. copyrighted products abroad.

Equity Risk

The Company is exposed to market risk as it relates to changes in the market value of its investments, including the investment in Google. The Company invests in equity instruments of public and private companies for operational and strategic business purposes. These securities are subject to significant fluctuations in fair market value due to volatility of the stock market and the industries in which the companies operate. These securities, which are classified in Investments, including available-for-sale securities on the accompanying consolidated balance sheet, include equity-method investments, investments in private securities, available-for-sale securities, restricted securities and equity derivative instruments. As of December 31, 2004, the Company had $121 million of cost-method investments, primarily relating to private equity securities, $1.958 billion of fair value investments, including $1.866 billion of investments in unrestricted public equity securities held for purposes other than trading and $92 million of equity derivative instruments (including the Company's option in WMG) and $2.624 billion of investments accounted for using the equity method of accounting.

Included in the $1.866 billion of investments in unrestricted public equity securities held for purposes other than trading is the Company's investment in Google, which has a fair value of approximately $980 million based on the December 31, 2004 market value of Google stock of $192.79 per share. A 10% appreciation in the stock price of Google would result in an increase in the Company's unrealized gain on this investment of approximately $59 million, net of tax. Conversely, a 10% depreciation in the stock price of Google would result in a decrease in the Company's unrealized gain on this investment of approximately $59 million, net of tax. As of February 28, 2005, Google stock closed at $187.99 per share, which decreased the fair value of the Company's investment to approximately $955 million.

The value of the WMG option is subject to fluctuations based upon the equity value of the Warner Music Group. A 10% increase or decrease in the equity value of the Warner Music Group would have a $6 million impact on the value of the option. The Warner Music Group is in a transition phase as it continues to restructure its operations. Accordingly, the value of the WMG option may change significantly, depending on the success of this restructuring and the general conditions in the music industry.

As a result of declines in the value of certain investments, the Company has recorded noncash pretax charges of $29 million in 2004, $204 million in 2003 and $2.199 billion in 2002. These charges were primarily to reduce the carrying value of certain publicly traded and privately held investments, restricted securities and investments accounted for using the equity method of accounting that had experienced other-than-temporary declines in value. In addition, these charges reflect market fluctuations in equity derivative instruments, which resulted in losses of $14 million in 2004, gains of $8 million in 2003 and gains of $13 million in 2002 (Note 7). While Time Warner has recognized all declines that are believed to be other-than-temporary, it is reasonably possible that individual investments in the Company's portfolio may experience an other-than-temporary decline in value in the future if the underlying investee company experiences poor operating results or if the U.S. equity markets experience future broad declines in value. See Note 7 to the accompanying consolidated financial statements for additional discussion.

CRITICAL ACCOUNTING POLICIES

The SEC considers an accounting policy to be critical if it is important to the Company's financial condition and results, and if it requires significant judgment and estimates on the part of management in its application. The development and selection of these critical accounting policies have been determined by the management of Time Warner and the related disclosures have been reviewed with the Audit and Finance Committee of the Board of Directors. For a summary of all of the Company's significant accounting policies, see Note 1 to the accompanying consolidated financial statements.

Revenue Recognition

Revenue recognition areas that incorporate significant judgment and estimates by management include the accounting for multiple-element transactions and gross versus net revenue recognition. See Note 1 for additional discussion.

Multiple-Element Transactions

Multiple-element transactions within Time Warner fall broadly into two categories:

1. Contemporaneous purchases and sales. The Company sells a product or service (e.g., advertising services) to a customer and at the same time purchases goods or services and/or makes an investment in that customer.

2. Sales of multiple products or services. The Company sells multiple products or services to a counterparty.

Contemporaneous Purchases and Sales

In the normal course of business, Time Warner enters into transactions in which it purchases a product or service and/or makes an investment in a customer and at the same time negotiates a contract for the sale of advertising, or other product, to the customer. Contemporaneous transactions may also involve circumstances where the Company is purchasing or selling goods and services and settling a Company dispute. For example, the AOL segment may have negotiated for the sale of advertising at the same time it purchased goods or services and/or made an investment in a counterparty. Similarly, when negotiating programming arrangements with cable networks, the Company's Cable segment may negotiate for the sale of advertising to the cable network.

Arrangements, although negotiated contemporaneously, may be documented in one or more contracts. In accounting for such arrangements, the Company looks to the guidance contained in the following authoritative literature:

- APB Opinion No. 29, "Accounting for Nonmonetary Transactions" ("APB 29");
- FASB Statement 153, "Exchanges of Nonmonetary Assets — an amendment of APB Opinion No. 29" ("FAS 153");
- Emerging Issues Task Force ("EITF") Issue No. 01-09, "Accounting for Consideration Given by a Vendor to a Customer" ("EITF 01-09"); and
- EITF Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor" ("EITF 02-16").

The Company accounts for each transaction negotiated contemporaneously based on the respective fair values of the goods or services purchased and the goods or services sold. If the Company is unable to determine the fair value of one or more of the elements being purchased, revenue recognition is limited to the total consideration received for the products or services sold less supported payments. For example, if the Company sells advertising to a customer for $10 million in cash and contemporaneously enters into an arrangement to acquire software for $2 million from the same customer; however, fair value for the software cannot be reliably determined, the Company would limit the recognized advertising revenue to $8 million and would ascribe no value to the software acquisition. As another example, if the Company sells advertising to a customer for $10 million in cash and contemporaneously invests $2 million in the equity of that same customer at fair value, the Company would recognize advertising revenue of $10 million and would ascribe $2 million to the equity investment. Accordingly, the judgments made in determining fair value in such arrangements impacts the amount and period in which revenues, expenses and net income are recognized over the term of the contract.

In determining the fair value of the respective elements, the Company refers to quoted market prices (where available), historical transactions or comparable cash transactions. In addition, the existence of price protection in the form of "most favored nation" clauses or similar contractual provisions are generally indicative that the stated terms of a transaction are at fair value.

Further, in a contemporaneous purchase and sale transaction, evidence of fair value for one element of a transaction may provide support for the fair value of the other element of a transaction. For example, if the Company sells advertising to a customer and contemporaneously invests in the equity of that same customer, evidence of the fair value of the investment may implicitly support the fair value of the advertising sold, since there are only two elements in the arrangement.

During 2004, the Company encountered judgments in the following contemporaneous transactions:

- **Sale of Winter Sports Teams.** Contemporaneous with the announced sale of the winter sports teams, the Company entered into an agreement with the buyer whereby its cable network operations would license the right to telecast the winter sports teams' games over a six-year period. In accounting for the sale, the Company has recorded a one-time loss in Operating Income based on the proceeds received. In contrast, the costs incurred under the licensing agreement will be recorded as an expense in Operating Income over the life of the licensing agreement. The key judgment is ensuring that both the sale arrangement and the licensing agreement are at fair value terms.

- **Sale of Investment in Gateway.** Contemporaneous with a sale of its interest in Gateway securities to Gateway, the Company received (1) cash and (2) the right to use a portion of the sale proceeds to offset amounts due to Gateway related to existing customer acquisition agreements between the parties. Additionally, the Company and Gateway agreed to settle an existing commercial dispute resulting in the Company paying Gateway approximately $3 million for the settlement. In accounting for the sale of the investment, the Company has recorded a one-time gain in Other income (expense), net (below Operating Income). In contrast, the one-time amount paid in settlement of the commercial dispute was recorded as expense in Operating Income. The key judgment in this transaction is ensuring that both the sale of securities and the settlement of the commercial dispute are at fair value terms.

- **Urban Cable Works of Philadelphia, L.P.** Contemporaneous with the Company's settlement of certain disputes with Inner City regarding the Urban Cable joint venture for $34 million, the Company also agreed to purchase, subject to the receipt of applicable regulatory approvals, all of Inner City's interests in the venture for approximately $53 million in cash. In accounting for the settlement of the disputes, the Company has recorded a one-time loss in Operating Income. In contrast, the amount paid to purchase Inner City's interest in Urban Cable will be recorded primarily as goodwill and franchise intangible assets, which will be subject to the Company's annual test for impairment. The key judgment is ensuring that both the settlement of the disputes and the purchase of Inner City's interest are at fair value terms.

- **Adelphia Communications Corporation Settlement.** Contemporaneous with the Company's settlement of pre-petition bankruptcy claims (e.g., accounts receivable) with Adelphia, the Company renewed its programming agreement with Adelphia. In accounting for the settlement of the pre-petition bankruptcy claims, the cash received is treated as a reduction of the related accounts receivable on the consolidated balance sheet. In contrast, the programming agreement will be recorded as an expense in Operating Income over the life of the agreement. The key judgment is ensuring that the settlement of pre-petition bankruptcy claims and the rates payable to the Company as part of the programming agreement are at fair value terms.

- **Comcast Tolling and Optional Redemption Agreement.** The Company's TWC Inc. subsidiary granted to Comcast an option, which originally could be exercised between December 1, 2004 and April 1, 2005, to redeem a portion of TWC Inc. stock held by Comcast in exchange for cable systems and cash. In exchange, Comcast agreed not to pursue registration rights with respect to the TWC Inc. stock owned by it until April 1, 2005. The key judgment is ensuring that the option granted by the Company to Comcast and Comcast's agreement to defer pursuing its registration rights on the TWC Inc. stock it currently holds are at fair value terms.

In each of these transactions, based on a thorough review of fair value evidence, the Company concluded that the stated terms of each transaction represented fair value and, accordingly, the Company accounted for each contract separately, based on its stated terms.

Sales of Multiple Products or Services

The Company's policy for revenue recognition in instances where multiple deliverables are sold contemporaneously to the same counterparty is in accordance with EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" and SEC Staff Accounting Bulletin No. 104, "Revenue Recognition." Specifically, if the Company enters into sales contracts for the sale of multiple products or services, then the Company evaluates whether it has objective fair value evidence for each deliverable in the transaction. If the Company has objective fair value evidence for each deliverable of the transaction, then it accounts for each deliverable in the transaction separately, based on the relevant revenue recognition accounting policies. However, if the Company is unable to determine objective fair value for one or more undelivered elements of the transaction, the Company generally recognizes Advertising revenue on a straight-line basis over the term of the agreement. For example, the AOL division might enter into an agreement for broadband service that includes AOL providing a modem in connection with the service and the subscriber paying an upfront fee as well as monthly charges. Because AOL is providing both a product and a service, revenue is allocated to the modem and service based on relative fair value.

Gross versus Net Revenue Recognition

In the normal course of business, the Company acts as or uses an intermediary or agent in executing transactions with third parties. The accounting issue encountered in these arrangements is whether the Company should report revenue based on the gross amount billed to the ultimate customer or on the net amount received from the customer after commissions and other payments to third parties. To the extent revenues are recorded on a gross basis, any commissions or other payments to third parties are recorded as expenses so that the net amount (gross revenues less expenses) is reflected in Operating Income. Accordingly, the impact on Operating Income is the same whether the Company records the revenue on a gross or net basis. For example, if the Company's Filmed Entertainment segment distributes a film to a theater for $15 and remits $10 to the independent production company, representing their share of proceeds, the Company must determine if the Filmed Entertainment segment should record gross revenue from the theater of $15 and $10 of expenses or if they should record as revenue the net amount recognized of $5. In either case, the impact on Operating Income is $5.

Determining whether revenue should be reported as gross or net is based on an assessment of whether the Company is acting as the principal or acting as an agent in the transaction. To the extent that the Company is acting as a principal in a transaction, the Company reports revenue on a gross basis. To the extent that the Company is acting as an agent in a transaction, the Company reports revenue on a net basis. The determination of whether the Company is acting as a principal or an agent in a transaction involves judgment and is based on an evaluation of the terms of an arrangement.

In determining whether the Company serves as principal or agent, the Company follows the guidance in EITF 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent" ("EITF 99-19"). Pursuant to such guidance, the Company serves as the principal in transactions in which it has substantial risks and rewards of ownership.

Specifically, the Company has the following examples of arrangements where it is an intermediary or uses an intermediary:

- **The Filmed Entertainment segment distributes films on behalf of independent film producers.** The Filmed Entertainment segment may provide motion picture distribution services for an independent production company in the worldwide theatrical, home video and television markets. The arrangement may cover multiple films that the independent film company has produced and owns the underlying copyright thereto. In addition, the independent film company may work collaboratively with the Filmed Entertainment segment regarding the distribution, marketing, advertising and publicity of each film in all media, including the timing and extent of the theatrical releases, the pricing and packaging of home video units and the approval of all television licenses. The Filmed Entertainment segment records revenue generated in such arrangements on a gross basis if it is the primary obligor and on a net basis if it is acting as an agent. The Filmed Entertainment segment is the merchant of record for the licensing arrangements, is the licensor/contracting party, provides the film materials to licensees and handles the billing and collection of all amounts due under such arrangements.

- **The Publishing segment utilizes subscription agents to generate magazine subscriptions.** The Publishing segment may generate magazine subscriptions by utilizing subscription agents. Typically, the agent secures subscriptions in exchange for a percentage of the subscription price. The Publishing segment has recorded subscription revenue generated by the agent net of any fees paid to the agent because the subscription agent has the primary contact with the customer, performs all of the billing and collection activities and passes the net proceeds from the subscription to the Publishing segment after removing the agent's commission.

- **The AOL segment sells advertising on behalf of third parties.** AOL may sell advertising to be displayed on a public website (outside of the AOL service) on behalf of a third party. Generally, AOL records revenue generated from such sales on a gross basis because AOL is responsible for identifying and contracting with third-party advertisers, establishing the selling price of the inventory, delivering the advertisements at AOL's cost and expense, performing all billing and collection activities and bearing sole liability for fulfillment of advertising.
- **The Cable segment bills for reimbursement of taxes paid to franchising authorities.** Included in the monthly bill to the Cable segment's customer is a line item identifying the reimbursement of taxes being paid by the cable company to the franchising authorities. The Cable segment includes in its determination of revenues the amounts received from the customer representing a reimbursement of franchise taxes paid by the cable company to the franchising authorities because the Cable segment is considered to be the primary obligor with respect to the customer purchasing the service and is assuming the credit risk (i.e., the Cable segment would still be required to remit the tax if the customer does not pay).

Asset Impairments

Investments

The Company's investments consist of fair value investments, including available-for-sale securities, investments accounted for using the cost method of accounting and investments accounted for using the equity method of accounting. See Note 7 for additional discussion. A judgmental aspect of accounting for investments involves determining whether an other-than-temporary decline in value of the investment has been sustained. If it has been determined that an investment has sustained an other-than-temporary decline in its value, the investment is written down to its fair value, by a charge to earnings. Such an evaluation is dependent on the specific facts and circumstances. Factors that are considered by the Company in determining whether an other-than-temporary decline in value has occurred include: the market value of the security in relation to its cost basis, the financial condition of the investee and the intent and ability to retain the investment for a sufficient period of time to allow for recovery in the market value of the investment.

In evaluating the factors above for available-for-sale securities, management presumes a decline in value to be other-than-temporary if the quoted market price of the security is 20% or more below the investment's cost basis for a period of six months or more (the "20% criterion") or the quoted market price of the security is 50% or more below the security's cost basis at any quarter end (the "50% criterion"). However, the presumption of an other-than-temporary decline in these instances may be overcome if there is persuasive evidence indicating that the decline is temporary in nature (e.g., strong operating performance of investee, historical volatility of investee, etc.). Additionally, there may be instances in which impairment losses are recognized even if the 20% and 50% criteria are not satisfied (e.g., there is a plan to sell the security in the near term and the fair value is below the Company's cost basis).

For investments accounted for using the cost or equity method of accounting, management evaluates information (e.g., budgets, business plans, financial statements, etc.) in addition to quoted market prices, if any, in determining whether an other-than-temporary decline in value exists. Factors indicative of an other-than-temporary decline include recurring operating losses, credit defaults and subsequent rounds of financing at an amount below the cost basis of the investment. This list is not exhaustive, and management weighs all known quantitative and qualitative factors in determining if an other-than-temporary decline in the value of an investment has occurred.

While Time Warner has recognized all declines that are believed to be other-than-temporary, it is reasonably possible that individual investments in the Company's portfolio may experience an other-than-temporary decline in value in the future if the underlying investee company experiences poor operating results or if the U.S. equity markets experience future broad declines in value. As of December 31, 2004 and 2003, the Company had no significant investments for which the fair value of the investment was below its carrying value.

Goodwill and Other Indefinite-Lived Intangible Assets

Goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is to identify a potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. The estimates of fair value of a reporting unit, generally the Company's operating segments, are determined using various valuation techniques, with the primary technique being a discounted cash flow analysis. A discounted cash flow analysis requires one to make various judgmental assumptions including assumptions about future cash flows, growth rates and discount rates. The assumptions about future cash flows and growth rates are based on the Company's budget and business plans. Discount rate assumptions are based on an assessment of the risk inherent in the respective reporting units. In estimating the fair values of its reporting units, the Company also used analyst estimates, as well as comparable market analyses. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not deemed impaired and the second step of the impairment test is not performed. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit.

The impairment test for other intangible assets not subject to amortization consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. The estimates of fair value of intangible assets not subject to amortization are determined using various discounted cash flow valuation methodologies. The most common among these is a "relief from royalty" methodology, which is used in estimating the fair value of the Company's brands and trademarks, and income methodologies, which are used to value cable and sports franchises. Market and income-based methodologies were used to value sports franchises. Significant assumptions inherent in the methodologies employed include estimates of royalty rates and discount rates. Discount rate assumptions are based on an assessment of the risk inherent in the respective intangible assets. Assumptions about royalty rates are based on the rates at which similar brands and trademarks are being licensed in the marketplace.

The Company's annual impairment analysis, which was performed during the fourth quarter, did not result in an impairment charge for 2004. In order to evaluate the sensitivity of the fair value calculations of the Company's reporting units on the impairment calculation, the Company applied a hypothetical 10% decrease to the fair values of each reporting unit. This hypothetical decrease would not result in the impairment of goodwill at any reporting unit. A hypothetical 10% decrease to the fair values of indefinite-lived intangible assets would result in an impairment of indefinite-lived intangible assets at Cable ($412 million, franchises) and Time Warner Book Group, a business included in the Publishing segment ($5 million, trademarks).

Accounting for Pension Plans

Time Warner and certain of its subsidiaries have defined benefit pension plans covering a majority of domestic employees and, to a lesser extent, international employees. Pension benefits are based on formulas that reflect the employees' years of service and compensation during their employment period and participation in the plans. The Company recognized domestic pension expense of $156 million in 2004, $202 million in 2003 and $94 million in 2002. The pension expense recognized by the Company is determined using certain assumptions, including the discount rate, the expected long-term rate of return on plan assets and the rate of compensation increases. See Notes 1 and 15 for additional discussion. The determination of assumptions for domestic pension plans is discussed in more detail below.

The Company used a discount rate of 6.25% to compute 2004 pension expense. The discount rate was determined by reference to the Moody's Aa Corporate Bond Index, adjusted for coupon frequency and duration of obligation. A decrease in the discount rate of 25 basis points, from 6.25% to 6.00%, while holding all other assumptions constant, would have resulted in an increase in the Company's domestic pension expense of approximately $18 million in 2004.

The Company's expected long-term rate of return on plan assets used to compute 2004 pension expense was 8%. In developing the expected long-term rate of return, the Company considered the pension portfolio's past average rate of earnings, portfolio composition and discussions with portfolio managers. The expected long-term rate of return is based on an asset allocation assumption of 75% equities and 25% fixed-income securities, which approximated the actual allocation as of December 31, 2004. A decrease in the expected long-term rate of return of 25 basis points, from 8.00% to 7.75%, while holding all other assumptions constant, would have resulted in an increase in the Company's domestic pension expense of approximately $5 million in 2004.

The Company used an estimated rate of future compensation increases of 4.5% to compute 2004 pension expense. An increase in the rate of 25 basis points while holding all other assumptions constant would have resulted in an increase in the Company's domestic pension expense of approximately $4 million in 2004.

Filmed Entertainment Revenues and Costs

The Company accounts for film and television production costs, as well as related revenues ("film accounting"), in accordance with the guidance in Statement of Position ("SOP") 00-2, "Accounting by Producers or Distributors of Films" ("SOP 00-2"). See Note 1 for additional discussion. An aspect of film accounting that requires the exercise of judgment relates to the process of estimating the total revenues to be received throughout a film's life cycle. Such estimate of a film's "ultimate revenue" is important for two reasons. First, for completed films and while a film is being produced and the related costs are being capitalized, it is necessary for management to estimate the ultimate revenues, less additional costs to be incurred, including exploitation costs, in order to determine whether the carrying value of a film is impaired and thus requires an immediate write-off of unrecoverable film costs. Second, the amount of capitalized film costs recognized as cost of revenues for a given film as it is exhibited in various markets, throughout its life cycle, is based upon the proportion of the film's revenues recognized for such period to the film's estimated ultimate total revenues. Similarly, the recognition of participations and residuals is based upon the proportion of the film's revenues recognized for such period to the film's estimated ultimate total revenues.

Management bases its estimates of ultimate revenue for each film on the historical performance of similar films, incorporating factors such as the star power of the lead actors and actresses, the genre of the film, prerelease market research (including test market screenings), the expected number of theaters in which the film will be released and the expected home video or DVD release date, if any. Management updates such estimates based on information available on the progress of a film's production and, upon release, the actual results of each film. For example, a film which has resulted in lower-than-expected theatrical revenues in its initial weeks of release would have its theatrical, home video and distribution ultimate revenues adjusted downward; a failure to do so would understate the amortization of capitalized film costs for the period. Since the amount of capitalized film cost to be amortized for a given film is fixed, the estimate of ultimate revenues impacts only the timing of film cost amortization. However, since participation and residuals costs are generally based on the financial results of a film, a reduction in estimated ultimate film revenue would similarly reduce the recognition of participation and residual costs.

Sales Returns and Uncollectible Accounts

One area of judgment affecting reported revenue and net income is management's estimate of product sales that will be returned and the amount of receivables that will ultimately be collected. In determining the estimate of product sales that will be returned, management analyzes historical returns, current economic trends and changes in customer demand and acceptance of Time Warner's products. Based on this information, management reserves a percentage of each dollar of product sales that provide the customer with the right of return. See Note 1 for additional discussion.

Similarly, management evaluates accounts receivable to determine if they will ultimately be collected. In performing this evaluation, significant judgments and estimates are involved, including an analysis of specific risks on a customer-by-customer basis for larger accounts, and an analysis of receivables aging that determines the percent that has historically been uncollected by aged category. Using this information, management reserves an amount that is believed to be uncollectible. Based on management's analysis of sales returns and uncollectible accounts, reserves totaling $2.109 billion and $2.079 billion have been established at December 31, 2004 and 2003, respectively. Total gross accounts receivable were $7.621 billion and $6.987 billion at December 31, 2004 and 2003, respectively.

The Company's products subject to return include DVDs and videocassettes at the Filmed Entertainment and Networks divisions and magazines, books and direct sales merchandise at the Publishing division. At December 31, 2004, total reserves for returns were approximately $854 million, $97 million and $537 million at the Filmed Entertainment, Networks and Publishing segments, respectively. See Note 1 for additional discussion.

RISK FACTORS AND CAUTION CONCERNING FORWARD-LOOKING STATEMENTS

Risk Factors

If the events discussed in these risk factors occur, the Company's business, financial condition, results of operations or cash flows could be materially adversely affected. In such case, the market price of the Company's common stock could decline.

The Company's America Online business continues to face substantial competition in maintaining and growing its subscriber base, in developing compelling products and services, and in increasing revenues from sources other than fees for the AOL service, and if America Online is unable to meet its competitive challenges, the Company's financial results could be adversely affected. During the last several years, the online services industry has been changing from one in which the only way for a household to access the Internet was through narrowband (i.e., telephone "dial-up") Internet access provided by Internet service providers to one in which households can access the Internet through a variety of connection methods, such as cable modems, DSL or wireless connections offered by a number of different providers, including Internet service providers, cable companies and telephone and other telecommunications companies. As a result, significant price and service competition for Internet access exists. Furthermore, unlike some of its competitors, AOL does not own or control access to a high-speed network that it can provide directly to its subscribers. As a result primarily of these factors, America Online has experienced declines in subscribers throughout 2003 and 2004, and declines are expected to continue into the foreseeable future. Declines in subscribers have resulted in decreased Subscription revenues and have had an adverse impact on profitability. The decline in membership may also adversely impact Advertising revenues generated from the AOL service.

Since late 2002, America Online's strategy has focused on improving and expanding its Internet products and services, including enhancement or upgrade to the content and features provided through the flagship AOL service, and introducing premium services, as well as reducing costs. In late 2004, America Online reorganized its operating structure and expanded its strategy from attracting and retaining subscribers, especially those who access the Internet via a high-speed connection, to focus also on increasing the value of and maintaining or increasing the size of its U.S. and worldwide audience to the America Online network of sites, content and services (as described in the Business section). America Online's strategy continues to include the development and offering of additional products and services to existing subscribers, as well as to Internet users in general. The success of its strategy will depend on a number of factors, including competition, the rate of decline in the number of subscribers to the AOL service, the ability to generate more activity on, and to attract more people to, its network of sites, content and services, the growth of the online advertising business, the ability to secure agreements with third parties for distribution of America Online products and services, accurate forecasting of consumer preferences, and the ability to anticipate and keep up with technological developments. If America Online is unsuccessful, Time Warner's financial condition, results of operations and cash flows could be adversely affected.

With respect to "dial-up" narrowband Internet access, America Online faces significant competition from other Internet service providers, particularly those with low-price offerings. To meet this competition through ways other than price reductions, America Online has focused on improving the quality of features and content provided on its flagship AOL service to seek, attract and retain narrowband Internet users, for example, by providing the McAfee Virus Scan product to AOL members without additional charge. America Online also operates lower-priced Internet services to compete with the low-price ISPs. It is too early to determine whether these services will be successful in retaining existing and attracting subscribers.

America Online expects to continue to experience declines in the number of subscribers. Each year, a significant portion of AOL members cancel their membership or are terminated by America Online either for non-payment of account charges or violation of one of the terms of service that apply to members (for example, sending spam e-mails or violating community guidelines in chat rooms). In addition, maintaining and growing the subscriber base is difficult because the larger the subscriber base, the greater the number of new subscribers required to offset those subscribers who cancel or are terminated. Prior to 2003, America Online had been able to attract sufficient new members to more than offset cancellations and terminations. In 2003 and 2004, however, America Online did not register new members in numbers sufficient to replace the subscribers who canceled or were terminated. One important reason for the declining number of subscribers has been that registrations have been declining in response to marketing campaigns and various other subscriber acquisition methods; continuing decreases in new registrations could adversely affect the rate of decline in the total number of subscribers. As part of its strategy announced in late 2004, America Online is planning over the course of the coming year to move certain proprietary content to the Internet, allowing all Internet users, not just members of the AOL service, to access such content without charge. This strategy could encourage subscribers to cancel their subscriptions at a faster rate than in the past. In addition, America Online is seeking to enter into agreements with high-speed access distributors, such as cable companies and telecommunications companies, to bundle and distribute the AOL service for a fee. Under these arrangements, including an agreement signed recently with Time Warner Cable, America Online anticipates that it will charge less, and accordingly earn less revenue, for the service than if it were selling directly to subscribers.

America Online continues to develop, test, change and implement price plans, service offerings and payment methods to identify effective ways to attract and retain members.

America Online will need to develop other sources of revenues to offset the lower revenues from service fees expected to result from the decline in subscribers and from the offering of the lower-priced Internet services to compete against other narrowband ISPs. For the foreseeable future, Advertising revenues will be an increasingly important source of revenues for America Online. America Online's ability to increase Advertising revenues depends in part on its ability to increase the value of its audience of unique visitors to the America Online network of sites, content and services, as well as its ability to maintain or increase its audience size. This audience includes AOL members as well as Internet users accessing America Online's network of sites, content and services from the Internet either in the U.S. or from another country. Although America Online has had some success in attracting an audience outside of its ISP membership at Internet Websites like MapQuest and Moviefone, America Online faces significant competition from third-party Internet sites, such as Yahoo! It is unknown whether America Online's strategy of increasing content available on the Web will be successful in generating increased activity by its audience or in maintaining or increasing its audience size, and thus increase Advertising revenues. In addition, America Online must continue to focus on establishing, expanding and renewing relationships with advertisers and improving its advertising business. America Online's Advertising revenues have improved as a result, in part, of America Online's paid-search relationship with Google and its acquisition of Advertising.com. Increased competition to provide Internet advertising opportunities could adversely impact Advertising.com's continued growth. In addition, America Online seeks to expand sources of Advertising revenue through introduction or expansion of Web-based services, such as In-Store.com and the proposed re-launch of the AOL.com Website as a portal in 2005. It is too early to determine if these Web-based services will be successful.

America Online has made progress in developing alternative sources of revenue and reducing costs, although it needs to continue to do so. For example, while AOL Europe's profitability increased in 2004, the European services are not the leading Internet service providers in France, Germany or the U.K. Competition includes telecommunications companies that may have greater resources and infrastructure. AOL's continued growth will depend in part on AOL Europe's increasing its profitability over the next year. In addition, while network service costs were cut substantially in 2004, further decreases in 2005 are expected, but in a smaller amount than in 2004. Decreases in network service costs in 2005 are expected to result from previously negotiated price decreases, as well as from continuing decreases in demand based on the decline in the number of subscribers to the AOL service who access the service via dial-up telephone. America Online's strategy includes continuing to introduce and expand use of existing premium digital services that provide incremental revenues, such as AOL PassCode, AOL Voicemail and MusicNet on AOL.

Developing and introducing digital services requires America Online to operate outside of its core area of expertise. Furthermore, revenues from digital premium services may be adversely affected by a reduction in prices for the services or from incorporating them into the standard AOL service offering rather than offering them separately as premium services, resulting from pressure from competitors who may offer similar services over time at lower prices or at no additional charge as part of their standard offerings.

The Company's Cable segment has begun providing its Digital Phone service over its cable systems and faces risks inherent to entering a new line of business, from competition and from regulatory actions or requirements. Coordinating the introduction of a product with which it has only limited operating experience may present significant challenges. First, although Time Warner Cable has introduced Digital Phone service in all its divisions as of December 31, 2004, it remains a relatively new technology. Furthermore, the Digital Phone service depends upon interconnection and related services provided by certain third parties. Time Warner Cable may encounter unforeseen difficulties as it introduces the product in new operating areas or increases the scale of its offering in areas in which it has launched. Second, Time Warner Cable may face heightened customer expectations and regulatory requirements related to the reliability of voice services as compared with video and high-speed data services. Time Warner Cable will need to undertake significant training of customer service representatives and technicians. If the service is not sufficiently reliable or Time Warner Cable otherwise fails to meet customer expectations or regulatory requirements, the Digital Phone business could be impacted adversely. Third, the competitive landscape for voice services is expected to be intense, with Time Warner Cable facing competition from other providers of VoIP services, as well as regional incumbent telephone companies, cellular telephone service providers, established long distance companies and others. The regional incumbent telephone companies have substantial capital and other resources, as well as longstanding customer relationships. Some of these companies have entered into co-marketing arrangements with direct-to-home satellite service providers to offer video services (and, in the future, will likely offer video services on their own), together with their telephone (including wireless) and DSL offerings. Such bundled offerings by telephone companies may compete with Time Warner Cable's offerings and could adversely impact Time Warner Cable. Finally, the Company expects advances in communications technology, as well as changes in the marketplace and the regulatory and legislative environment. Consequently, the Company is unable to predict the effect that ongoing or future developments in these areas might have on the Cable segment's voice business and operations.

The voice services business may also present additional regulatory risks. It is unclear whether and to what extent traditional state and federal telephone regulations will apply to telephony services provided using VoIP technology. In addition, regulators could allow utility pole owners to charge cable operators offering voice services higher rates for pole rental than is allowed for cable and high-speed services. The FCC recently initiated a rulemaking proceeding examining the proper regulatory approach to voice services utilizing VoIP technology. Congress is considering enacting new laws to govern those services. Additionally, there are court cases addressing the proper regulatory treatment for the service, and there are rulemakings and various other proceedings underway at the state level. In view of these various activities at the state and federal level, the Company cannot be certain what impact regulation will have on the Digital Phone business.

Pending shareholder litigation or failure to fulfill the obligations under the deferred prosecution agreement with the U.S. Department of Justice could adversely affect Time Warner's operations. In connection with the resolution of the investigation by the DOJ of the Company, America Online entered into a deferred prosecution agreement with the DOJ. In accordance with the agreement, the DOJ filed a criminal complaint against America Online in December 2004 for the conduct of certain employees in connection with securities fraud by PurchasePro.com, but the DOJ will defer prosecution of AOL and will dismiss the complaint in December 2006 provided the Company fulfills its obligations under the deferred prosecution agreement. For a discussion of these obligations, see "Legal Proceedings — Update on Status of Government Investigations." If the Company does not satisfy its obligations, the DOJ can proceed with the prosecution of America Online for actions in connection with PurchasePro.com, as set forth in the complaint, and may consider additional actions against the Company, which could have significant adverse effects on its operations and financial result. The Company intends to satisfy its obligations under the deferred prosecution agreement. As of March 1, 2005, there were forty-one putative class action and shareholder derivative lawsuits alleging violations of federal and state securities laws as well as purported breaches of fiduciary duties pending against Time Warner, certain of its current and former executives, past and present members of its Board of Directors and, in certain instances, America Online. There is also a consolidated action making allegations of ERISA violations. The complaints purport to be made on behalf of certain of the Company's shareholders and allege, among other things, that Time Warner violated various provisions of the securities laws. There are also actions filed by individual shareholders pending in federal and state courts. The Company is unable to predict the outcome of the pending shareholder litigation. The Company has not established any reserves associated with shareholder and civil litigation due to their preliminary status and because it is unable to reasonably estimate a range of possible loss. The Company is incurring expenses as a result of the pending shareholder litigation, and any costs associated with judgments in or settlements of these matters could adversely affect its financial condition and results of operations. See "Legal Proceedings — Securities Matters."

Technological developments may adversely affect the Company's competitive position and limit its ability to protect its valuable intellectual property rights. Time Warner's businesses operate in the highly competitive, consumer-driven and rapidly changing media and entertainment industries. These businesses, as well as the industries generally, are to a large extent dependent on the ability to acquire, develop, adopt, and exploit new technologies to distinguish their products and services from those of their competitors. In addition, the Company may face legal and practical limitations on its ability to enforce the Company's intellectual property rights as a result of technological developments that facilitate the theft and unlawful distribution of the Company's copyrighted works in digital form, including via the Internet. For example:

- The Company's cable business may be adversely affected by more aggressive than expected competition from alternate technologies, such as satellite, DSL, traditional phone, and wireless and power-line services; by the failure to choose technologies appropriately; by the failure of new equipment, such as digital set-top boxes or digital video recorders, or by the ability of new services, such as digital cable, high-speed data services, Digital Phone and Video-On-Demand, to appeal to enough consumers, to be available at prices consumers are willing to pay, to function as expected or to be delivered in a timely fashion;

- The Company's America Online business may be adversely affected by competitors' abilities to develop new technologies more quickly, including more compelling features/functionalities and premium digital services for Internet users, and by the uncertainty of the costs for obtaining rights from third parties, including appropriate patent licenses for technologies and methods used to deliver new services; and

- The Company's filmed entertainment and television network businesses may be adversely affected by the fragmentation of consumer leisure and entertainment time caused by a greater number of choices resulting from technological developments, the impact of digital video recorders or other technologies that change the nature of the advertising and other markets for television products.

Caution Regarding Forward-Looking Statements

The SEC encourages companies to disclose forward-looking information so that investors can better understand a company's future prospects and make informed investment decisions. This document contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, particularly statements anticipating future growth in revenues, Operating Income before Depreciation and Amortization and cash flow. Words such as "anticipates," "estimates," "expects," "projects," "intends," "plans," "believes" and words and terms of similar substance used in connection with any discussion of future operating or financial performance identify forward-looking statements. These forward-looking statements are based on management's present expectations and beliefs about future events. As with any projection or forecast, they are inherently susceptible to uncertainty and changes in circumstances, and the Company is under no obligation to, and expressly disclaims any obligation to, update or alter its forward-looking statements whether as a result of such changes, new information, subsequent events or otherwise.

Additionally, Time Warner operates in highly competitive, consumer-driven and rapidly changing media, entertainment and Internet businesses. These businesses are affected by government regulation, economic, strategic, political and social conditions, consumer response to new and existing products and services, technological developments and, particularly in view of new technologies, the continued ability to protect intellectual property rights. Time Warner's actual results could differ materially from management's expectations because of changes in such factors. Other factors and risks could adversely affect the operations, business or financial results of Time Warner or its business segments in the future and could also cause actual results to differ materially from those contained in the forward-looking statements, including those identified in Time Warner's other filings with the SEC, and the following factors and risks:

For Time Warner's AOL business:

- the ability to successfully implement its business strategy;
- the ability to develop and introduce new products and services to remain competitive;
- the ability to differentiate its products and services from its competitors;
- the ability to develop, adopt or have access to new technologies;
- the ability to have access to distribution channels controlled by third parties;
- the ability to manage its subscriber base profitably;
- the ability to provide adequate server, network and system capacity;
- the risk of business interruption caused by computer viruses, worms or other malicious activity, weather events, natural disasters, terrorist attacks, third-party supplier failures, or unforeseen events;
- the risk of unanticipated increased costs for network services;
- the ability to maintain, and the cost of maintaining, the privacy and security of company and customer information;
- increased competition from providers of Internet services, including providers of broadband access;
- the ability to generate increased usage of sites and services that are part of the America Online network, and the ability to maintain or expand the audience for its sites, content and services;
- the ability to attract additional traditional advertisers to the online advertising medium;
- the ability to maintain or renew existing advertising or marketing commitments;
- the risk that the online advertising industry will not continue to grow, and that even if the industry continues to grow, the risk that America Online will not successfully compete in securing advertising relationships;
- the ability to maintain or enter into new electronic commerce, marketing or content arrangements;
- risks associated with state, local or federal taxation of online services and Internet access providers;
- risks associated with foreign currency exchange rates;
- the risks from changes in U.S. and international regulatory environments affecting interactive services; and
- the ability to reduce losses at the international businesses that are still unprofitable.

For Time Warner's cable business:

- more aggressive than expected competition, including price competition, from other distributors of video programming, including direct to home satellite distributors, regional incumbent telephone companies and from competitors using new technologies;
- more aggressive than expected competition, including price competition, from other distributors of high-speed data services, including DSL, satellite and terrestrial wireless distributors, power companies and from competitors using new technologies;

- more aggressive than expected competition, including price competition, from other distributors of voice services, including regional telephone companies, long distance providers, national VoIP providers, wireless distributors and from competitors using new technologies;
- greater than expected increases in programming or other costs, including costs of new products and services, or difficulty in passing such costs to subscribers;
- increases in government regulation of video services, including regulation that limits cable operators' ability to raise rates, that requires that particular programming be carried or offered in a particular manner (for instance, "a la carte"), or that dictates set-top box or other equipment features, functionalities or specifications;
- government regulation of other services, such as high-speed data and voice services, including regulation that results in the imposition of higher pole fees for such services;
- government regulation that dictates the manner in which it operates its cable systems or determines what to offer, such as the imposition of "forced access" rules or common carrier requirements;
- increased difficulty in obtaining franchise renewals;
- the failure of new equipment, such as digital set-top boxes or digital video recorders, or services, such as digital video service, high-speed data service, voice service or video-on-demand, to appeal to enough subscribers or to be available at prices subscribers are willing to pay, to function as expected and to be delivered in a timely fashion;
- fluctuations in spending levels by advertisers and consumers;
- changes in technology and failure to anticipate technological developments or to choose technologies appropriately; and
- unanticipated funding obligations relating to its cable joint ventures.

For Time Warner's filmed entertainment businesses:

- the ability to continue to attract and select desirable talent and scripts at manageable costs;
- general increases in production costs;
- fragmentation of consumer leisure and entertainment time and its possible negative effects on the broadcast and cable networks, which are significant customers of the filmed entertainment businesses;
- continued popularity of merchandising;
- the uncertain impact of technological developments that facilitate theft and unlawful distribution of the Company's copyrighted works and by legal and practical limitations on the ability to enforce the Company's intellectual property rights;
- the ability to develop and apply adequate protections for filmed entertainment content in a digital delivery environment;
- the ability to develop successful business models for the secure delivery of filmed entertainment products in a digital environment;
- risks associated with foreign currency exchange rates;
- with respect to feature films, the increasing marketing costs associated with theatrical film releases in a highly competitive marketplace;

- with respect to television programming, a decrease in demand for television programming provided by non-affiliated producers and increased competition in viewership for broadcast programming due to the increasing number of cable and pay television services;
- with respect to home video, the threat of an impending format war over the next generation of high definition DVD product might prevent a smooth transition from the current, highly profitable DVD product to the next generation, thereby fragmenting and diminishing the potential market while harming current DVD sales as the industry and consumers wait to see which format or formats will prevail; and
- the ability to maintain an ad supported commercial television model in the face of challenges posed by increased consumer usage of digital video recorders or other technologies that change the nature of the advertising and other markets for television products.

For Time Warner's network businesses:

- increased competition from large media companies whose increasing scale could result in competitive advantages including advertising sales, promotions, programming and other areas;
- greater than expected newsgathering, programming or production costs;
- increased resistance by cable and satellite distributors to wholesale price increases;
- the negative impact on premium programmers of greater than anticipated basic cable rate increases to consumers;
- increased regulation of distribution agreements;
- the sensitivity of network advertising to economic cycles and to new media technologies;
- the negative impact of further consolidation of multiple-system cable operators;
- theft and unlawful distribution of content by means of interception of cable and satellite transmissions or Internet peer-to-peer file sharing;
- the impact of digital video recorders or other technologies that change the nature of the advertising and other markets for television products;
- the development of new technologies that alter the role of programming networks and services; and
- greater than expected fragmentation of consumer viewership, as well as the possible loss of viewers, as a result of the increased number of programming services and the increased popularity of alternatives to television.

For Time Warner's publishing businesses:

- declines in spending levels by advertisers and consumers;
- the ability in a challenging environment to continue to develop new profitable sources of circulation;
- substantial postal rate increase expected in 2006;
- unanticipated increases in paper costs;
- increased costs and business disruption resulting from instability in the newsstand distribution channel;
- increased competition from new magazine entrants may have an impact on its most profitable magazines, including *People;*
- risks associated with foreign currency exchange rates;

- changes in government regulation of direct marketing;
- receipt of information identifying debit card purchasers which may require changes in payment acceptance procedures for such purchasers, which could decrease subscription renewals; and
- the introduction and increased popularity over the long term of alternative technologies for the distribution of news and information.

For Time Warner generally, achieving the Company's financial objectives, including growth in operations, maintaining financial ratios and a strong balance sheet, could be adversely affected by decreased liquidity in the capital markets, including any reduction in the ability to access either the capital markets for debt securities or bank financings, failure to meet earnings expectations, significant acquisitions or other transactions, economic slowdowns, the impact of terrorist acts and hostilities in Iraq and elsewhere in the world, increased expenses as a result of the shareholder litigation pending against Time Warner, as well as the risk of costs associated with judgments in or settlements of such matters, and changes in the Company's plans, strategies and intentions. In addition, lower than expected valuations associated with the cash flows and revenues at its segments may result in its inability to realize the value of recorded intangibles and goodwill at those segments.

TIME WARNER INC.
CONSOLIDATED BALANCE SHEET
December 31,
(millions)

	2004	2003 (restated)
ASSETS		
Current assets		
Cash and equivalents	$ 6,139	$ 3,040
Restricted cash	150	—
Receivables, less allowances of $2.109 and $2.079 billion	5,512	4,908
Inventories	1,737	1,390
Prepaid expenses and other current assets	1,101	1,255
Current assets of discontinued operations	—	1,675
Total current assets	14,639	12,268
Noncurrent inventories and film costs	4,415	4,465
Investments, including available-for-sale securities	4,703	3,770
Property, plant and equipment	13,094	12,559
Intangible assets subject to amortization	3,892	4,229
Intangible assets not subject to amortization	39,656	39,656
Goodwill	39,667	39,459
Other assets	3,273	2,742
Noncurrent assets of discontinued operations	—	2,632
Total assets	$123,339	$121,780
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 1,494	$ 1,629
Participations payable	2,579	1,955
Royalties and programming costs payable	1,018	1,022
Deferred revenue	1,497	1,731
Debt due within one year	1,672	2,287
Other current liabilities	6,313	6,097
Current liabilities of discontinued operations	51	1,574
Total current liabilities	14,624	16,295
Long-term debt	20,703	23,458
Deferred income taxes	14,943	12,655
Deferred revenue	905	955
Mandatorily convertible preferred stock	1,500	1,500
Other liabilities	4,341	4,452
Noncurrent liabilities of discontinued operations	38	901
Minority interests	5,514	5,351
Commitment and contingencies (Note 18)		
Shareholders' equity		
Series LMCN-V common stock, $0.01 par value, 105.7 million shares and 171.2 million shares outstanding, respectively	1	2
Time Warner common stock, $0.01 par value, 4.483 and 4.365 billion shares outstanding	45	44
Paid-in-capital	156,252	155,579
Accumulated other comprehensive income (loss), net	106	(415)
Accumulated deficit	(95,633)	(98,997)
Total shareholders' equity	60,771	56,213
Total liabilities and shareholders' equity	$123,339	$121,780

See accompanying notes.

TIME WARNER INC.
CONSOLIDATED STATEMENT OF OPERATIONS
Years Ended December 31,
(millions, except per share amounts)

	2004	2003 (restated)	2002 (restated)
Revenues:			
Subscriptions	$ 21,605	$ 20,448	$ 18,959
Advertising	6,955	6,180	6,045
Content	12,350	11,446	10,216
Other	1,179	1,489	1,840
Total revenues[(a)]	42,089	39,563	37,060
Costs of revenues[(a)]	(24,449)	(23,422)	(22,291)
Selling, general and administrative[(a)]	(10,300)	(9,834)	(8,794)
Amortization of intangible assets	(626)	(640)	(557)
Legal reserves related to the government investigations	(510)	—	—
Restructuring costs	(50)	(109)	(327)
Asset impairments	(10)	(318)	(42,511)
Gains on disposal of assets, net	21	14	6
Operating income (loss)	6,165	5,254	(37,414)
Interest expense, net[(a)]	(1,533)	(1,734)	(1,624)
Other income (expense), net	521	1,210	(2,341)
Minority interest expense, net	(246)	(214)	(278)
Income (loss) before income taxes, discontinued operations and cumulative effect of accounting change	4,907	4,516	(41,657)
Income tax provision	(1,698)	(1,370)	(313)
Income (loss) before discontinued operations and cumulative effect of accounting change	3,209	3,146	(41,970)
Discontinued operations, net of tax	121	(495)	(1,012)
Income (loss) before cumulative effect of accounting change	3,330	2,651	(42,982)
Cumulative effect of accounting change, net of tax	34	(12)	(54,235)
Net income (loss)	$ 3,364	$ 2,639	$(97,217)
Basic income (loss) per common share before discontinued operations and cumulative effect of accounting change	$ 0.70	$ 0.70	$ (9.42)
Discontinued operations	0.03	(0.11)	(0.23)
Cumulative effect of accounting change	0.01	—	(12.17)
Basic net income (loss) per common share	$ 0.74	$ 0.59	$ (21.82)
Average basic common shares	4,560.2	4,506.0	4,454.9
Diluted income (loss) per common share before discontinued operations and cumulative effect of accounting change	$ 0.68	$ 0.68	$ (9.42)
Discontinued operations	0.03	(0.11)	(0.23)
Cumulative effect of accounting change	0.01	—	(12.17)
Diluted net income (loss) per common share	$ 0.72	$ 0.57	$ (21.82)
Average diluted common shares	4,694.7	4,623.7	4,454.9

(a) Includes the following income (expenses) resulting from transactions with related companies:

Revenues	$ 221	$ 382	$ 652
Costs of revenues	(254)	(236)	(126)
Selling, general and administrative	32	23	21
Interest income, net	25	19	13

See accompanying notes.

TIME WARNER INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
Years Ended December 31,
(millions)

	2004	2003 (restated)	2002 (restated)
OPERATIONS			
Net income (loss)[(a)]	$ 3,364	$ 2,639	$(97,217)
Adjustments for noncash and nonoperating items:			
Cumulative effect of accounting change, net of tax	(34)	12	54,235
Depreciation and amortization	3,207	3,139	2,763
Amortization of film costs	2,925	2,584	2,536
Asset impairments	10	318	42,511
Loss on writedown of investments	15	212	2,212
Gain on sale of investments, net	(447)	(810)	(136)
Equity in losses of investee companies and cash distributions	20	154	366
Changes in operating assets and liabilities, net of acquisitions:[(b)]			
Receivables	(853)	(310)	139
Inventories	(3,218)	(3,332)	(2,478)
Accounts payable and other liabilities	264	(120)	346
Other balance sheet changes	1,363	1,270	(171)
Adjustments relating to discontinued operations	2	845	1,651
Cash provided by operations	6,618	6,601	6,757
INVESTING ACTIVITIES			
Investments and acquisitions, net of cash acquired	(877)	(570)	(7,394)
Investments and acquisitions from discontinued operations	—	(52)	(162)
Capital expenditures and product development costs from continuing operations	(3,024)	(2,761)	(2,843)
Capital expenditures from discontinued operations	—	(126)	(386)
Investment proceeds from available-for-sale securities	532	1,079	187
Investment proceeds from discontinued operations	—	1,056	—
Other investment proceeds	2,866	1,451	361
Cash provided (used) by investing activities	(503)	77	(10,237)
FINANCING ACTIVITIES			
Borrowings	1,631	2,492	23,535
Debt repayments	(4,834)	(7,230)	(18,984)
Redemption of redeemable preferred securities of subsidiary	—	(813)	(255)
Proceeds from exercise of stock options	353	372	297
Current period repurchases of common stock	—	—	(102)
Dividends paid and partnership distributions of discontinued operations, net	—	—	(11)
Principal payments on capital leases	(191)	(178)	(61)
Other	25	(11)	20
Cash provided (used) by financing activities	(3,016)	(5,368)	4,439
INCREASE IN CASH AND EQUIVALENTS	3,099	1,310	959
CASH AND EQUIVALENTS AT BEGINNING OF PERIOD	3,040	1,730	771
CASH AND EQUIVALENTS AT END OF PERIOD	$ 6,139	$ 3,040	$ 1,730

(a) Includes net income (loss) from discontinued operations of $121 million in 2004, $(495) million in 2003 and ($1.012) billion in 2002.
(b) 2004 includes $300 million in noncash legal reserves related to the government investigations.

See accompanying notes.

TIME WARNER INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(millions)

	Common Stock	Paid-In Capital	Retained Earnings (Accumulated Deficit)	Total
BALANCE AT DECEMBER 31, 2001 (restated)	$44	$155,172	$ (4,387)	$150,829
Net loss	—	—	(97,217)	(97,217)
Foreign currency translation adjustments	—	—	(300)	(300)
Unrealized gains on securities, net of $37 million tax provision[a]	—	—	56	56
Realized and unrealized losses on derivative financial instruments, net of $10 million tax benefit	—	—	(21)	(21)
Unfunded accumulated benefit obligation, net of $213 million income tax benefit	—	—	(319)	(319)
Comprehensive (loss)	—	—	(97,801)	(97,801)
Repurchases of Time Warner Stock	—	(102)	—	(102)
Dilution of interest in Time Warner Entertainment Company, L.P., net of $276 million income tax impact	—	(414)	—	(414)
Shares issued pursuant to stock options, restricted stock and benefit plans, including $102 million income tax benefit	1	478	—	479
BALANCE AT DECEMBER 31, 2002 (restated)	45	155,134	(102,188)	52,991
Net income	—	—	2,639	2,639
Foreign currency translation adjustments	—	—	(77)	(77)
Unrealized loss on securities, net of $34 million tax benefit[b]	—	—	(50)	(50)
Realized and unrealized losses on derivative financial instruments, net of $9 million tax benefit	—	—	(6)	(6)
Reversal of unfunded accumulated benefit obligation, net of $180 million income tax provision	—	—	270	270
Comprehensive income	—	—	2,776	2,776
Shares issued pursuant to stock options, restricted stock and benefit plans, including $23 million income tax benefit	1	445	—	446
BALANCE AT DECEMBER 31, 2003 (restated)	46	155,579	(99,412)	56,213
Net income	—	—	3,364	3,364
Foreign currency translation adjustments	—	—	(66)	(66)
Unrealized gain on securities, net of $388 million tax provision[c]	—	—	582	582
Realized and unrealized losses on derivative financial instruments, net of $0.6 million tax provision	—	—	1	1
Reversal of unfunded accumulated benefit obligation, net of $3 million income tax provision	—	—	4	4
Comprehensive income	—	—	3,885	3,885
Shares issued pursuant to stock options, restricted stock and benefit plans, including $244 million income tax benefit	—	673	—	673
BALANCE AT DECEMBER 31, 2004	$46	$156,252	$ (95,527)	$ 60,771

(a) Includes a $34 million pretax reduction (tax effect of $14 million) related to realized gains on the sale of securities in 2002 and an increase of $738 million pretax (tax effect of $295 million) related to impairment charges on investments that had experienced other-than-temporary declines. These charges are included in the 2002 net loss.

(b) Includes a $218 million pretax reduction (tax effect of $87 million) related to realized gains on the sale of securities in 2003 and an increase of $11 million pretax (tax effect $4 million) related to impairment charges on investments that had experienced other-than-temporary declines. These changes are included in the 2003 net income.

(c) Includes a $268 million pretax reduction (tax effect of $107 million) related to realized gains on the sale of securities in 2004 and an increase of $4 million pretax (tax effect $2 million) related to impairment charges on investments that had experienced other-than-temporary declines. These changes are included in the 2004 net income.

See accompanying notes.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business and Basis of Presentation

Description of Business

Time Warner Inc. ("Time Warner" or the "Company") is a leading media and entertainment company, whose businesses include interactive services, cable systems, filmed entertainment, television networks and publishing. Time Warner classifies its business interests into five reportable segments: *AOL:* consisting principally of interactive services; *Cable:* consisting principally of interests in cable systems that provide video programming, high-speed data and Digital Phone services; *Filmed Entertainment:* consisting principally of feature film, television and home video production and distribution; *Networks:* consisting principally of cable television and broadcast networks; and *Publishing:* consisting principally of magazine and book publishing. Financial information for Time Warner's various reportable segments is presented in Note 17.

Basis of Presentation

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. For the year ended December 31, 2002, the results of operations reflect a reduction in the Company's consolidated revenues, Operating Loss, and Net Loss of approximately $254 million, $1.274 billion and $1.479 billion, respectively. 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 incremental losses assumed by AOL related to the consolidation of AOL Europe beginning in 2000 and the treatment of consideration received on certain other transactions as a reduction of the purchase price of AOL Europe as opposed to advertising revenue reduced 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. 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 the AOL Segment, for the year ended December 31, 2002, the results of operations reflect a reduction in AOL's revenues and Operating Loss of approximately $234 million and $1.274 billion, respectively. The remaining impact on the Company's consolidated revenues represents a reduction in consolidated revenues from certain transactions whereby the advertising was delivered by another Time Warner segment. For the year ended December 31, 2003, the results of operations reflect a reduction in AOL's revenues and Operating Income of approximately $2 million and $1 million, respectively. There was no impact on the previously reported results of operations for the first three quarters of the year ended December 31, 2004.

As previously addressed, 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.

Basis of Consolidation

The consolidated financial statements include 100% of the assets, liabilities, revenues, expenses and cash flows of Time Warner and all entities in which Time Warner has a controlling voting interest ("subsidiaries") and variable interest entities ("VIE") required to be consolidated in accordance with U.S. generally accepted accounting principles. Intercompany accounts and transactions between consolidated companies have been eliminated in consolidation.

The financial position and operating results of substantially all foreign operations are consolidated using the local currency as the functional currency. Local currency assets and liabilities are translated at the rates of exchange on the balance sheet date, and local currency revenues and expenses are translated at average rates of exchange during the period. Resulting translation gains or losses are included in the accompanying consolidated statement of shareholders' equity as a component of Accumulated other comprehensive income (loss), net.

The effects of any changes in the Company's ownership interests resulting from the issuance of equity capital by consolidated subsidiaries or equity investees to unaffiliated parties are accounted for as capital transactions pursuant to the SEC's Staff Accounting Bulletin No. 51, "Accounting for Sales of Stock by a Subsidiary."

Discontinued Operations

As discussed in Note 4, 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 to Cinram International, Inc. for approximately $1.05 billion in cash. 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.

As discussed in Note 6, beginning in the third quarter of 2002, the Company's results of operations have been adjusted to reflect the results of certain cable television systems held in the TWE-Advance/Newhouse

Partnership ("TWE-A/N") as discontinued operations for all periods presented herein. In addition, unless specifically noted, amounts disclosed in the notes to the consolidated financial statements are for continuing operations.

Use of Estimates

The preparation of the financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and footnotes thereto. Actual results could differ from those estimates.

Significant estimates inherent in the preparation of the accompanying consolidated financial statements include accounting for asset impairments, allowances for doubtful accounts, film ultimates, video and magazine returns, business combinations, pensions and other postretirement benefits, income taxes and contingencies.

Recently Issued Accounting Guidance

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 to reported net income and earnings per share. See "Stock-Based Compensation" 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.

Exchanges of Nonmonetary Assets

In December 2004, the FASB issued FASB Statement 153, "Exchanges of Nonmonetary Assets — an amendment of APB Opinion No. 29" ("FAS 153"). FAS 153 eliminates the exception to account for nonmonetary exchanges of similar productive assets at carrying value and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance; otherwise, the exchange principal of fair value applies. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. FAS 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The provisions of FAS 153 are not expected to have a material impact on the Company's consolidated financial statements.

Inventory Costs

In November 2004, the FASB issued FASB Statement 151, "Inventory Costs" ("FAS 151"). FAS 151 amends the guidance in Accounting Research Bulletin 43, "Inventory Pricing" ("ARB 43") and requires abnormal amounts of idle facility expense, freight handling costs and wasted material (spoilage) to be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal" as previously defined in ARB 43. Furthermore, FAS 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. FAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The provisions of FAS 151 will not have a significant impact on the Company's financial statements.

Use of Residual Method in Fair Value Determinations

In September 2004, the Emerging Issue Task Force ("EITF") issued Topic No. D-108, "Use of the Residual Method to Value Acquired Assets Other than Goodwill" ("Topic D-108"). Topic D-108 requires the direct value method, rather than the residual value method, be used to value intangible assets other than goodwill for such assets acquired in business combinations completed after September 29, 2004. Under the residual value method, the fair value of the intangible asset is determined to be the difference between the enterprise value and the fair value of all other separately identifiable assets; whereas, under the direct value method all intangible assets are valued separately and directly. Topic D-108 also requires that registrants who have applied the residual method to the valuation of intangible assets for purposes of impairment testing shall perform an impairment test using the direct value method on all intangible assets. Previously, the Company had used a residual value methodology to value cable franchise and sports franchise intangible assets. Pursuant to the provisions of Topic D-108, the Company utilized a traditional discounted cash flow methodology to value cable franchise intangibles for its December 2004 impairment test. Market and income-based methodologies were used to value sports franchises. The provisions of Topic D-108 did not affect the consolidated financial statements.

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.

At December 31, 2004, the Company had one entity deemed to be a VIE for which the Company is not considered the primary beneficiary. At December 31, 2004, this entity had total assets of $29 million and total liabilities of $44 million. In addition in 2004 it had total revenues of $176 million and a net loss of $123 million.

Summary of Significant Accounting Policies

Cash and Equivalents

Cash equivalents consist of commercial paper and other investments that are readily convertible into cash and have original maturities of three months or less. Cash equivalents are carried at cost, which approximates fair value.

Restricted Cash

As part of the Company's proposed settlement with the DOJ, the Company established a $150 million fund that the Company may use only to settle any related shareholder or securities litigation. This amount is reflected as Restricted cash in the accompanying consolidated balance sheet.

Investments

Investments in companies in which Time Warner has significant influence, but less than a controlling voting interest, are accounted for using the equity method. This is generally presumed to exist when Time Warner owns between 20% and 50% of the investee. However, in certain circumstances, Time Warner's ownership percentage exceeds 50% but the Company accounts for the investment using the equity method because the minority shareholders hold certain rights that allow them to participate in the day-to-day operations of the business.

Under the equity method, only Time Warner's investment in and amounts due to and from the equity investee are included in the consolidated balance sheet; only Time Warner's share of the investee's earnings (losses) is included in the consolidated operating results; and only the dividends, cash distributions, loans or other cash received from the investee, additional cash investments, loan repayments or other cash paid to the investee are included in the consolidated cash flows. In circumstances in which the Company's ownership in an investee is in the form of a preferred security or otherwise senior security, Time Warner's share in the investee's income or loss is determined by applying the equity method of accounting using the "hypothetical-liquidation-at-book-value" method. Under the hypothetical-liquidation-at-book-value method, the investor's share of earnings or losses is determined based on changes in the investor's claim in the book value of the investee. Additionally, the carrying value of investments accounted for using the equity method of accounting is adjusted downward to reflect any other-than-temporary declines in value (see "Asset Impairments" below).

Investments in companies in which Time Warner does not have a controlling interest or is unable to exert significant influence are accounted for at market value if the investments are publicly traded and any resale restrictions are less than one year ("available-for-sale investments"). If there are resale restrictions greater than one year or if the investment is not publicly traded then the investment is accounted for at cost. Unrealized gains and losses on investments accounted for at market value are reported, net-of-tax, in the accompanying consolidated statement of shareholders' equity as a component of Accumulated other comprehensive income (loss), net until the investment is sold or considered impaired (see "Asset Impairments" below), at which time the realized gain or loss is included in income. Dividends and other distributions of earnings from both at-market-value investments and investments accounted for at cost are included in income when declared.

Accounts Receivable Securitization Facilities

Time Warner has certain accounts receivable securitization facilities that provide for the accelerated receipt of cash on available accounts receivable. These securitization transactions are accounted for as sales in accordance with FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities — a replacement of FASB Statement No. 125" ("FAS 140"), because the Company has relinquished control of the receivables. For further information, see Note 10.

Derivatives

The Company accounts for derivative instruments in accordance with FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"), FASB Statement No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities — an amendment of FASB Statement No. 133" ("FAS 138") and FASB Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("FAS 149"). These pronouncements require that all derivative instruments be recognized on the balance sheet at fair value. In addition, these pronouncements provide that for derivative instruments that qualify for hedge accounting, changes in the fair value will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings or recognized in shareholders' equity as a component of accumulated other comprehensive income (loss) until the hedged item is recognized in earnings, depending on whether the derivative is being used to hedge changes in fair value or cash flows. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings. The Company uses derivative instruments principally to manage the risk associated with movements in foreign currency exchange rates, the risk that changes in interest rates will affect the fair value or cash flows of its debt obligations and equity price risk in the Company's investment holdings. See Note 16 for additional information regarding derivative instruments held by the Company and risk management strategies.

Financial Instruments

The carrying value of Time Warner's financial instruments approximates fair value, except for differences with respect to long-term, fixed-rate debt (Note 10) and certain differences relating to investments accounted for at cost and other financial instruments that are not significant (Note 7). The fair value of financial instruments is generally determined by reference to market values resulting from trading on a national securities exchange or in an over-the-counter market. In cases where quoted market prices are not available, fair value is based on estimates using present value or other valuation techniques.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Additions to property, plant and equipment generally include material, labor and overhead. Depreciation, which includes amortization of capital leases, is provided generally on the straight-line method over useful lives ranging up to 40 years for buildings and related improvements and up to 16 years for furniture, fixtures and other equipment. For cable television plant upgrades and cable converters and modems, depreciation is provided generally over useful lives of 3-16 and 3-5 years, respectively. Property, plant and equipment, including capital leases, consists of:

	December 31, 2004	December 31, 2003
	(millions)	
Land and buildings	$ 3,203	$ 2,494
Cable television equipment	10,168	9,979
Furniture, fixtures and other equipment	6,696	5,622
	20,067	18,095
Less accumulated depreciation	(6,973)	(5,536)
Total	$13,094	$12,559

Capitalized Software Costs

Time Warner capitalizes certain costs incurred for the development of internal use software. These costs, which include the costs associated with coding, software configuration, upgrades and enhancements, are included in Other assets in the accompanying consolidated balance sheet.

AOL's subscription services are comprised of various features, which contribute to the overall functionality of the services. AOL capitalizes costs incurred for the production of computer software that generates the functionality within its products. Capitalized costs typically include direct labor and related overhead for software produced by AOL, as well as the cost of software purchased from third parties. Costs incurred for a product prior to the determination that the product is technologically feasible (research and development costs), as well as maintenance costs of established products, are expensed as incurred. Once technological feasibility has been established, such costs are capitalized until the software has completed testing and is mass-marketed. Amortization is provided on a product-by-product basis using the greater of the straight-line method or the current year revenue as a percentage of total revenue estimates for the related software product, not to exceed five years, commencing the month after the date of the product release. Included in costs of revenues are research and development costs totaling $134 million in 2004, $139 million in 2003 and $136 million in 2002. The total net book value of capitalized software costs was $237 million and $295 million as of December 31, 2004 and December 31, 2003, respectively. Amortization of capitalized software costs was $210 million in 2004, $194 million in 2003 and $196 million in 2002.

Intangible Assets

As a creator and distributor of branded information and copyrighted entertainment products, Time Warner has a significant number of intangible assets, including cable television and sports franchises, film and television libraries and other copyrighted products, trademarks and customer subscriber lists. In accordance with U.S. generally accepted accounting principles, Time Warner does not recognize the fair value of internally generated intangible assets. Costs incurred to create and produce copyrighted product, such as feature films and television series, generally are either expensed as incurred or capitalized as tangible assets, as in the case of cash advances and inventoriable product costs. However, accounting recognition is not given to any increase in asset value that may be associated with the collection of the underlying copyrighted material. Additionally, costs incurred to create or extend brands, such as magazine titles and new television networks, generally result in losses over an extended development period and are recognized as a reduction of income as incurred, while any corresponding brand value created is not recognized as an intangible asset in the consolidated balance sheet. However, intangible assets acquired in business combinations accounted for under the purchase method of accounting are recorded at fair value on the Company's consolidated balance sheet.

In January 2002, the Company adopted FASB Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("FAS 142"), which required that goodwill, including goodwill included in the carrying value of investments accounted for using the equity method of accounting and indefinite-lived other intangible assets deemed to have an indefinite useful life, cease amortizing. The new rules also required that goodwill of consolidated businesses and certain intangible assets be assessed for impairment using fair value measurement techniques. As a result, a substantial portion of the Company's goodwill and intangible assets, including cable television franchises, sports franchises and brands and trademarks, ceased amortizing.

Asset Impairments

Investments

The Company's investments consist of fair-value investments, including available-for-sale investments, investments accounted for using the cost method of accounting and investments accounted for using the equity method of accounting. The Company regularly reviews its investment securities for impairment based on criteria that include the extent to which carrying value exceeds its related market value, the financial condition of the investee, and the intent and ability to retain the investment for a sufficient period of time to allow for recovery in the market value of the investments. For more information, see Note 7.

Long-Lived Assets

Long-lived assets are tested for impairment whenever events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Determining the extent of an impairment, if any, typically requires various estimates and assumptions including cash flows directly attributable to the asset, the useful life of the asset and residual value, if any. When necessary, we use internal cash flow estimates, quoted market prices and appraisals as appropriate to determine fair value.

Goodwill and Indefinite-Lived Intangible Assets

Goodwill and other indefinite-lived intangible assets, primarily certain franchise assets, trademarks and brand names, are tested annually as of December 31 and whenever events or circumstances make it more likely than not that an impairment may have occurred, such as a significant adverse change in the business climate or a decision to sell or dispose of the unit. Estimating fair value is performed by utilizing various valuation techniques, with the primary technique being a discounted cash flow. The use of a discounted cash flow model often involves the use of significant estimates and assumptions. For more information, see Note 2.

Accounting for Pension Plans

Time Warner and certain of its subsidiaries have defined benefit pension plans covering a majority of domestic employees and, to a lesser extent, international employees. Pension benefits are based on formulas that reflect the employees' years of service and compensation during their employment period and participation in the plans. The pension expense recognized by the Company is determined using certain assumptions, including the expected long-term rate of return on plan assets, the discount rate used to determine the present value of future pension benefits and the rate of compensation increases. The determination of these assumptions is discussed in more detail in Note 15.

Revenues and Costs

AOL

Subscription revenues are recognized over the period that services are provided. Advertising, Content and Other revenues are recognized as the services are performed or when the goods are delivered. AOL generates Advertising revenues by directly selling advertising or through transaction-based arrangements. Advertising revenue related to advertising sold by AOL is generally categorized into two types of contracts: standard and nonstandard. The revenues derived from standard advertising contracts, in which AOL provides a minimum number of impressions for a fixed fee, are recognized as the impressions are delivered. The revenues derived from nonstandard advertising contracts, which provide carriage, advisory services, premier placements and exclusivities, navigation benefits, brand affiliation and other benefits, are recognized, on a straight-line basis, over the term of the contract, provided that AOL is meeting its obligations under the contract (e.g., delivery of impressions). In cases where refund arrangements exist, upon the expiration of the condition related to the refund, revenue directly related to the refundable fee is recognized on a straight-line basis over the remaining term of the agreement. Transaction-based arrangements generally involve either arrangements in which AOL performs advertising and promotion through prominent display of a partner's content on one of AOL's services, or arrangements in which AOL's Advertising.com, Inc. ("Advertising.com") subsidiary performs advertising on a third-party website. As compensation for display of a partner's content, AOL is paid a share of the partner's advertising revenues. For performance-based advertising, AOL is paid an agreed to fee based on customer specified results, such as registrations or sales leads. Advertising revenue related to these transaction-based arrangements is recognized when the amount is determinable (i.e., generally when performance reporting is received from the partner). Deferred revenue consists primarily of prepaid electronic commerce and advertising fees and monthly and annual prepaid subscription fees billed in advance.

For promotional programs in which consumers are typically offered a subscription to AOL's subscription services at no charge as a result of purchasing a product from the commerce partner, AOL records Subscription revenue, based on net amounts received from the commerce partner, if any, on a straight-line basis over the term of the service contract with the subscriber.

The accounting rules for advertising barter transactions require that historical cash advertising of a similar nature exist in order to support the recognition of advertising barter revenue. The criteria used by the accounting rules used to determine if a barter and cash transaction are considered "similar" include circulation, exposure or saturation within an intended market, timing, prominence, demographics and duration. In addition, when a cash transaction has been used to support an equivalent quantity and dollar amount of barter revenue, the same cash transaction cannot serve as evidence of fair value for any other barter transaction. While not required by the accounting rules, AOL management adopted a more conservative policy by establishing an additional size criterion to the determination of "similar." Pursuant to such criterion, beginning in the second quarter of 2003, an individual cash advertising transaction of comparable average value or higher value must exist in order for revenue to be recognized on an intercompany advertising barter transaction. Said differently, no intercompany advertising barter revenue is recognized if a cash advertising transaction of comparable average value or higher value has not been entered into in the past six months, even if all of the other accounting criteria have been satisfied.

Cable

Cable revenues are principally derived from video programming, high-speed data and Digital Phone subscriber fees and advertising. Subscriber fees are recorded as revenue in the period that the service is provided, and Advertising revenues, including advertising purchased by programming vendors, are recognized in the period that the advertisements are exhibited. Video programming costs are recognized as the services are provided. Launch fees received by the Company from programming vendors are recognized as a reduction of expense over the life of the related programming arrangement. Fees received from programming vendors representing the reimbursement of marketing costs are recognized as a reduction in marketing expense in the period that such reimbursements are received.

Publishing

Magazine Subscription and Advertising revenues are recognized at the magazine cover date. The unearned portion of magazine subscriptions is deferred until the magazine cover date. Upon cover date, a proportionate share of the gross subscription price is included in revenues, net of any commissions paid to subscription agents. Also included in Subscription revenues are revenues generated from single-copy sales of magazines through retail outlets such as newsstands, supermarkets, convenience stores and drugstores, which may or may not result in future subscription sales.

Certain products, such as books and other merchandise, are sold to customers with the right to return unsold items. Revenues from such sales are recognized when the products are shipped, based on gross sales less a provision for future estimated returns based on historical experience.

Inventories of books and other merchandise are stated at the lower of cost or estimated realizable value. Cost is determined using primarily the first-in, first-out method, or alternatively the average cost method. Returned goods included in inventory are valued at estimated realizable value, but not in excess of cost. See Note 9 for additional discussion of inventory.

Networks

The Networks segment recognizes Subscription revenue as services are provided based on the per subscriber negotiated contractual programming rate for each multi-system operator ("MSO") and the estimated number of subscribers at the respective MSO.

In the normal course of business, the Networks segment enters into long-term license agreements to acquire programming rights. An asset and liability related to these rights is created (on a discounted basis) when (i) the cost of each program is reasonably determined, (ii) the program material has been accepted in accordance with the terms, and (iii) the program is available for its first showing or telecast. As discussed below, there are slight variations in the accounting depending on whether the network is advertising supported (e.g., TNT, TBS, The WB Television Network ("The WB Network") or not advertising supported (e.g., HBO).

For advertising-supported networks, the Company's general policy is to amortize the programming costs on a straight-line basis (or per play basis if greater) over the licensing period. There are, however, exceptions to this general rule. For example, because of the significance of the rights fees paid for sports programming licensing arrangements (i.e., NBA and MLB), programming costs are amortized using an income-forecast model, in which total revenue generated under the sports programming is estimated and the costs associated with this programming are amortized as revenue is earned, based on the relationship that the programming costs bear to total estimated revenues, which approximates the pattern with which the network will utilize and benefit from providing the sports programming. In addition, based on historical advertising sales, the Company believes that, for certain types of programming, the initial airing has more value than subsequent airings. In these circumstances, the Company will use an accelerated method of amortization. Additionally, if the Company is licensing the right to air a movie multiple times over a certain period and the movie is being shown to the public for the first time on a Company network (a "Premiere Movie"), a portion of the licensing cost is amortized on the initial airing of the movie, with the remaining cost amortized on a straight-line basis (or per play basis, if greater) over the remaining licensing period. The determination of the amount of amortization to accelerate in the first showing versus subsequent showings has been determined based on a study of historical advertising sales for similar programming.

For a premium cable network that is not advertising supported (e.g., HBO), programming costs are generally amortized on a straight-line basis in the year that the related shows are exhibited. When the Company has the right to exhibit feature theatrical programming in multiple windows over a number of years, the Company uses historical audience performance as its basis for determining the amount of a film's programming amortization attributable to each window.

The Company records programming arrangements (e.g., film inventory, sports rights, etc.) at the lower of unamortized cost or estimated net realizable value. For broadcast television networks (e.g., The WB Network) whose sole revenue is advertising, the Company estimates the net realizable value of unamortized cost based on the estimated advertising that can be sold during the season in which the package of programming is aired. For cable networks (e.g., TBS, TNT, etc.), which earn both Advertising and Subscription revenues, the Company evaluates the net realizable value of unamortized cost based on the package of programming provided to the subscribers by the network. Specifically, in determining whether the programming arrangements for a particular network are impaired, the Company determines the net realizable value for all of the network's programming arrangements based on a projection of the network's estimated combined subscription revenues and advertising revenues. Similarly, given the premise that customers subscribe to a premium service because of the overall quality of its programming, the Company performs its evaluation of the net realizable value of unamortized programming costs based on the package of programming provided to the subscribers by the network. Specifically, the Company determines the net realizable value for all of its premium service programming arrangements based on projections of estimated subscription revenues.

Filmed Entertainment

Feature films are produced or acquired for initial exhibition in theaters, followed by distribution in the home video, pay cable, basic cable, broadcast network and syndicated television markets. Generally, distribution to the theatrical, home video and pay cable markets is completed principally within three years of initial release. Thereafter, feature films are distributed to the basic cable, broadcast network and syndicated television markets. Theatrical revenues are recognized as the films are exhibited. Revenues from home video sales are recognized on the date that video units are made widely available-for-sale or rental by retailers based on gross sales less a provision for future estimated returns based on historical experience. Revenues from the distribution of theatrical product to cable, broadcast network and syndicated television markets are recognized when the films are available to telecast.

Television films and series are initially produced for broadcast networks, cable networks or first-run television syndication and may be subsequently licensed to foreign or domestic cable and syndicated television markets, as well as sold on home video. Revenues from the distribution of television product are recognized when the films or series are available to telecast, except for barter agreements where the recognition of revenue is deferred until the related advertisements are exhibited. Similar to theatrical home video sales, revenue from home video sales of television films and series is recognized at the later of the delivery date or the date that video units are made widely available-for-sale or rental by retailers.

License agreements for the telecast of theatrical and television product in the cable, broadcast network and syndicated television markets are routinely entered into well in advance of the available date for telecast, which is generally determined by the telecast privileges granted under previous license agreements. Accordingly, there are significant contractual rights to receive cash and barter under these licensing agreements. For cash contracts, the related revenues (which are discounted based on when cash will be collected) will not be recognized until such product is available for telecast under the contractual terms of the related license agreement. For barter contracts, the related revenues will not be recognized until the product is available for telecast and the advertising spots received under such contracts are either used or sold to third parties. All of these contractual rights for which revenue is not yet recognizable are referred to as "backlog."

Inventories of theatrical and television product consist of videocassettes, DVDs and compact video discs and are stated at the lower of cost or net realizable value. Returned goods included in inventory are valued at estimated realizable value, but not in excess of cost.

Film costs include the unamortized cost of completed theatrical films and television episodes, theatrical films and television series in production and film rights acquired for the home video market. Film costs principally consist of direct production costs, production overhead, development and pre-production costs, and are stated at the lower of cost, less accumulated amortization, or fair value. The amount of capitalized film costs recognized as cost of revenues for a given film as it is exhibited in various markets, throughout its life cycle, is determined using the film forecast method. Under this method, the amount of capitalized costs recognized as expense is based upon the proportion of the film's revenues recognized for such period to the film's estimated remaining ultimate revenues. Similarly, the recognition of expenses for participations and residuals is recognized upon the proportion of the film's revenues recognized for such period to the film's estimated remaining ultimate revenues. These estimates are revised periodically and losses, if any, are provided in full. See Note 9 for additional details of film costs.

A portion of the costs of acquiring Historic TW Inc. ("Historic TW") in 2001 and of acquiring the remaining Time Warner Entertainment Company, L.P. ("TWE") content assets in 2003 was allocated to theatrical and television product, including purchased program rights and product that had been exhibited at least once in all markets ("Library"). Library product is amortized in amortization expense over 20 years using the film-forecast method. See Note 2 for additional details of Library.