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September 13, 2000

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

VIA HAND DELIVERY

Darryl Cooper, Esq.
Cable Services Bureau
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

**Re: Notice of *Ex Parte* Presentation
Applications of America Online, Inc. and Time Warner Inc. for Transfers of Control (CS Docket No. 00-30)**

Dear Mr. Cooper:

At the request of Anne Levine, please find enclosed copies of the following analyst reports regarding the proposed merger of AOL and Time Warner: (1) Credit Lyonnais Securities, *America Online Inc./Time Warner Inc.*, February 28, 2000; (2) Salomon Smith Barney, *AOL and Time Warner Link: The Dynamic Duo Form a Free Cash Flow Dynamo*, March 22, 2000; and (3) First Union Securities, *AOL Time Warner*, June 20, 2000.

Kindly direct any questions regarding these documents to the undersigned.

Respectfully submitted,

Pet DR

Peter D. Ross

cc: Magalie Roman Salas (2 copies)

No. of Copies rec'd 0+1
List A B C D E

Attachment

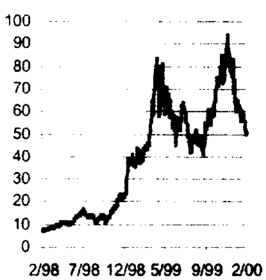
America Online, Inc. ADD

Time Warner Inc. BUY

AOL (NYSE)	
Share Price as of February 25, 2000	**$59 5/8**
12-Month Target	**$68**
52-Wk Range	$95 13/16–$38 7/16
Shares Out (mm) PF	4,800.0
Market Cap (bn) PF	$286.2
Float (mm) PF	3,622.5
Avg Daily Vol. (mm)	29.4
Div/Yield	Nil/Nil
5-Year Sec Growth Rate (c)	16.2%
Balance Sheet Data as of	12/31/99
Net Cash (mm)	$954
Book Value/Share	$2.74
Net Debt/Cap	NA

(c) Compound Average Growth Rate of Estimated Fair Trading Value 2000–2005

Price Graph (AOL)



FY End Dec.	Revenues ($mm)	EBITDA (a) ($mm)	EPS ($)	CFPS ($)	P/CF (x)	Net Debt ($mm)	EV (b)/ EBITDA
1999A@	5,718.0	1,251.0	0.39	0.51	164.5	954.0	129.4
2000E@	40,089.4	9,735.1	(0.82)	1.31	45.4	16,141.5	27.7
2001E@	46,210.3	13,019.8	(0.30)	1.88	31.8	9,039.5	19.6
2002E	53,131.5	16,167.0	0.24	2.46	24.3	(1,365.7)	14.7

@ Pro forma; 1999 results exclude Time Warner. AOL currently operates under a June 30 fiscal year, figures for 1999 are calendar 1999 results.
(a) Earnings before Interest, Taxes, Depreciation, and Amortization
(b) Enterprise Value = Market Capitalization plus Ending Net Debt less Non-Cash Flow-Producing Assets

AOL + TWX = Super-Cap Content/Distribution Growth Stock; Shakeout of Investor Base Creates Potential for Further Volatility; Initiating Coverage of AOL with an ADD Rating

- We are reinstating coverage of Time Warner with a BUY rating and initiating coverage of America Online (to become AOL Time Warner) with an ADD rating.
- Our base sum-of-the-parts valuation model suggests that AOL Time Warner should trade at $68 per share. At 1.5 AOL Time Warner shares per each Time Warner share, Time Warner should trade at $102 per share, or 21.4% above the current price.
- We project that, at 21% per year, AOL Time Warner should have one of the fastest five-year EBITDA growth rates of any major media entertainment company, rivaling those of Liberty Media Group and USA Networks, Inc. We estimate that cross promotion and other synergies could accelerate the projected five-year (2000PF–2005) EBITDA growth rate of the Time Warner assets from 12% to 16%, mainly on the music and magazine publishing sides, but also at Time Warner Digital.
- AOL Time Warner will enter existence with a powerful balance sheet (net debt of only 1.35x pro forma 2001 EBITDA), and we forecast that it could generate $7.1 billion of free cash flow in 2001, growing at 30% per year.
- AOL Time Warner appears to be among the companies best positioned to take advantage of the Internet distribution/e-commerce platform. This is mainly a function of its large paying subscriber bases, the depth of its content, and its ability to reach hundreds of millions of consumers through the various AOL Time Warner businesses.

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Company Overview

On January 10, 2000, America Online Inc. (AOL) and Time Warner Inc. entered into a merger agreement under which AOL will essentially acquire Time Warner in a purchase transaction for a fixed 1.5 shares of the resulting company (to be called AOL Time Warner) per each Time Warner share. The acquisition, expected to close by the end of 2000, will create an entity with a projected $40 billion in revenue and $13 billion in EBITDA (including synergies) during its first full year of operation. Further, the new company will have an estimated year-end 2000 net debt load of only $16.1 billion and will have an expanded share base of 4.8 billion. AOL shareholders will own 55% of AOL Time Warner and Time Warner shareholders will own the remaining 45%. Note that Time Warner and AOL collectively have options outstanding.

AOL Time Warner represents the first full-fledged merger of an Internet company and an established media company.

Pro forma for the Time Warner acquisition, AOL Time Warner operates in nine major areas of the entertainment and media business. For full descriptions of these businesses, refer to page 38. One broad way to look at the company is by the source of revenues, broken down as follows:

1. **Subscriptions (40% of pro forma 2000 revenues):** Subscription revenues come from (1) magazines; (2) carriage fees from MSOs for basic cable networks; (3) fees from HBO subscribers; (4) AOL Internet access fees; and (5) monthly cable subscriber fees.

2. **Content (40% of pro forma 2000 revenues):** The content operations consist of filmed entertainment/TV programming, recorded music, and publishing businesses.

3. **Advertising/e-commerce (20% of pro forma 2000 revenues):** This category consists of Time Warner's approximate $5.0 billion in ad revenues, plus AOL's advertising/ e-commerce revenue streams. About 79% of this $5.0 billion comes from Time Warner's magazines and basic cable networks. We believe this should be the fastest growing of the three business segments.

Of the three broad above-delineated business categories in AOL Time Warner, we expect that advertising/e-commerce and content, currently accounting for 60% of pro forma revenues, should grow the most rapidly, with subscription growth slowing due to declining prices for Internet access.

AOL, basic cable networks, HBO, and magazines will drive AOL Time Warner's growth

Exhibits 1 and 2 break down the contributions of the various historic business segments to total AOL Time Warner revenues (before inter-company eliminations) and EBITDA (before corporate overhead). As can be seen, cable systems, AOL's online services, and the Time Warner basic cable networks are the largest EBITDA contributors. On a pro forma basis, we estimate that businesses growing at an annual rate of 15% or higher—AOL, basic cable networks and HBO—will comprise 42% of total pro forma 2000 EBITDA.

Exhibit 1: Contribution to Revenues

[illegible]	1998PF	1999PF	2000PF	2001E	2002E	2003E	2004E	2005E
Revenues:								
Cable Networks								
TBS News Networks	4.1%	4.4%	3.5%	3.4%	3.3%	3.3%	3.3%	3.3%
TBS Entertainment Networks & Sports	8.2%	9.4%	7.6%	7.5%	7.2%	7.2%	7.1%	7.1%
Total TBS	12.3%	13.8%	11.1%	10.9%	10.6%	10.5%	10.5%	10.4%
HBO	7.6%	7.6%	5.7%	5.7%	5.6%	5.5%	5.5%	5.5%
Total Cable Networks	19.9%	21.4%	16.8%	16.6%	16.2%	16.0%	16.0%	15.9%
Publishing:								
Magazines	11.8%	12.0%	8.9%	8.6%	8.4%	8.2%	8.0%	7.8%
Books	4.8%	4.3%	3.2%	3.0%	2.9%	2.9%	2.8%	2.8%
Total Publishing	16.6%	16.3%	12.0%	11.6%	11.4%	11.1%	10.8%	10.5%
Warner EMI Music	14.9%	13.4%	20.5%	19.1%	17.9%	17.2%	16.6%	15.8%
Filmed Entertainment								
Warner Brothers	22.4%	23.2%	17.0%	15.7%	15.3%	14.6%	14.0%	13.6%
TBS Film & Production	7.1%	5.1%	4.0%	4.0%	3.7%	3.6%	3.5%	3.4%
Total Filmed Entertainment	29.5%	28.3%	20.9%	19.7%	19.1%	18.1%	17.4%	16.9%
WB Network	1.0%	1.3%	1.1%	1.2%	1.3%	1.3%	1.4%	1.4%
Cable TV Systems								
TWX	3.0%	2.9%	2.2%	2.2%	2.2%	2.1%	2.1%	2.1%
TWE	15.1%	16.3%	12.5%	12.5%	12.1%	11.9%	11.7%	11.4%
Total Cable TV Systems	18.2%	19.2%	14.7%	14.7%	14.3%	14.1%	13.8%	13.4%
Digital Media			0.1%	0.2%	0.4%	0.6%	0.8%	1.0%
AOL			13.7%	16.9%	19.5%	21.5%	23.2%	24.9%
Total Gross Revenues	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Credit Lyonnais Securities (USA) estimates and company reports

Exhibit 2: Contribution to EBITDA

EBITDA:								
Cable Networks								
TBS News Networks	5.9%	6.0%	4.6%	4.1%	3.8%	3.7%	3.6%	3.6%
TBS Entertainment Networks & Sports	8.4%	12.3%	8.7%	7.8%	7.4%	7.2%	6.8%	6.5%
Total TBS	14.3%	18.3%	13.3%	11.9%	11.2%	10.9%	10.5%	10.1%
HBO	8.5%	8.8%	6.5%	6.6%	6.8%	6.8%	6.7%	6.8%
Total Cable Networks	22.8%	27.1%	19.8%	18.5%	18.0%	17.6%	17.2%	17.0%
Publishing:								
Magazines	9.6%	9.8%	7.4%	7.6%	8.0%	8.0%	8.0%	8.1%
Books	2.7%	2.2%	1.4%	2.1%	2.5%	2.6%	2.6%	2.6%
Total Publishing	12.3%	12.0%	8.8%	9.7%	10.5%	10.7%	10.6%	10.7%
Warner EMI Music	10.1%	8.3%	12.4%	12.3%	11.8%	11.3%	10.8%	10.0%
Filmed Entertainment								
Warner Brothers	12.0%	11.5%	8.1%	8.0%	7.8%	6.5%	6.0%	5.7%
TBS Film & Production	3.5%	3.4%	1.5%	1.3%	1.1%	1.1%	1.0%	1.0%
Total Filmed Entertainment	15.5%	14.9%	9.6%	9.3%	9.0%	7.6%	7.0%	6.7%
WB Network	-1.6%	-1.4%	-0.8%	-0.3%	0.2%	0.5%	0.8%	0.9%
Cable TV Systems								
TWX	6.6%	5.7%	4.2%	3.7%	3.5%	3.4%	3.2%	3.1%
TWE	34.3%	33.7%	24.1%	21.5%	19.8%	18.9%	17.8%	16.9%
Total Cable TV Systems	40.9%	39.4%	28.3%	25.2%	23.3%	22.3%	21.0%	20.0%
Digital Media		-0.3%	-0.2%	-0.3%	-0.1%	0.1%	0.4%	0.7%
AOL			22.2%	25.6%	27.4%	29.9%	32.2%	33.9%
Total Gross Revenues	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Credit Lyonnais Securities (USA) estimates and company reports

Key Points

1. **We are reinstating our investment rating on Time Warner at BUY, and initiating coverage of America Online (to become AOL Time Warner) with an ADD rating.**

   We estimate a fair trading value of $68 per pro forma AOL Time Warner share on 2001 estimates. As our base valuation methodology, we are employing a sum-of-the-parts model (as we did in our coverage of Time Warner on a standalone basis). We have essentially added a valuation for AOL and the value of synergies in the various AOL Time Warner parts. Time Warner shareholders today receive 1.5x this value, or $102 per share within one year. We estimate that the combined company will achieve EBITDA growth of an estimated 20.9% over the five-year 2000PF–2005 period.

   One-year targets derived from discounted cash flow analysis and a weighted fair trading multiple yield a fair trading value (FTV) in the $65–$69 per share range. To derive a fair valuation multiple on companywide EBITDA, we used the weighted average of the projected five-year EBITDA growth rates of the AOL and Time Warner assets after the merger.

2. **We project that AOL Time Warner shares will increase in fair trading value at a compound annual growth rate of 16.2% over the 2001PF–2005 period.**

   Our projections call for AOL Time Warner shares to increase in fair trading value from $68 per share in 2001 to $92 per share in 2003 and $122 per share in 2005. Principal value growth drivers include: (1) escalating advertising/e-commerce revenue streams combined with widening margins at AOL due to a highly scalable business model; (2) consistent mid-teens EBITDA growth at the Turner networks; and (3) the generation of an estimated cumulative free cash flow on a combined basis of $72 billion over the 2000PF–2005 period.

   A potential obstacle to value growth at AOL Time Warner will be the company's ability to find high-return investments for its growing free cash flow. Our models assume that all excess cash will first go to debt reduction, and when debt is exhausted, be carried as cash on the balance sheet, earning roughly 5% interest.

We would be buyers of AOL at $55 per share and below and Time Warner at $82 per share and below

3. **We project that AOL Time Warner will enter existence with a powerful balance sheet.**

   The combined balance sheets of AOL Time Warner benefit from AOL's projected net cash position of $2.25 billion at the end of calendar 2000, yielding net debt of just over $16.1 billion at the end of 2000. This forecast factors in Time Warner's estimated year-end 1999 net debt of $18.0 billion, assumption of $1.5 billion in EMI debt, and $1.3 billion incurred from the special payment to EMI shareholders that is part of the recent Warner Music-EMI joint venture.

   We project AOL Time Warner will have a pro forma net debt to EBITDA ratio in 2000 of an estimated 1.66x. In our view, the company could generate free cash flow on the order of $7.1 billion in its first full year of existence, increasing at an estimated compound average rate of 30.6% per year for three years. AOL Time Warner's free cash flow could increase from $7.1 billion in 2001 PF to $10.4 billion in 2002 and $13.4 billion in 2003, aided by increasing EBITDA and lower capital spending, particularly after Time Warner Cable completes its 550–750 MHz plant upgrade in early 2001.

4. **The deal appears to be a good one for AOL and Time Warner shareholders.**

   From a short-term perspective, however, the deal appears to favor current Time Warner shareholders, as the company will most likely be viewed as an accelerated growth entertainment company. AOL Time Warner will have one of the fastest five-year EBITDA growth rates among major entertainment companies, rivaling those of Liberty Media Group (proportionate accounting) and USA Networks—but from a larger pro forma base. We estimate that AOL Time Warner's EBITDA will grow at a rate 500–700 basis points faster than the average of its peer entertainment companies.

   We project 21% annual EBITDA growth at the combined company. AOL's projected 31.2% five-year average EBITDA growth propels the combined company, augmented by the Time Warner basic cable networks and HBO. We project $2.2 billion in calendar 2001 EBITDA for AOL, followed by $3.4 billion in 2002 and $4.5 billion in 2003. We believe the basic cable networks will record annual EBITDA growth of 14%–18% in 2000 and 2001, reaching $1.6 billion, and we look for HBO to grow 16% and 17% in 2000 and 2001, reaching $870 million.

   We forecast that the company's secular annual EBITDA growth rate will accelerate from the low teens without AOL to 21% per year. Our outlook is based on strong support from Time Inc. and upsides from Time Warner Music, Time Warner Digital, and Warner Brothers due to AOL cross-promotions and enhanced digital delivery,

5. **AOL Time Warner appears to be among the companies best positioned to take advantage of the Internet distribution/e-commerce platform.**

   This is mainly a function of its large paying subscriber bases, the depth of its content, and its ability to reach hundreds of millions of consumers through the various AOL Time Warner businesses. As a result, we believe AOL Time Warner will be able to derive an additional $700–$800 million in revenues and $400–$500 million in EBITDA from Time Warner's magazine and book publishing, recorded music, HBO, and the company's cable TV system operations.

6. **Early in its life, we expect AOL Time Warner's value growth to be driven by increases in subscribers and advertising/e-commerce dollars at AOL and global expansion of the basic cable networks.**

AOL's performance continues to exceed expectations

AOL's standalone operations continue to report outstanding revenue and EBITDA growth. The company reported 108% EBITDA growth to $453 million in its fiscal 2Q00 (ended December 31, 1999) on revenue growth of 41% to $1.6 billion, on the strength of 79% growth in advertising and e-commerce and 36% growth in subscription revenues. EBITDA margins reached 28%. AOL's advertising backlog increased to more than $2.4 billion in the quarter, up from $2.0 billion at the end of 1Q00, while the company added 1.8 million AOL subscribers. Several factors are propelling AOL's growth:

- Continued domestic subscriber growth, with an added 4–5 million per year. The driving forces here remain branded distribution and easy-to-use Internet access, supplemented by new content features.

- Rapid growth in advertising/e-commerce revenues as AOL's paying subscriber base grows. AOL thus will enhance its growing position as a "must-have" partner for advertisers and e-commerce retailers as it grows.

7. **We believe growth from the AOL brand and enhanced cash flows from the Time Warner brands could be complemented over a longer horizon by new businesses created by new distribution channels for new content.**

   However, regardless of the added revenue streams from new businesses, we think many aspects of the business will not change, notably its scalability and the ongoing appeal of core content areas such as music downloading, e-mail, news, and instant messaging.

8. **Although there could be management shakeouts as the company's ongoing executive structure takes shape, AOL Time Warner will enter existence with top-flight managers.**

   - Steve Case has proven skillful at adapting AOL to various challenges, while Gerald Levin has aggressively orchestrated operating harmony and cost control at the difficult-to-manage Warner. Robert Pittman is an exceptional marketer and Richard Parsons has managed to orchestrate relative harmony among the diverse Time Warner management team.

   - Time Warner has some of the best established media managers in the business, with Don Logan at Time Inc., Jeff Bewkes at HBO, Joe Collins at Warner Cable, Terry McGuirk at Turner Networks, and the new team of Roger Ames and Ken Berry at Warner EMI Music.

9. **AOL should galvanize Time Warner's Internet strategy through its ability to add distribution and advertisers.**

   Time Warner's content-based Web sites attract 12.2–13.0 million monthly unique visitors, led by CNN.com. Traffic has been static for about one year. We expect that AOL's clout with subscribers and increasingly high visibility should dramatically accelerate the growth rate of CNN.com and other sites. Profitability should emerge far earlier because AOL's embedded infrastructure allows earlier breakeven in new services.

Risks

1. **Internet access is becoming more of a commodity service and, without compelling content, could become more so in a broadband, open access environment.**

We do not consider free Internet access to be a profitable business model

Internet service providers (ISPs) are increasingly competing on price, with numerous European access providers already offering free monthly access in order to aggregate audiences for eventual ad revenue streams. We do not believe that the economic model for free ISPs lends itself to the U.S. market, as (1) the European ISPs are funded by a percentage of per-minute local charges from telephone companies, and (2) audiences drawn by the services are unappealing to advertisers due to their lack of loyalty.

However, AOL still relies for 70% of its revenues on monthly access fees for its dial-up service. We expect Microsoft to aggressively attack AOL's subscriber base through low-cost pricing via bundling and rebates. Although the company is rapidly making the transition to an advertising/e-commerce revenue model, a more rapid decline in access fees than we envision could severely hamper the company's valuation.

AOL has several factors working in its favor.

- It is the premium Internet brand. According to surveys, AOL has more than 50% unaided awareness among Internet users—far and away the highest among major Internet companies (Yahoo! is at 14%, while Microsoft, AT&T, and CompuServe are in the single digits).

- AOL's premium Internet access service continues to grow in the face of increasing competition and selected AOL price increases. Churn is actually down 10%–15% over the past 18 months. This growth highlights AOL's uniqueness, offering consumers ease of use, convenience (stock quotes and portfolio, parental control and other features), and growing visibility. In an example of classic consumer behavior, consumers want simplicity and AOL answers their needs.

- In virtually all consumer markets, premium brands hold market share. This is true with Coca-Cola, Marlboro, the Seagram luxury sprits & wines, and many others.

2. **Consumer reaction to advertising on the Internet is not yet fully understood, in our opinion.**

Not only is there great uncertainty about the effectiveness of banner advertisements, but the power of traditional consumer brands on the Internet is still debatable. Until these issues become clearer, not only the future Internet economic model but also the power of brands are suspect.

However, we believe that highly focused brands can prosper on the Internet, particularly when augmented with new content enabled by growth of broadband network capabilities. Among the targeted categories that should be successful are news/finance, children's services, sports, music and other entertainment, and various other services that augment established off-line markets. A few points:

- Internet brands that are an extension of traditional media and can benefit from cross-promotion will most likely stand a better chance of survival than services that attempt to establish brands on the Internet. While there are few clear examples of success at this juncture, we believe CNN and other such brands can add to brand values when properly enabled, especially when they can be developed and launched at relatively low cost.

- Brands can take up to 10 years and cost as much as $1.0 billion to establish. Given accelerated Internet time and clutter, there might emerge no new broad Internet brands beyond Yahoo! and AOL, which we view as the most successful Internet brands by far. Note that brands are distinguished from successful Internet models in the case of eBay and several others.

- The economics of the off-line world clearly do not apply to the Internet. Although entry costs are low in many cases, the result is an abundance of noise that requires huge sums to be spent on marketing relative to revenues.

- Internet advertising is clearly in its infancy (about 2% of total advertising), and banner ads represent only the earliest stages of the form. With the advent of broadband, streaming media, and evolved forms of rich media, we believe Internet advertising will become pervasive. Rich media (ads with video, audio, interactive options, and e-commerce capabilities) deliver far higher click-through rates and audience retention than banners, where click-through rates have fallen below 1%.

- Historically, the introduction of new communications technologies has enabled rapidly evolving forms of advertising, and the Internet should be no different.

Interestingly, direct mail is now regarded as the most endangered form of advertising because consumers have too much control (they simply dump direct mail clutter). Because of the control consumers have on the Internet, new forms of advertising/promotion will become all-invasive for targeted audiences and the content perhaps as involved as current interactive video games. Online advertising, which is really a hybrid of traditional advertising, direct response advertising, and cost per lead, could ultimately slow the growth of the Internet if it becomes too pervasive. However, AOL attempts to create new features as advertising on the Internet increases, thus keeping the Internet experience positive for consumers.

3. **We believe that no clear valuation consensus on AOL Time Warner will emerge before the merger closes.**

   Thus, the shares of both companies could drift throughout the year. Although we are confident in our valuation of AOL Time Warner, we realize this is not a consensus view. Further, with AOL, minor assumption changes translate into large DCF valuation differences, as seen in the sensitivity analysis we provide within our Valuation section.

4. **In spite of the link between established and new media provided by Pittman, there are bound to be management conflicts as the two companies begin to integrate.**

   Culturally, the two companies are radically different, with AOL being one of the most aggressive companies around in new product development, marketing, and protecting its franchise. Managers below Case and Pittman are known to be "killers and cutthroats," according to the press. All management is given abundant incentives in the form of AOL stock. Given Time Warner's historic inability to make its powerful individual operations work together, notably in its efforts to digitize the company, AOL and Time Warner could go through an intense early period of culture clash. Further, if growth at the combined company is slower than expected, important AOL executives could leave the company.

The AOL/Time Warner Fit

What are the assets that AOL brings to the table in this union?

1. **Subscriber base:** With more than 21 million paying customers to its dial-up Internet access service, AOL has more than 10 times the paying customer base of its nearest competitor. The company also brings more than 3.1 million subscribers in the developing, competitive European markets and has launched dial-up access service in Japan, Australia, Brazil, and Hong Kong. In addition, AOL's communications portal ICQ has more than 50 million registered users (most of whom reside internationally), while its browser Netscape Navigator has 70 million and its Netcenter portal has 25 million.

2. **Relationships with content partners:** AOL does not technically create any of its own content (other than chat pages, live online events, and message board links). Rather, it relies upon partnerships with content-rich companies that require access to AOL's subscriber base. AOL offers news (CBS News, Associated Press, *New York Times*, *Time*); finance (Bloomberg, *Financial Times*, Intuit, TheStreet.com, DLJdirect, E*Trade, Citibank, etc.); health (drkoop.com, Medscape, the Mayo Clinic); travel (Travelocity.com, American Airlines, Avis, Hertz, etc.); sports (CBS Sportsline, Athlete

direct); entertainment (Oprah, Rosie, *People* magazine, *Entertainment Weekly*, E! Online); and kids (Cartoon Network, Nickelodeon, Children's Television Workshop, *Time for Kids*). Because of its extensive paying subscriber base, AOL attracts top established media and online media content.

3. **Relationships with online advertisers:** AOL has a $2.4 billion advertising backlog as of the quarter ended December 31, 1999. This backlog has grown more than 100% in the past 18 months as advertisers realize that AOL's growing paid subscriber base is perhaps the most valuable collection of eyeballs on the Internet. We believe AOL's advertising/e-commerce revenues should at least track projected growth of these businesses on the Internet. As with content partners, e-merchants are increasingly compelled to link up with AOL due to the increasing power of its subscriber base. Further, the advertiser bases of Time Warner and AOL are complementary. Time Warner does business with top-50 advertisers (packaged goods, auto makers, etc.), while AOL does business with many Warner advertisers, but a far greater portion of dot.com companies. AOL Time Warner should be able to cross-pollinate these advertiser bases, with the major draw being the company's combination of subscriber bases and brands.

From AOL's perspective, Time Warner brings the following assets to the party:

1. **Established brands built up through many years:** We believe such brands will be impossible to duplicate solely via the Internet because of competing noise and lack of brand-building time.

2. **Broadband access to about 20 million homes passed:** Broadband answers a critical need for AOL, which has found it difficult to secure open access to broadband networks.

3. **A subscriber/readership base in the hundreds of millions worldwide for Time Warner magazines and cable networks.**

AOL and Time Warner are both focused on subscription-based distribution and consumer branding. Technology is not the foremost consideration here, but rather content, customers, brands, marketing, and Internet communities. Furthermore, the combination of AOL and Time Warner brings what appear to be the essential elements of Internet success to the table: (1) a large subscriber base; (2) deep content, both highly specific and general; (3) the ability to reach hundreds of millions of people; and (4) many relationships with advertisers.

AOL and Time Warner operate largely complementary businesses.

AOL and Time Warner combine the largest subscription bases in the online and established media worlds

1. **Time Warner and AOL represents a combination of the largest paying subscriber bases and audience impressions in the established and the Internet worlds.**

   The combined companies make almost 2.5 billion impressions on consumers each month, including duplication.

   - AOL brings the largest paying subscriber base on the Internet, with 23.8 million subscribers worldwide at the end of calendar 1999. This includes 17.4 million to the domestic full-pay America Online service, 3.1 million to AOL Europe, 2.5 million to CompuServe 2000 and CompuServe Classic worldwide, and more than 740,000 to Gateway.net.

   - AOL's Instant Messenger service has more than 50 million users.

   - The company's communications portal ICQ and its Netcenter have 50 million and 20 million registrants, respectively.

- Time Warner brings a vast array of brands reaching global audiences, including CNN (1 billion households within reach), HBO (35 million subscribers), Time Inc.'s magazines (120 million readers), Warner Cable (13 million subscribers), Road Runner (over 400,000 customers), and three of the top five basic cable networks (TNN, TBS and Cartoon Network).

The merger is all about direct marketing

2. **The merger initially is all about direct marketing.**

The combined audience reach of the two companies will be used to aggressively cross-promote subscription products and services of both companies to a greater extent than previously. Time Warner's *People, TeenPeople, Entertainment Weekly*, CNN, and other brands are already available through AOL. However, there exist substantial opportunities to expand this relationship, as CNN.com and entertaindom.com programming and Warner EMI Music clips will be featured on numerous AOL sites. Time Warner will also promote the AOL service across its media properties and include AOL disks in promotional mailings. AOL will make its content assets—Instant Messenger, Digital City, AOL Search, and AOL MovieFone—available on Road Runner. Time Warner and MovieFone will also cross-promote Warner Brothers movies.

In our projections for the combined company, we use a high direct response success rate of 8% to increase AOL subscriptions through Time Warner's aggregate magazine, cable and HBO paying subscriber bases and magazines. We also use an 8% success rate for the reverse relationship—using AOL to increase Time Warner subscriptions.

CNN will also be critical to AOL's efforts to strengthen its international businesses, where it has faced the power of entrenched phone monopolies leading Internet markets, free service (subsidized by payments from local call revenues), and the need to localize its services.

3. **As broadband networks are further deployed, the quality of content on the Internet should change dramatically, enabled by streaming video and the introduction of wireless Internet services.**

At this point, AOL Time Warner, either alone or in partnership with others, will create Internet-specific video and audio interactive product that is basically a new form of entertainment and information. These new "killer apps" could drive consumers' embrace of the Internet. Not only will content be radically different and unique to the Internet, but advertising will also emerge from the development-stage and ineffective banner advertising prevalent today.

4. **AOL gains ownership of the country's second-largest MSO in Time Warner Cable, with more than 13 million subscribers, thus arguably eliminating its biggest threat, other than Microsoft, over the next several years.**

The company thus can ensure open ISP access to the cable pipeline at Warner Cable, as well as on the telephone companies' DSL platforms, DirecTV's digital satellite platforms, and through palm pilot and wireless broadband access. Coupled with AT&T's inclination toward open access, fully 40% of the homes passed in the cable industry will be open-access-friendly. Several smaller MSOs are likely to follow suit, given the weight of AT&T and Time Warner in the industry. AOL thus gains the ability to connect directly to broadband cable customers without an @Home gatekeeper (@Home and Road Runner subscribers pay $9.95 extra per month on top of their cable ISP bill to receive AOL), along with the opportunity to offer new interactive services. Further, AOL Time Warner stands to benefit from the emerging presence of broadband

and the evolution of the Internet from a static medium to a more dynamic arena of TV-quality video and CD-quality sound.

Synergy Opportunities

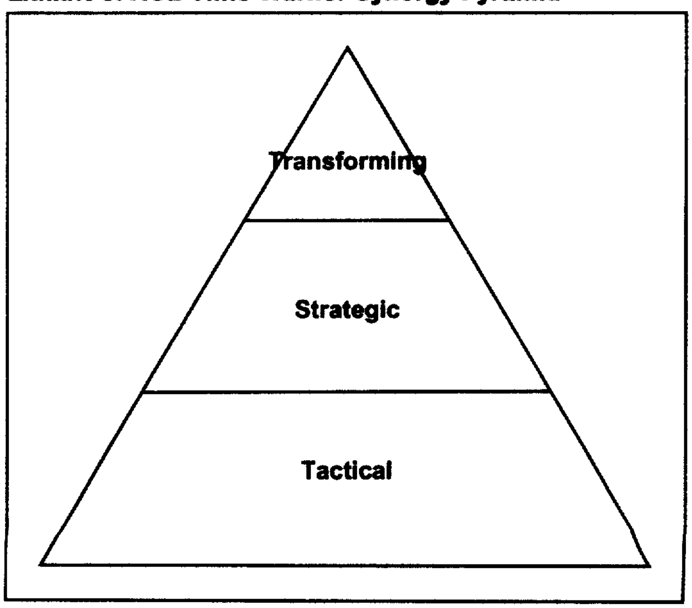
In 1984, Disney was operated in such a way that the pent-up value of its brands and its creative capabilities were obscured. With the addition of an aggressive, value-driven management team, Disney unleashed its creative powers and capitalized on new distribution avenues to trigger a 10-fold increase in the company's equity capitalization in the following eight years.

We believe Time Warner today is in many ways analogous to Disney in 1984. While we do not view Time Warner as so severely undermanaged as Disney was in 1984, the company nevertheless has experienced great difficulty in working across its strong individual businesses. The autonomy that has allowed the magazine, cable network, cable system, and other operations to excel under highly qualified operating management has not translated into the ability to work with each other to create new revenue opportunities.

Simultaneously, Time Warner's content operations now face a period of perhaps unprecedented distribution change that will entail the evolution of new entertainment forms and consumer access to a far larger portion of archived/catalog materials than ever before.

Broadly speaking, the combined management views three levels from which AOL Time Warner will derive synergies. These levels of synergies are presented below in the form of a pyramid.

Exhibit 3: AOL Time Warner Synergy Pyramid



Source: Credit Lyonnais Securities (USA) Inc.

1. **Transforming:** At this level, the company will work to develop new industry from the vast capabilities of AOL and Time Warner. The hardest to achieve, transforming synergies entail developing new uses of technologies from a combined skill set to create

value for customers. Steve Case will devote much of his time to this area, as well as dealing with policy matters.

2. **Strategic:** Similarly, strategic synergies include the creation of new business opportunities from existing assets. In the case of AOL Time Warner, the most obvious possibilities lie in the distribution of content via new means (e.g., digital recorded music downloads and video streaming).

3. **Tactical:** Tactical synergies are the most immediate benefits the company hopes to capture from the merger—the cost savings and revenue-generating opportunities that are available to the company by merely applying new business methods. Most of the $1 billion in synergies of which management speaks are contained here. The major areas where we see AOL Time Warner adding to revenues and cash flows are recorded music, magazines, direct mail publishing, HBO and cable TV systems.

   - **Marriage of the Time Warner content with the online market power of AOL distribution and vice versa:**

     This is arguably the central strategy behind the marriage of the two companies. We believe that AOL Time Warner will opt to create some content specifically for its own use, in order to distinguish the basic AOL narrowband and broadband Internet access services, while creating others for third-party use. AOL is determined not to be a portal through which customers pass to get somewhere else. (The company has been very successful in this regard, with 88% of AOL subscribers' online hours spent in AOL programming areas.) In one model, the value accretes to the AOL service and, with the other, the value accretes to created content separate from the AOL service. The provision of potentially valuable content to an in-house distribution system has been a flawed model historically, with either the distribution pipeline or the content suffering if in-house content is either poor or exceptionally good. Both Case and Levin embrace open networks.

   - **Cost savings:**

     A large part of the expected revenue synergy and cost savings gains of $1.0 billion in AOL Time Warner's first full year of operations is expected to come from cost savings, primarily through consolidation of duplicate corporate, back-office and other functions. We expect layoffs as well.

   - **AOL Anywhere:**

     Not only can the AOL narrowband, dial-up Internet access service probably benefit from cross-marketing to Time Warner's subscriber bases, but AOL could create a broadband version of itself and bundle it with Time Warner's basic cable networks. The beneficiaries in such an arrangement would be AOL online or on TV and the Time Warner Cable operations. AOL has already entered into several relationships with other prospective broadband service providers, including regional Bell operating companies (RBOCs) that reach 65% of the nation's households, and direct broadcast satellite (DBS) service provider DirecTV. The company has also developed relationships with Motorola for its digital smart phones and 3Com for its Palm Pilots, thus covering much of the potential broadband wired and wireless markets. We expect that AOL will also enter into some form of content provision agreements with a fiber-based long haul carrier.

- **Music:**

  We project that Warner EMI's online music sales will increase from an estimated 5% of total sales in 2000 to 15% of total sales by 2005 (in line with estimates of industry online sales as a percentage of the total). Further, we believe the revenue benefits will flow through to EBITDA at 25% margins—conservative in light of 30% margins in the music publishing business.

  Using Warner EMI Music artists, AOL will attempt to create music destinations on its service that complement the company's online music activities. These are focused today on Internet radio (the suite of Spinner Networks products, including the Spinner Player and digitized music channels from Spinner.com), MP3/CD/other digital music downloading formats (Winamp), and personalized streaming audio (SHOUTcast).

  Further, because of its highly developed online marketing operations, AOL should be able to expand Warner EMI Music sales across its membership base and spearhead the digital downloading of Warner EMI's catalog and current artist portfolios. The company will also attempt to develop a new talent service along the lines of that envisioned by Universal Music. Warner EMI is the only music company with access to such a large online subscriber base.

  We believe that online sales (both retail and download) will certainly cut into the existing CD market share, but the greater convenience of online music selling will expand the overall music pie significantly. AOL Time Warner can become both the recorded music company and the online retailer. The company will cross-promote recorded music extremely aggressively and the market should expand with the necessary broadband connections and "viral" marketing (word of mouth).

- **News:**

  In addition to CNN.com's online news services, we expect AOL to capitalize on the *Time* magazine and NY News 1 cable news franchises. We expect that CNN will become the key anchor tenant of AOL's online news area. From a broader perspective, we expect that AOL will attempt to leverage CNN's strengths internationally to expand its global subscriber base. Logically, one would expect simultaneous releases of breaking news stories on both CNN and AOL News. The two services are likely to heavily cross-promote one another, although CBS's domestic U.S.-only cross marketing agreement with AOL appears to preclude an immediate exclusive CNN cross-promotional effort.

- **Motion Picture/TV Programming:**

  In theory, Time Warner could distribute clips or the entirety of its film/TV programming over the Internet medium with the arrival of streaming video. The Internet could become a feedback loop for prospective TV series and films, as well. Warner Brothers already launched entertaindom.com, a Web site showing cartoons and other programming designed specifically for the Internet. AOL's ownership of MovieFone clearly comes into play here.

- **Publishing:**

  We project that AOL's cross-marketing can translate into an extra 10% growth in circulation and ad revenues in both 2001 and 2002. We expect EBITDA flowthrough will be extremely high. Time Inc.'s magazines appear to offer exciting Internet potential that has not yet been realized (see Time Warner Digital section below). Time has also not realized noticeable synergies with CNN, as had been hoped. Time Inc. supplies content from *People* and *Teen People*, as well as *Entertainment Weekly*, exclusively to AOL, which plans to launch a content and commerce service tied to *InStyle*. We believe there is great untapped potential in *Sports Illustrated* and *Time* magazines on the Internet, as well.

Aside from pure online leverage potential, we believe that a 3% success rate for Time Inc. subscriptions into the AOL subscriber base is achievable. Further, with the declining effectiveness of direct mail and disenchantment with sweepstakes subscription sales, the Internet could be used as a major subscription seller in the future.

- **Telephony:**

  AOL Time Warner plans to combine AOL's instant messaging products with Time Warner's broadband cable TV and telephony capability, bundling all three services to achieve higher growth rates for each individually. Bundling has become the central strategy behind numerous telecom services mergers and offering end-to-end telecom and Internet services remains a major goal in both industries. At least one of the three services would be offered at a discount. Arguably, a merger of the two companies is not necessary for this strategy to be implemented, but single-product companies such as AOL are vulnerable. We expect AOL Time Warner's telephony strategy to include a joint venture with AT&T that will bring open access for AOL from AT&T cable in return for the residential telephony venture in discussion for the past year. The resolution of the Time Warner Entertainment minority held by AT&T could be included in this transaction.

- **Audience aggregator potential from offering third parties access to combined subscriber bases:**

  The billions of impressions AOL Time Warner makes on consumers each month should be extremely attractive to potential e-tailers, both online and cross-promoted off-line.

- **International expansion:**

  AOL faces stiff competition in its prospects for expansion in international markets. Thus, the local clout of CNN and other Time Warner operations could aid AOL's international penetration. Media Metrix's November usage estimates for Germany, France, and the U.K. indicate AOL is in third to fifth place in Europe's major Internet markets. AOL Latin America officially launched its first country-specific service in Brazil (where there are already 500 ISPs in service) in November.

Time Warner Digital

We believe Time Warner has had all the elements in place for a successful digital strategy. However, the company has thus far lacked the cohesiveness to put its efforts together into a meaningful digital thrust. Historically, Time Warner has been viewed as heavy-handed and slow to react in its Internet efforts, partially due to the burden of separate cultures at its Time, Warner Brothers, and Turner units.

Until recently, most of Time Warner's Internet operations remained embedded in Pathfinder.com, which was the most visited of the company's Web sites as of mid-year, even though it was for all intents and purposes obsolete. Time Warner went through a failed experiment in aggregating the Warner and Time Inc. Web sites under the Pathfinder umbrella—users wanted to access the CNN and Time sites without going through a portal-type entry.

Management developed the basics of a companywide Internet strategy and aggregated all of its Internet interests into Time Warner Digital, run by Rich Bressler. Vice President Jim Moloshok is directly beneath Bressler in the Time Warner Digital hierarchy, and Jim Bannister heads up the company's entertainment hub operations. Moloshok and Bannister launched WB Online in 1995, and for several years the site has been profitable, due to its four revenue streams: advertising, content, licensing to AOL and Microsoft, and e-commerce and distribution. Time Warner Digital's central credo was to take advantage of its relationships with large numbers of consumers and longtime relationships with advertisers to build its Internet operations. The goals of Time Warner Digital are very similar to those of AOL Time Warner. They included:

1. Maintain the Warner and Time brands across the new Internet medium—a vital goal as consumer leisure time is gravitating to the Internet.
2. Cross-promote company products.
3. Create a standalone company that was to have become publicly traded, with the intrinsic benefits of being an acquisition currency for Internet companies and an incentive for talented Internet management to stay at Warner through stock options.
4. Ultimately create the Web sites that can channel Internet users to e-commerce sites to purchase Time Warner and other products in a retail world that is no longer based on brick-and-mortar points of sale. The central concept of the Internet appears to be easy impulse buying with sellers unburdened by the need for inventory or other physical constraints.
5. Establish a new method for audience testing of films, TV programs, etc. through on-Web original productions. Later, film and TV programming will be viewed on a PPV basis on the PC as well as the TV and in theatres.
6. Create multiple new revenue streams for TV content (i.e., advertising, e-commerce, sponsorship/promo, subscription, etc.).

The collective Time Warner Digital Web sites attracted 12.2–12.3 million unique visitors in December 1999, ranking it number 10 of all at-home and work sites by Media Metrix. This aggregation is generating billions of page views per month.

The five Time Warner Digital hubs were to be grouped according to the strengths inherent in the Time Inc. and Warner brands and were designed to allow the company to reformat existing content for use on the Internet. In CNN, *Sports Illustrated*, *Time*, *People*, *Southern Living*, and others, the company possesses many of the best-known brands in their fields, but all face intense competition on the Internet.

Time Warner has since scaled back its projected hubs to three. The three hubs are outlined briefly in the following bullet points:

1. **Personal Finance/Business:** This hub will be centered around the cnnfn.com Web site, which generates an estimated 1 billion-plus page views per year. In contrast, AOL's personal finance destination generates these page view levels in one month.
2. **News, Information, Sports:** Centered around the CNN and Time Inc. brands, the news hub will attempt to overcome some of the shortcomings of CNN/Time's historic attempts to integrate their brands and operating skill sets.

CNN has aggressively embraced the Internet

As part of Time Warner's developing Internet operations, CNN has been aggressive in developing on-line news businesses. CNN News Group operates nine Web sites, mostly through CNN Interactive. CNN's major Web sites are CNN.com and CNN Plus, a section of the primary Web site offering transcripts of CNN programming, games, chat rooms and other features. In addition, CNN operates Allpolitics.com (a political news Web site produced with Time magazines and *Congressional Quarterly*), CNN Custom News (a personalized news site), and additional online services in Spanish, Portuguese, Swedish, and Norwegian. The CNN News Group also operates CNNfn.com and CNNSI.com, which will be part of the business and sports hubs.

Like most Internet content operations, as well as the Internet offspring of major entertainment companies, CNN's Web sites are designed to establish beachheads where consumers are spending an increasing amount of their leisure time. All of these businesses are ad-supported, with charter sponsors such as Citibank and banner advertisers. Turner has a dedicated Internet ad sales staff and usually leverages its relationships with existing accounts for Internet sponsorships. The sports section of the hub will be centered around the Web sites for CNN/SI and most likely draw on numerous sports sources from *Sports Illustrated* and *Sports Illustrated for Kids*.

3. **Entertainment:** From its precursor as WB Online, this hub will contain the old WB Online as well as a mixture of news, listings, databases, and entertainment programming. The latter's centerpiece is Entertaindom, recently developed to embody "content, community, and commerce," the three relationship builders online. Entertaindom contains content developed specifically for the Internet, with the first being Driveon.com, a broadband interactive show offering video clips, celebrity interviews, and TV-style magazine material from *EW* and *People*. The site also contains content from third-party providers such as AtomFilms and Macromedia's Shockwave. The site uses animation, claymation, and live-action short films to cater to the short attention span that characterizes Internet usage. Because the WB's original videos for the Internet require high bandwidth, the WB will deliver its Animation content via DVDs containing the material which is encrypted (WebDVD). Consumers must visit the site at selected times to unlock the programming. This approach has met with skepticism due to the failure rate of past efforts to deliver Internet content via disks. If the concept works, management feels it can deliver an audience comparable to that of a hit TV show.

Also in the entertainment hubs is Warner's 50-50 joint venture with FortuneCity called ACMEcity, which launched in January 1999. ACMEcity is an online community wherein Warner attempts to aggregate all of the Warner characters into an area where the company can generate ad revenues. Fans set up their own fansites around popular Warner movie or TV characters and these sites all link back to Warner Web sites. Revenues are derived mainly from advertising placed by Warner on the fansites. ACMEcity now has 300,000 community members and 900,000 pages of content.

TW Digital's Entertaindom follows many content development failures, caused by high development costs relative to a small audience. Among other so-called second generation Internet content providers are Digital Entertainment Network and Pseudo Networks.

There is a school of thought that believes the Internet will not emerge as an entertainment medium, at least until broadband Internet access is widespread. Consumers are likely to demand at least TV-level quality for entertainment to emerge as an Internet business. We believe that the Internet via PC will remain primarily a medium for information and communication, while Internet via TV will emerge as the Internet access means for entertainment product.

However, Entertaindom's WebDVD-type delivery could benefit from the projected rapid growth of the DVD population, with as many as 20 million PCs containing DVD players within 12–18 months.

The predominant revenue streams on the Time Warner hubs will be advertising and sponsorship, as well as e-commerce, for the next several years. The company had planned to spend close to $250 million this year on development in this area.

With only entertaindom.com launched of the company's three Internet hubs, Time Warner clearly needs impetus behind its Internet efforts. We believe the AOL subscriber base can be a powerful tool to establish "place of mind" for Time Warner's digital/Internet offerings.

The following exhibit summarizes synergies we believe AOL Time Warner can achieve in its first two full years of operation.

Exhibit 4: AOL Time Warner Synergy Summary

[illegible]	[illegible]	[illegible]
HBO		
Cumulative Incremental Subscribers (1.7 mm in 2001 and 2002)	1.7	3.4
x Annual Subscription Fee Per Average Subscriber	$59.00	$60.77
Revenue Impact	100.3	206.6
Publishing:		
Magazines		
Advertising Pages		
Incremental Ad Page Growth from AOL	3.0%	5.0%
Cumulative Ad Page Growth from AOL	878.9	1,801.82
x Net Ad $/page ($000s)	87.6	92.0
Net Revenue Impact ($ millions)	77.0	165.8
Books		
Time Life Inc.		
Incremental Annual Revenue Growth	10.0%	10.0%
Cumulative Revenue Growth from AOL	10.0%	21.0%
Net Revenue Impact ($ millions)	49.9	115.2
Warner EMI Music		
Online Music Sales/Downloads as % of Offline	5.0%	7.0%
Net Revenue Impact ($ millions)	357.7	458.2
Cable Systems (ex. JVs)		
Cumulative Incremental Basic Sub Growth from 2000E Base	0.5%	2.0%
Cumulative Incremental Basic Subs from AOL	54,418.1	218,488.6
Average Annual Cumulative Basic Sub Adds	27,209.0	136,453.4
x Average Monthly Revenues per Basic Subscriber	$48.00	$51.36
Net Revenue Impact ($ millions)	15.7	84.1
Time Warner Digital		
Advertising:		
Culmulative Incremental Annual User Sessions (millions)	22.0	48.4
x Average Pages Viewed per User Session	24.3	27.3
x Average Ad Revenue per Page View	$0.02	$0.02
Incremental Ad Revenues	9.6	29.7
E-Commerce		
Incremental Page Views	534.8	1,323.7
x Commerce Page Views—% of Total Annual Page Views	4.0%	8.0%
x Take Rate	27.0%	32.0%
x Average Purchase Price	$14.11	$13.69
x Assumed TWX Commissions	10.0%	10.0%
Incremental E-Commerce Revenues	8.2	46.4
Net Revenue Impact ($ millions)	17.7	76.1
Total Revenue Synergies ($ millions)	**618.3**	**1,106.0**
Cost Synergies	350.0	450.0
Total Synergies ($ millions)	**968.3**	**1,556.0**

Source: Credit Lyonnais Securities estimates

Valuation: Where Should AOL Time Warner Trade?

The Outstanding Issues

There are several central valuation issues surrounding AOL Time Warner, some of which are industry-specific and some of which are company-specific. From an industry perspective, there are two major considerations:

1. **We believe that future hybrid media/Internet firms will be held predominantly by media investors and be valued as fast-growth entertainment companies.**

   This is due to the different perspectives of Internet and traditional media shareholders regarding investment horizon; orientation (value, growth, momentum, for instance); and growth expectations. Because of the size of embedded EBITDA of these new hybrids, we believe sustained 30% annual EBITDA growth is virtually impossible. For this reason, Internet investors will most likely seek smaller Internet plays or move to other industries.

2. **We do not believe there is any confluence model that can satisfy Internet investors due to slowed companywide EBITDA growth under all scenarios.**

   We believe the long-term growth expectations of Internet investors are exceedingly unrealistic given the uncertainties surrounding the economic models for Internet companies.

We address some company-specific valuation issues below.

Our Valuation Methodologies

We value AOL Time Warner in several ways:

Sum-of-the-Parts

As is true of pre-merger Time Warner and the other media companies in our universe, we believe sum-of-the-parts is the most useful way to capture the diverse economic characteristics of the businesses. Here, we use a variety of methodologies, which are presented in Exhibit 5.

Exhibit 5: Methodologies for Sum-of-the-Parts Valuation

Asset	Methodology
Developed Basic Cable Networks	14.5x–16.5x EBITDA
Developing/International Basic Networks	16.5x est 2005 EBITDA, disct'd @ 12%–13% per year
HBO	13.0x EBITDA
Cable TV Systems	14.0x analog cable EBITDA, plus DCF for new services
Filmed Entertainment	12.0x rolling 5 yr average EBITDA
Recorded Music	11.0x EBITDA
Magazine Publishing	15.5x EBITDA
Book Publishing	9.5x EBITDA
WB Network	DCF
AOL	DCF
Investments	Various

Source: Credit Lyonnais Securities estimates

The resulting AOL Time Warner valuation is presented below.

Exhibit 6: Sum-of-the-Parts AOL Time Warner Valuation

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Magazine Publishing (15.5x EBITDA)	9,665	11,478	15,648	20,440	23,911	27,821	32,220
Book Publishing (9.5x EBITDA)	1,296	1,374	2,699	3,956	4,816	5,521	6,306
TWX Cable TV Systems (14.0x EBITDA)	5,053	5,332	6,080	7,083	7,818	8,585	9,501
High Speed Data (12x Yr 2005 EBITDA, disct'd @ 17.5%)	329	386	454	533	627	750	848
Digital TV(12x Yr 2003 EBITDA, disct'd @ 17.5%)	267	314	369	434	510	595	648
Recorded Music (11x EBITDA)	5,786	6,857	8,977	10,716	11,978	13,244	14,073
TBS Assets:							
Entertainment Networks							
Core TNT/TBS and Other (@ 16.5x EBITDA)	10,016	10,146	10,920	12,029	12,874	13,549	14,212
Startup Networks (@ 16.5x 2003 EBITDA, discounted @ 12%)	6,793	7,608	8,521	9,544	10,689	11,972	13,409
New Line/Castle Rock (12x EBITDA)	2,592	1,770	2,089	2,260	2,455	2,675	2,926
Total Entertainment	19,401	19,524	21,530	23,833	26,018	28,196	30,547
News:							
Domestic Networks (16x EBITDA)	5,141	5,266	5,403	5,679	5,955	6,230	6,502
CNNI (16x Est. 2005 EBITDA disct'd @ 13%)	2,726	3,080	3,480	3,933	4,444	5,022	5,675
CNNfn (15x est. 2005 EBITDA, disct'd @ 13%)	353	399	451	509	575	650	735
CNNSI (15x est. 2005 EBITDA, disct'd @ 13%)	561	634	716	809	914	1,033	1,167
Total News	8,781	9,378	10,050	10,930	11,889	12,935	14,079
Gross TBS Value	28,181	28,902	31,580	34,763	37,906	41,130	44,626
Time Warner Digital (DCF)	1,534	1,764	2,028	2,333	2,683	3,085	3,548
Sports Teams	540	583	630	680	735	793	857
World Championship Wrestling (@ 12x est. EBITDA $27 mm)	324	356	392	431	474	522	574
Real Estate, Other	378	408	441	476	514	555	600
n-tv (+20% yr)	138	166	199	239	287	344	413
America Online (See Exhibit 8)		182,984	204,710	228,402	254,635	283,301	314,451
Equity Investments:							
Time Warner Telecom (51% @ FTV)	1,468	1,533	1,792	2,051	2,365	2,708	3,100
CDNow (37% at FTV)	535	630	739	871	1,021	1,194	1,395
Court TV (+15% yr. - 50%)	300	345	397	456	525	603	694
TWE Japan (37.3%) +20% yr.	415	498	597	717	860	1,032	1,238
Road Runner (38%)	1,318	1,467	1,685	1,957	2,293	2,707	3,183
Total Investments	4,036	4,473	5,210	6,051	7,064	8,244	9,610
80% TWE (See Exhibit 7)	37,561	44,362	55,224	65,944	76,330	87,540	100,178
Gross Value	**95,089**	**289,739**	**334,640**	**382,481**	**430,288**	**482,032**	**538,452**
Less: Ending Debt	(18,010)	(16,142)	(9,040)	1,366	14,788	31,686	52,334
Add: 20% of TWE Net Debt (Cash)	1,216	1,026	522	(238)	(1,129)	(2,166)	(3,368)
Add: 50% Warner EMI Net Debt		1,375	880	166	(725)	(1,808)	(3,036)
Net Estimated Fair Trading Value	**78,295**	**275,999**	**327,002**	**383,775**	**443,221**	**509,744**	**584,380**
Average Common Shares Outstanding (millions)	1,398	4,800	4,800	4,800	4,800	4,800	4,800
Fair Trading Value per Share	**$55.99**	**$57.50**	**$68.13**	**$79.95**	**$92.34**	**$106.20**	**$121.75**

Source: Credit Lyonnais Securities estimates

Exhibit 7: Sum-of-the-Parts Time Warner Entertainment Valuation

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Cable Systems (14.0x EBITDA)	29,918	33,926	40,048	45,695	50,944	55,516	60,517
High Speed Data (12x Yr 2003 EBITDA, disct'd @ 17.5%)	1,455	1,710	2,009	2,361	2,774	3,488	4,394
Digital TV (12x Yr 2003 EBITDA, disct'd @ 17.5%)	1,213	1,425	1,674	1,967	2,311	2,773	3,017
AT&T JV (22.5% TWE owned)	1,415	1,605	1,819	2,081	2,382	2,835	3,372
Filmed Entertainment (12.0x EBITDA)	12,358	13,832	15,399	15,399	15,399	15,399	15,399
Home Box Office:							
Domestic HBO (13x EBITDA)	7,228	8,477	11,322	14,563	16,881	19,553	22,662
HBO International Ventures (15x 2000 EBITDA disct'd @ 13%)	821	927	1,048	1,184	1,338	1,512	1,709
Total Home Box Office Fair Trading Value	8,049	9,405	12,370	15,748	18,219	21,065	24,371
Equity Accounted Investments:							
Cable TV Systems (Same Multiples as Consol.; EBITDA $27 (+7% yr) less debt x 50%)	220	238	257	277	299	323	349
50% of Texas Partnership	1,498	1,886	2,243	2,540	2,805	3,027	3,255
50% of Kansas City Cable Partners	788	979	1,150	1,298	1,447	1,573	1,706
WB Network (75%; @13x 2007 EBITDA, disct'd @ 13%)	1,225	1,384	1,564	1,768	1,998	2,257	2,551
Comedy Central (@ 16x Est. 2005 EBITDA, disct'd @ 13%)	553	625	707	798	902	1,020	1,152
PrimeStar Partners LP - 31% - Value +13% Yr	9	10	12	13	15	17	19
PrimeStar Subscribers ($1400/sub) + 25% yr	10	13	16	20	24	31	38
Australia Theme Parks (+15%/yr)	350	402	463	532	612	704	809
Total TWE Investments	4,653	5,537	6,410	7,246	8,102	8,951	9,878
Gross TWE Fair Trading Value	**59,060**	**67,439**	**79,729**	**90,495**	**100,131**	**110,026**	**120,947**
Less: Ending Debt	(6,080)	(5,131)	(2,608)	1,189	5,647	10,828	16,841
Less: 18.5% Newhouse Cable Minority	(6,028)	(6,856)	(8,090)	(9,254)	(10,365)	(11,429)	(12,567)
Net TWE Fair Trading Value	**46,951**	**55,452**	**69,030**	**82,430**	**95,413**	**109,425**	**125,222**
TWX Portion = 80%	37,561	44,362	55,224	65,944	76,330	87,540	100,178
UMG Position = 20%	9,390	11,090	13,806	16,486	19,083	21,885	25,044

Source: Credit Lyonnais Securities estimates

Within our sum-of-the-parts, we note several valuation issues, notably (1) the valuation of America Online and (2) the determination of multiples to be assigned to the basic cable network and magazine publishing EBITDA streams.

1. **The main difference from our previous Time Warner model is the incorporation of the value of the AOL businesses.**

   For this purpose we have constructed an eight-year discounted cash flow valuation model for AOL (adjusted to the December fiscal year to which it will convert upon consummation of the deal). This valuation is presented in the exhibit on the following page. The most pertinent assumptions we make are (1) the weighted average cost of capital (WACC) and (2) the long-term growth in free cash flow to firm (FCFF).

   - **WACC:** As AOL is running a net cash position on its balance sheet, WACC is the cost of equity, we which determine by applying a projected beta to a market proxy. As seen below, AOL's historical beta is approximately 1.78. As the Internet becomes a larger portion of the general economy and less speculative as investment vehicles, we believe the volatility of Internet shares will come down. Thus, we are using a projected beta of 1.2. As a proxy for required market return, we are using 12%. At a 1.25 beta, AOL's required return on equity would be 14.1%.

   - **Long-term growth:** Although AOL's annual FCFF growth rates remain in the 16%–20% in the outer years of our projection period, growth over the long term will resemble perpetual long-term revenue growth. In this scenario, we believe subscription will eventually become a commodity and be priced downward to marginal levels and possibly even zero. If so, growth will be driven by advertising and e-commerce commissions. While both online advertising and e-commerce revenues are projected to escalate rapidly for the next 5–10 years and probably beyond, their growth must eventually mirror those of traditional advertising and commerce, which have traditionally grown at annual rates in the single digits. Factoring the higher growth rates in the early years of the terminal period, we use a 10% long-term growth rate assumption.

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

Exhibit 8: Standalone America Online Discounted Cash Flow Valuation

[illegible]	[illegible]	[illegible]	2001E	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	2007E	2008E
Free Cash Flow	(308)	1,299	2,233	3,138	4,148	5,336	6,567	7,869	9,267	10,806
Add: After-Tax Interest (0 if Net Cash)										
Free Cash Flow to Firm (FCFF)	**(308)**	**1,299**	**2,233**	**3,138**	**4,148**	**5,336**	**6,567**	**7,869**	**9,267**	**10,806**
% Change		-521.7%	72.0%	40.5%	32.2%	28.7%	23.1%	19.8%	17.8%	16.6%
Assumptions:										
Long-Term Terminal Growth Rate	10.0%									
Proxy Market Return	12.0%									
Historical Beta	1.78									
Assumed Forward Beta	1.17									
Cost of Capital	14.10%									
Terminal	24.4x									
Years to Discount	0	1	2	3	4	5	6	7	8	9
		0	1	2	3	4	5	6	7	8
			0	1	2	3	4	5	6	7
				0	1	2	3	4	5	6
					0	1	2	3	4	5
						0	1	2	3	4
							0	1	2	3
								0	1	2
									0	1
										0
Present Value of FCFF	(308)	1,149	1,749	2,175	2,544	2,896	3,154	3,345	3,486	3,597
		1,299	1,977	2,457	2,874	3,273	3,564	3,780	3,939	4,065
			2,233	2,777	3,248	3,698	4,027	4,271	4,451	4,593
				3,138	3,670	4,179	4,551	4,826	5,030	5,190
					4,148	4,722	5,143	5,454	5,684	5,865
						5,336	5,811	6,163	6,423	6,628
							6,567	6,964	7,258	7,489
								7,869	8,201	8,463
									9,267	9,563
										10,806
Sum of Present Value or FCFF Stream	23,787	27,228	29,300	30,585	31,015	30,360	28,277	24,533	18,830	10,806
Present Value of Terminal Value	95,689	108,129	122,186	138,070	156,019	176,301	199,220	225,119	254,385	287,454
Option Cash	382	382	382	382	382	382	382	382	382	382
Investments										
$1.5 Billion in DirecTV Preferred (6.4%, convert within 3 yrs 6/03)	1,500	1,500	1,500	1,500	1,725	1,984	2,281	2,624	3,017	3,470
25% China.com @ Mkt Value +20% Yr		860	1,032	1,238	1,486	1,783	2,140	2,568	3,082	3,698
Other Investments @ Mkt +20% Yr		6,300	7,560	9,072	10,886	13,064	15,676	18,812	22,574	27,089
Gateway Investment		620	744	893	1,071	1,286	1,543	1,851	2,222	2,666
80% of AOL Canada	4,431	5,112	5,842	6,689	7,678	8,794	10,025	11,394	12,915	14,608
50% of AOL Europe	11,955	13,632	15,587	17,861	20,467	23,432	26,783	30,557	34,791	39,536
50% of AOL Hong Kong	371	431	497	577	672	787	914	1,061	1,228	1,417
50% of AOL Japan	2,771	3,190	3,680	4,273	4,955	5,750	6,642	7,647	8,763	10,012
50% of AOL Australia	886	1,016	1,169	1,347	1,568	1,817	2,099	2,415	2,772	3,174
50% of AOL Latin America	5,545	6,385	7,336	8,440	9,787	11,353	13,144	15,181	17,474	20,044
NOL		8,200	7,896	7,476	6,923	6,209	5,324	4,252	2,970	1,451
Gross Company Value	**147,319**	**182,984**	**204,710**	**228,402**	**254,635**	**283,301**	**314,451**	**348,384**	**385,404**	**425,807**
Ending Net Cash (Debt)	954	2,253	4,486	7,624	11,772	17,108	23,674	31,543	40,811	51,617
Net Present Value	**148,273**	**185,237**	**209,196**	**236,027**	**266,407**	**300,409**	**338,126**	**379,938**	**426,214**	**477,424**
Diluted Shares	2,496	2,496	2,496	2,496	2,496	2,496	2,496	2,496	2,496	2,496
NPV per Share	**$59.40**	**$74.21**	**$83.81**	**$94.56**	**$106.73**	**$120.36**	**$135.47**	**$152.22**	**$170.76**	**$191.28**
% Change		24.9%	12.9%	12.8%	12.9%	12.8%	12.6%	12.4%	12.2%	12.0%

Source: Credit Lyonnais Securities estimates

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