

TIME WARNER INC.
Form DEF 14A
April 24, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

SCHEDULE 14A
Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934
(Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Pursuant to § 240.14a-12

Time Warner Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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- x No fee required.
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April 24, 2015

Dear Fellow Shareholder:

2014 was a milestone year for Time Warner.

We completed the strategic transition of the company from a traditional media conglomerate to a global media company focused on high-quality video content. It's a process that began several years ago and culminated with the separation of Time Inc. in 2014.

As a result, Time Warner is uniquely well positioned for today's media environment. We have the scale that comes with industry-leading positions in cable networks at Turner and Home Box Office and with the world's preeminent television and film studio at Warner Bros. And we have the focus that comes with a naturally aligned set of businesses. This combination allows us to move swiftly to take advantage of the growing worldwide consumer demand for high-quality video content, while leading the industry in developing new products and services that capitalize on technology and address consumers' ever-evolving expectations.

Sustained Performance. Last year, we made great progress in executing our strategy to drive superior and sustained operating and financial performance. The core of our strategy is to use our industry-leading scale to produce high-quality, branded video content and distribute that content on traditional and emerging platforms worldwide, and to manage our businesses and capital resources with a high degree of discipline to provide for ongoing earnings growth and direct returns of capital to our shareholders.

As a result, we grew Adjusted EPS by 18% and Free Cash Flow by 12% in 2014. Our Total Shareholder Return (TSR) for the year was 30%, the highest among all our media peers and double the S&P 500 average. This represents a continuation of our strong performance, with Adjusted EPS growth of at least high teens for the sixth consecutive year and a TSR of 244% over the last five years. We demonstrated our commitment to providing direct returns to our shareholders, with \$6.6 billion in share repurchases and dividends in 2014 and a cumulative \$26 billion since 2008. In early 2015, we reinforced this commitment by raising our dividend by 10%, the sixth straight year of double-digit increases.

Plans for Future Growth. In addition to delivering strong performance in 2014, we adopted an aggressive plan for Time Warner as a video-focused company. At our investor event on October 15th following the spin-off of Time Inc. and the withdrawal of an unsolicited takeover offer by Twenty-First Century Fox, our management team presented specific strategic, operating, and financial goals for the company through 2018, reflecting the long-range plan for 2014-2018 approved by the Board of Directors. While acknowledging the challenges facing the media industry, we also identified key upside opportunities including HBO NOW, a stand-alone HBO streaming service (which launched in April of this year), a global initiative by Turner and Warner Bros. to expand our kids' businesses, and an ambitious plan to use DC Comics' rich trove of characters and stories across Warner Bros.' businesses, including consumer products and videogames.

Next Generation of Management. 2014 was also the first full year with a new senior management team in place at our three operating divisions—John Martin at Turner, Richard Plepler at Home Box Office and Kevin Tsujihara at Warner Bros.—and a new CFO at Time Warner—Howard Averill. Reflecting the deep management strength we have at Time Warner, these executives bring decades of company and industry experience to their new positions. They also exemplify a renewed energy, drive, and natural ability to work together to create shareholder value.

Effective Governance. In the following proxy statement, you can read a great deal more about our Board, strong governance policies and practices, and compensation programs. Our governance policies and practices and compensation programs are based on a few key pillars, including:

A thoughtful approach to governance, with the overriding goal of having effective structures, policies and practices that serve the best interests of our shareholders over the long-term.

A strong, independent and informed board, whose members bring a diversity of perspectives, backgrounds, skills and tenure to help oversee a global media company, including experience in the media, technology, and consumer-facing industries, as well as success in building and managing large and successful global enterprises.

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A robust shareholder engagement program, which allows for a constructive dialogue on variety of topics with our shareholders that helps to inform our Board's decisions.

An approach to compensation that is designed to attract and retain a strong management team in a competitive environment, and that provides appropriate incentives to drive exceptional long-term performance.

On behalf of the entire Board of Directors, we want to express our appreciation for your investment in Time Warner.

As the company executes the plans we've shared with you, the Board of Directors and management will continue to look for additional opportunities to drive sustained and superior performance for you, our shareholders.

We look forward to seeing those of you who are planning to attend the Annual Meeting in person. If you are unable to attend the meeting in person, you may listen to the webcast of the Annual Meeting live at www.timewarner.com/annualmeetingmaterials.

Sincerely,

Jeffrey L. Bewkes
Chairman of the Board

Stephen F. Bollenbach
Lead Independent Director

and Chief Executive Officer

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NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

Annual Meeting Date: Friday, June 19, 2015

Time: 10:00 a.m. (local time)

Location: Georgia World Congress Center, Georgia Ballroom, Building C, Level 3,
235 Northside Drive, Atlanta, Georgia

(see directions on the last page of the Proxy Statement)

Record Date: Close of business on April 20, 2015

You are cordially invited to attend Time Warner Inc.'s 2015 Annual Meeting of Shareholders (the Annual Meeting or the 2015 Annual Meeting).

Meeting Agenda:

1. Elect the 12 directors named in the Proxy Statement;
2. Ratify the appointment of Ernst & Young LLP as the Company's independent auditor for 2015;
3. Hold an annual advisory vote to approve named executive officer compensation;
4. Consider and vote on the shareholder proposals included in the Proxy Statement, if properly presented at the Annual Meeting; and
5. Transact such other business as may properly come before the Annual Meeting.

Who Can Vote at the Annual Meeting: Only holders of Time Warner's common stock as of the record date are entitled to vote on the proposals described above at the Annual Meeting or any adjournments or postponements of the meeting.

Voting: Whether or not you plan to attend the Annual Meeting in person, your vote is important. After reading the Proxy Statement, please promptly submit your proxy or voting instructions by Internet, telephone or mail by following the instructions in your Notice of Internet Availability of Proxy Materials, proxy card or voting instruction form. Any holder of record who is present at the Annual Meeting may vote in person, which will revoke any previously submitted proxy. If your shares are held through a bank or brokerage account and you want to vote in person at the Annual Meeting, you will need to contact your bank or broker to obtain a written legal proxy from the record holder of your shares.

Attending the Annual Meeting: If you are attending the Annual Meeting in person, you can register in advance by calling (855) 883-3141 by 5:00 p.m. EST, Monday, June 15, 2015. A map with directions to the Annual Meeting is provided on the last page of the Proxy Statement. You will be required to present government-issued photo identification (*e.g.*, driver's license or passport) to be admitted to the Annual Meeting. Inspection of packages and bags, among other measures, may be employed to enhance the security of those attending the Annual Meeting. These procedures may require additional time, so please plan accordingly. To avoid disruption, admission may be limited once the Annual Meeting begins. If you are unable to attend the meeting in person, you may listen to the webcast of the Annual Meeting live at www.timewarner.com/annualmeetingmaterials.

TIME WARNER INC.

Paul F. Washington

Corporate Secretary

April 24, 2015

Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting of Shareholders to Be Held on Friday, June 19, 2015:

This Proxy Statement and the Company's 2014 Annual Report to Shareholders are available electronically at www.timewarner.com/annualmeetingmaterials.

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This summary highlights information contained in this Proxy Statement. We encourage you to read the entire Proxy Statement carefully before voting.

Matters to Be Voted on at the Annual Meeting

Matter	Board Recommendation	Page Reference For More Information
Proposal 1: Election of Directors	FOR each nominee	Pages 4 to 15
Election of 12 directors for a term of one year and until their successors are duly elected and qualified:		
James L. Barksdale	Jessica P. Einhorn	
William P. Barr	Carlos M. Gutierrez	
Jeffrey L. Bewkes	Fred Hassan	
Stephen F. Bollenbach	Kenneth J. Novack	
Robert C. Clark	Paul D. Wachter	
Mathias Döpfner	Deborah C. Wright	
Proposal 2: Ratification of the appointment of Ernst & Young LLP as independent auditor for 2015	FOR	Page 16
Proposal 3: Advisory vote to approve named executive officer compensation	FOR	Page 17
Proposal 4: Shareholder proposal on right to act by written consent	AGAINST	Pages 18 to 20
Proposal 5: Shareholder proposal on tobacco depictions in films	AGAINST	Pages 21 to 23
Proposal 6: Shareholder proposal regarding greenhouse gas emission targets	AGAINST	Pages 24 to 26

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Business and Governance

Focused Business Model	<p>With the spin-off of Time Inc. in June 2014 (the Time Separation), Time Warner Inc. (Time Warner or the Company) completed multi-year transition under the leadership of Jeff Bewkes to a global media company focused on high-quality video content with an unmatched collection of television and film businesses</p> <ul style="list-style-type: none"> i Biggest cable network group (Turner Broadcasting System, Inc. (Turner) and Home Box Office, Inc. (Home Box Office)) i Largest television and feature film studio in the world (Warner Bros. Entertainment Inc. (Warner Bros.)) <p>Also completed transition in senior leadership, with new CEOs assuming responsibility at Turner, Home Box Office and Warner Bros. and a new CFO at Time Warner – these executives bring deep industry experience to their new roles, and their appointments reflect the Company’s strong succession processes</p>
Clear Operating Strategy	<p>Use leading scale and brands to create the best content</p> <p>Use technology to enhance consumer experience, drive usage and improve Company economics</p> <p>Expand internationally with a focus on faster-growing territories</p> <p>Focus on operating and capital efficiency</p>
Sustained Strong Financial Performance	<p>Increased Adjusted EPS 18% to \$4.15, the 6th consecutive year of at least high teens growth</p> <p>Posted Adjusted Operating Income of \$5.8 billion in 2014 and grew Adjusted Operating Income at a 6% compound annual growth rate (CAGR) over the</p>

past five years

Grew Free Cash Flow 12% to \$3.5 billion

Delivered shareholder returns of 30.0%, 162.5% and 244.3% over the one, three and five-year periods, respectively, in each case at or near the top of the Company's entertainment and media peer group

**Compensation Program Closely
Aligned with Performance**

Compensation program supported strong financial and operating performance by the Company in 2014

- i Substantial emphasis on variable performance-based compensation (93% for CEO)
- i Mix of performance measures tied to underlying business and stock performance, with focus on long-term sustainable growth
- i Challenging financial and strategic goals set at the beginning of each performance period
- i Compensation decisions informed by shareholder perspectives

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- i Shareholders representing 89.5% of the votes cast at the Company’s 2014 Annual Meeting of Shareholders (the 2014 Annual Meeting) voted in favor of the compensation of the named executive officers (NEOs) included in the Company’s 2014 Proxy Statement

Taking into account shareholder feedback received in recent years and the results of the 2014 advisory vote on NEO compensation, the Compensation and Human Development Committee (the Compensation Committee) determined to maintain the overall executive compensation structure for 2015




Strong Governance Practices

The Board of Directors (the Board or the Board of Directors) leadership structure and composition provide effective independent oversight

Leading governance policies and practices guide the Board in carrying out its duties and responsibilities. Key examples of Time Warner’s long-standing commitment to strong governance practices and policies include:

- i A substantial majority of directors must be **independent**
- i **Board qualifications** ensure that directors have a variety of complementary skills, professional experience, and backgrounds and bring **diverse viewpoints and perspectives** to the Board
- i A **mix of tenures** for non-employee directors with an expectation that average tenure will generally not exceed 10 years
- i A **Lead Independent Director** with significant authority and responsibilities
- i **Annual elections** of directors with a **majority-vote standard** in uncontested elections
- i **No supermajority voting provisions** in the Company’s Charter or By-Laws
- i **Stock ownership requirements** for executive officers and directors
- i **Prohibitions on hedging and pledging** Company common stock by executive officers and directors
- i **Codes of conduct** for executive officers and directors
- i Shareholders having the **right to request special meetings** (15% threshold)



Long-standing practice of engaging with shareholders throughout the year on a range of compensation, governance and environmental and other corporate responsibility matters

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Proposal 1: Election of Directors

One Time Warner Center

New York, NY 10019-8016

PROXY STATEMENT

This Proxy Statement is being furnished to holders of Time Warner common stock, par value \$0.01 per share (Common Stock), as of the record date (April 20, 2015) in connection with the solicitation of proxies by the Board of Directors of Time Warner Inc., a Delaware corporation, for use at the Annual Meeting of Time Warner's shareholders (the Annual Meeting) to be held on Friday, June 19, 2015, at the Georgia World Congress Center, Georgia Ballroom, Building C, Level 3 in Atlanta, Georgia, commencing at 10:00 a.m., local time, and at any adjournment or postponement of the meeting, for the purpose of considering and acting on the matters set forth in the accompanying notice and in this Proxy Statement.

COMPANY PROPOSALS

Proposal 1: Election of Directors

Director Nominees

12 Director Nominees. The Board nominated for election at the Annual Meeting the 12 nominees named below on the recommendation of the Nominating and Governance Committee of the Board (the Nominating Committee). Each of the nominees currently serves as a director of the Company and was elected by the shareholders at the 2014 Annual Meeting. If any nominee is unable or unwilling to serve as a director at the time of the 2015 Annual Meeting, the persons named in the proxy card (who are appointed by shareholders as their proxies) intend to vote, in their discretion, for such other persons, if any, as may be designated by the Board. As of the date of this Proxy Statement, the Board has no reason to believe that any of the nominees will be unable or unwilling to serve as a director if elected. The persons named in the proxy card as shareholders' proxies intend to vote such proxy for the election of each of the nominees, unless a shareholder indicates on the proxy that the vote should be against any or all of the nominees.

Election for a One-Year Term. The nominees will be elected to serve for a one-year term until (i) the next annual meeting of shareholders and until their successors have been duly elected and qualified or (ii) their earlier death, resignation or retirement.

Majority Voting Standard for Election of Nominees. Because the election of the directors at the 2015 Annual Meeting is uncontested, a majority of the votes duly cast by the holders of Common Stock with respect to each director is required for the election of that director.

Director Resignation By-Law Provision. If an incumbent director nominee in an uncontested election receives more against votes than for votes, the director must submit an offer to resign from the Board. The Board will then consider the resignation offer and may either accept the resignation offer or reject the resignation offer and seek to address the underlying cause(s) of the against votes. The Board is required to make its determination within 90 days following the

certification of the shareholder vote and make a public announcement of its decision, including a statement regarding the reasons for its decision if the Board rejects the resignation offer.

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Proposal 1: Election of Directors

Director Nomination Process

There are a number of different ways an individual can be nominated for election to the Board.

Nominations Developed by the Nominating Committee. The Nominating Committee follows the steps described below to identify and propose an individual for election to the Board:

In addition to evaluating the composition of the Board as part of an annual self-evaluation process, the Nominating Committee conducts periodic assessments of the overall composition of the Board in light of the Company's current and expected future business needs and structure and, based on such assessments, may establish specific qualifications that it will seek in Board candidates. The Nominating Committee reports on the results of these assessments to the Board.

The Nominating Committee seeks advice and the names of potential director candidates from members of the Board, management, major shareholders, and other public and private sources. The Nominating Committee sometimes retains a search firm to assist it in these efforts. The Nominating Committee reviews the qualifications of incumbent candidates for re-nomination to the Board annually.

The Nominating Committee recommends a slate of director candidates, which may include both incumbent and new director nominees, to submit for shareholder approval at the annual meeting of shareholders. The Nominating Committee may also recommend that the Board elect new members of the Board who will serve until the next annual meeting of shareholders.

Shareholder Recommendations Submitted to the Nominating Committee. Shareholders may submit names of director candidates to the Nominating Committee for its consideration by following the process described below under **Other Procedural Matters – Procedures for Submitting Director Recommendations and Nominations.**

Shareholder Nominations Submitted to Shareholders. Shareholders may submit nominations directly to the Company's shareholders by following the process set forth in the Company's By-laws. This process is described below under **Other Procedural Matters – Procedures for Submitting Director Recommendations and Nominations.**

Criteria for Board Membership

The Nominating Committee and the Board take into consideration many factors in reviewing candidates and apply the same criteria to all candidates. The Board believes that the Company is best served by a board of directors consisting of individuals who not only share certain characteristics such as a high level of integrity, professional accomplishment and business judgment, but also bring a variety of complementary skills, professional experience, backgrounds and diverse viewpoints and perspectives to the Board.

Board Statement regarding Tenure and Mandatory Retirement Age. The Corporate Governance Policy provides that non-employee directors will not be eligible for nomination for a term during which they will reach age 75.

Reflecting a commitment to Board refreshment, this Policy also states that the Board believes the Board and the Company are well-served by having non-employee directors with a mix of tenures and expects that the average tenure of non-employee directors will generally not exceed 10 years.

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Table of Contents**Proposal 1: Election of Directors***Criteria for All Director Candidates**Additional Criteria for New Director Candidates*

Personal Qualities. Each director must possess a demonstrated reputation for integrity, judgment, acumen and high professional and personal ethics.

Experience. Each director should be financially literate and have significant experience at the policy-making level in business, government or the non-profit sector. **In evaluating director candidates, the Board also considers the categories of business experience discussed below in light of the Company's current and expected business needs.**

Independence. A majority of the Board, and, unless otherwise determined by the Board, any newly nominated non-employee candidate for the Board, must satisfy the criteria to be considered an independent director under the Company's By-laws and Corporate Governance Policy and the applicable New York Stock Exchange (the NYSE) listing standards.

Commitment. Each director must have the time and ability to make a constructive contribution to the Board, as well as a clear commitment to fulfilling the director's fiduciary duties and serving the interests of the Company's shareholders. In addition, to help ensure that directors have sufficient time to devote to their responsibilities as a director, the Board has determined that directors should generally serve on no more than five other public company boards. Directors are required to offer their resignation upon a significant change in their primary

Professional Experience. New director candidates should have significant high-level leadership experience at a public corporation or other firm, in government or at a non-profit institution. The performance of the director candidate while at such public corporation or other firm, in government or at a non-profit institution is an important factor the Nominating Committee considers when evaluating a candidate.

Diversity. The Corporate Governance Policy requires the Nominating Committee and the Board to consider the Board's overall composition when considering director candidates, including whether the Board has an appropriate combination of professional experience, skills, knowledge and variety of viewpoints and backgrounds in light of the Company's current and expected future business needs. In addition, as set forth in the Policy Statement Regarding Director Nominations, the Nominating Committee believes that it is desirable for new candidates to contribute to the variety of viewpoints on the Board, which may be enhanced by a mix of different professional and personal backgrounds and experiences.

Committee Eligibility. The Nominating Committee believes it is desirable for new candidates to satisfy the requirements for serving on the Board's committees, as set forth in the charters for those committees and applicable regulations.

professional responsibilities, and, in such case, the Nominating Committee will make a recommendation to the Board as to whether to accept the offer of resignation.

Director Experience. The Nominating Committee believes it is useful for candidates for the Board to have experience as a director of a major public corporation.

Age. Under the Company's By-laws and Corporate Governance Policy, each director must be at least 21 years of age at the commencement of service as a director and is not eligible for nomination for a term during which they will reach age 75.

Antitrust Requirements. Each director must satisfy the requirements of antitrust laws, which limit service as an officer or director of the Company's significant competitors.

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Table of Contents**Proposal 1: Election of Directors***Business Experience Considered for All Director**Director Nominee Experience**Candidates*

Leadership and Senior Management. Experience serving as a founder, chief executive officer or a senior executive of a major corporation or firm (or a comparable position in government or the non-profit sector). Directors who have served in significant leadership positions over an extended period, especially chief executive officer positions are important, as they bring experience with developing, implementing and overseeing the execution of business plans and strategies. Directors with this experience also generally possess strong leadership qualities and the ability to identify and develop those qualities in others.

All of the nominees for director have leadership or senior management experience, including eight nominees who are either current or former chief executive officers of public or private companies.

Media, Communications or Technology Businesses. Knowledge of and experience in media, communications and/or technology businesses. As a leading media and entertainment company, relevant industry experience is important in understanding the Company's business, strategy and long-range plans. In addition, directors who have relevant industry experience can offer advice and insights regarding new technologies and business models, which is particularly important with the significant changes that are occurring in the media and entertainment industry.

The vast majority of the nominees for director have highly relevant industry experience. The nominees include a former President and Chief Executive Officer of Netscape Communications Corp., a former Executive Vice President and General Counsel of Verizon Communications Inc., a former Senior Executive Vice President and Chief Financial Officer of The Walt Disney Company, a current director of Omnicom Group, Inc., a former Vice Chairman of the Company and America Online, Inc., the current Chairman and Chief Executive Officer of Axel Springer SE, and a former member of the board of managers of Beats Electronics, LLC and Beats Music, LLC.

Finance, Investments or Banking. Knowledge of and experience in finance, investments and/or banking. Experience in this area is important because it assists the Company's directors in understanding and evaluating the Company's capital structure, financing and investment activities and financial statements. It is also important because it assists them in understanding and overseeing the Company's financial reporting and internal controls.

All of the nominees who serve on the Audit Committee qualify as financially literate under the NYSE listing standards and four of them qualify as audit committee financial experts under the SEC's rules. The nominees also include the Chairman and President of Barksdale Management Corporation, a private investment management company, a director of BlackRock, Inc., a Partner and Managing Director at Warburg Pincus LLC, the Founder and Chief Executive Officer of Main Street

Advisors, Inc., a private company that provides investment and financial advisory services to high net worth individuals, and the Non-Executive Chairman of Carver Bancorp, Inc.

Consumer-Focused Businesses. Knowledge of and experience in businesses with products or services that directly serve consumers. As a Company focused on capitalizing on the growing global demand for high-quality video content, directors with expertise in consumer-focused businesses can provide insights regarding the marketing and distribution of the Company's content to consumers around the world.

The vast majority of the nominees for director have experience as either a senior executive officer or member of the board of a consumer-focused business.

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Proposal 1: Election of Directors

Legal, Regulatory and Government Relations. Legal (including corporate governance), regulatory and/or government relations experience. Directors who have served in the government or have significant legal or regulatory experience can provide insight into working constructively with governments around the world and addressing significant public policy matters, such as piracy.

The nominees for director include a former Attorney General of United States and a former U.S. Secretary of Commerce. The nominees also include the former Dean and Royall Professor of Law at Harvard Law School and a former partner of Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, PC.

International Operations or Global Economic Policy. Knowledge of and experience in managing or investing in companies with international operations or experience with policies regarding global economic development and cooperation. Time Warner's success depends, in part, on its ability to continue to grow its international operations. Directors with international experience can provide useful business and cultural perspectives regarding the Company's international operations.

The nominees for director include the current Chairman and Chief Executive Officer of Axel Springer SE, an integrated multimedia company based in Germany, a former executive at The World Bank and former visiting fellow at the International Monetary Fund, a former Chairman and Chief Executive Officer of Schering Plough Corporation, a former Co-Chairman and Chief Executive Officer of Hilton Hotels Corporation and the Chair of the Albright Stonebridge Group, a global strategy firm, who also has nearly 30 years of international business experience from his prior roles with Kellogg Company.

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Proposal 1: Election of Directors

Background of Director Nominees

Set forth below is information regarding each of the 12 nominees, including their ages as of April 23, 2015 and key skills and professional qualifications. The Board and the Nominating Committee believe that the depth and breadth of qualifications, skills and experiences of the nominees, all of whom are current directors of the Company, have contributed to an effective and well-functioning Board and that, individually and as a whole, the nominees possess the necessary qualifications to provide effective oversight of and advice to the Company's management and businesses.

*The Board of Directors recommends a vote **FOR** the election of the 12 director nominees.*

James L. Barksdale

Age 72

Director since 2001

Chairman and President of Barksdale Management Corporation, a private investment management company April 1999 to present.

Prior Professional Experience: Mr. Barksdale served as President and Chief Executive Officer of Netscape Communications Corp. from 1995 to 1999 (when it was acquired by America Online, Inc.); Chief Operating Officer and then Chief Executive Officer of McCaw Cellular Communications (now AT&T Wireless Services) from 1992 to 1994; Chief Information Officer and then Executive Vice President and Chief Operating Officer of FedEx Corporation from 1979 to 1992; and Chief Information Officer and in other management positions at Cook Industries from 1972 to 1979.

Public Company Directorships: Mr. Barksdale serves as a director of FedEx Corporation. Mr. Barksdale also served as a director of a predecessor company of Time Warner from March 1999 to January 2001.

Key Skills and Qualifications: Mr. Barksdale brings more than 25 years of entrepreneurial leadership and senior management experience as a former senior executive (including Chief Executive Officer) of several major companies with international

operations. Mr. Barksdale's experience includes leadership roles at consumer-focused, technology-based companies, such as Netscape Communications Corp., McCaw Cellular Communications (now AT&T Wireless Services) and FedEx Corporation. Mr. Barksdale is also a former director of Sun Microsystems, Inc. (now Oracle Corporation). Mr. Barksdale also brings financial experience to the Board, including through his role at Barksdale Management Corporation. Mr. Barksdale also has significant experience with mergers and acquisitions, both in executive roles at corporations such as Netscape Communications Corporation and as Chairman and President of Barksdale Management Corporation.

William P. Barr

Age 64

Director since 2009

Former Attorney General of the United States.

Prior Professional Experience: Mr. Barr served as Of Counsel of Kirkland & Ellis LLP from January 2009 to July 2009; Executive Vice President and General Counsel of Verizon Communications Inc. from June 2000 to December 2008; Executive Vice President and General Counsel of GTE Corporation from 1994 to June 2000; a partner of Shaw, Pittman, Potts & Trowbridge (now Pillsbury Winthrop Shaw Pittman LLP) from 1993 to 1994; the 77th Attorney General of the United States from 1991 to 1993; Deputy Attorney General of the United States from 1990 to 1991; Assistant Attorney General for the Office of Legal Counsel from 1989 to 1990; and a partner of Shaw, Pittman, Potts & Trowbridge from 1984 to 1989.

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Proposal 1: Election of Directors

Public Company Directorships: Mr. Barr serves as a director of Dominion Resources, Inc. and Selected Funds.

Key Skills and Qualifications: Mr. Barr, who is Chair of the Company's Compensation Committee, brings leadership experience in government as a former Attorney General of the United States and head of the U.S. Department of Justice. He also has more than 14 years of leadership and senior management experience in major corporations in the media and telecommunications industries, as the former Executive Vice President and General Counsel of Verizon Communications Inc. and its predecessor, GTE Corporation. As a former Attorney General of the United States, General Counsel and partner of a major law firm, Mr. Barr has a strong background in a wide range of legal, regulatory and government relations matters, including overseeing the negotiation of and obtaining regulatory approvals for significant mergers and acquisitions, such as the Bell Atlantic Corporation and GTE Corporation merger that formed Verizon Communications Inc. and Verizon Communications Inc.'s subsequent acquisitions of MCI Communications Corporation and Alltel Corporation. In addition, due to his service as General Counsel of Verizon Communications Inc. and GTE Corporation, Mr. Barr has knowledge of and experience in consumer-focused businesses with international operations. As a director of Selected Funds, where he is currently a director or trustee of three separate investment companies in the fund complex, Mr. Barr has knowledge of and experience in finance and investments.

Jeffrey L. Bewkes

Age 62

Director since 2007

Chairman of the Board and Chief Executive Officer of the Company January 2009 to present.

Prior Professional Experience: Mr. Bewkes served as President and Chief Executive Officer of the Company from January 2008 through December 2008; President and Chief Operating Officer of the Company from January 2006 through December 2007; Chairman, Entertainment & Networks Group, of the Company from July 2002 through December 2005; Chairman and Chief Executive Officer of the Home Box Office division of the Company from 1995 to July 2002; and President and Chief Operating Officer of the Home Box Office division of the Company from 1991 to 1995.

Public Company Directorships: Mr. Bewkes served as a director of Time Inc. for many years, resigning on June 6, 2014 in connection with the Time Separation. Time Inc. became a public company on May 9, 2014.

Other Directorships: Mr. Bewkes is a Trustee of the Yale Corporation of Yale University. He is a member of the board of the Partnership for New York City and the advisory boards of the Creative Coalition and the George Washington University Law School.

Key Skills and Qualifications: Mr. Bewkes has more than 30 years of experience at the Company and its subsidiaries, including 24 years of leadership and senior management experience serving as the Chief Executive Officer or in other senior executive positions at the Company and Home Box Office. His unique in-depth knowledge of the Company's history and businesses, including his deep understanding of the Company's operations and strategy and the media and entertainment industry, provide him a strong foundation for leading the Board, as Chairman, and facilitating effective communication between management and the Board.

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Proposal 1: Election of Directors

Stephen F. Bollenbach **Age 72** **Director since 2001**

Former Co-Chairman and Chief Executive Officer of Hilton Hotels Corporation.

Prior Professional Experience: Mr. Bollenbach served as Co-Chairman and Chief Executive Officer of Hilton Hotels Corporation from May 2004 to October 2007; President and Chief Executive Officer of Hilton Hotels Corporation from 1996 to 2004; Senior Executive Vice President and Chief Financial Officer of The Walt Disney Company from 1995 to 1996; President and Chief Executive Officer of Host Marriott Corporation from 1993 to 1995; and Chief Financial Officer of Marriott Corp. from 1992 to 1993.

Public Company Directorships: Mr. Bollenbach serves as a director of KB Home, Macy's, Inc., Moelis & Company and Mondelēz International, Inc. Mr. Bollenbach also served as a director of a predecessor company of Time Warner from 1997 to January 2001.

Key Skills and Qualifications: Mr. Bollenbach, who serves as the Company's Lead Independent Director, has more than 15 years of leadership and senior management experience as a former Chief Executive Officer or senior executive of several major companies. In particular, he has experience in the media and entertainment industry, international operations, and consumer-facing businesses through his experience at companies including The Walt Disney Company and Hilton Hotels Corporation. Further, Mr. Bollenbach has extensive knowledge of and experience in finance and investments as a former Chief Financial Officer of several major companies, including The Walt Disney Company. Mr. Bollenbach also has extensive experience with corporate transactions; for example, while he was the Chief Executive Officer, Hilton Hotels Corporation acquired Promus Hotel Corporation (which owned the DoubleTree, Hampton Inn, Embassy Suites and Homewood Suites brands) in 1999 and Hilton Group plc for \$5.7 billion in 2006, which reunited Hilton Hotels in the U.S. and internationally, and made Hilton the fifth largest hotel operator. Mr. Bollenbach also oversaw the sale of Hilton Hotels Corporation to The Blackstone Group L.P. in 2007.

Robert C. Clark **Age 71** **Director since 2004**

Distinguished Service Professor at Harvard University July 2003 to present.

Prior Professional Experience: Mr. Clark served as the Dean and Royall Professor of Law at Harvard Law School from 1989 to 2003; a professor at Harvard Law School from 1978 to 2003; a professor at Yale Law School from 1974 to 1978; and an associate at Ropes & Gray from 1972 to 1974.

Public Company Directorships: Mr. Clark serves as a director of Omnicom Group, Inc.

Other Directorships: Mr. Clark is a trustee of Teachers Insurance and Annuity Association, a life insurance company focused on serving the retirement needs of the higher education community.

Key Skills and Qualifications: Mr. Clark has 14 years of leadership experience as a former Dean of Harvard Law School. Mr. Clark's expertise and insights in the areas of corporate law (including mergers and acquisitions and corporate governance), finance and regulation are useful to the Nominating Committee, which he chairs, as well as the rest of the Board. His experience serving on the boards of directors of other companies provides him with knowledge of a number of industries, including the advertising industry. As a trustee of a life insurance company, Mr. Clark also brings his understanding of finance, investments and the views of pension funds and other institutional investors.

2002 through June 2012; a consultant at Clark & Weinstock, a strategic communications and public affairs consulting firm, from 2000 to 2002; a Visiting Fellow at the International Monetary Fund from 1998 to 1999; and in various executive positions (including Managing Director for Finance and Resource Mobilization) at The World Bank from 1978 to 1979 and 1981 to 1999.

Public Company Directorships: Ms. Einhorn serves as a director of BlackRock, Inc.

Other Directorships: Ms. Einhorn serves as a director of the Peterson Institute for International Economics and the National Bureau of Economic Research. Ms. Einhorn is also Resident Senior Advisor and a member of the advisory board of The Rock Creek Group.

Key Skills and Qualifications: Ms. Einhorn brings leadership experience in international organizations and education administration, including 10 years as Dean of the Paul H. Nitze School of Advanced International Studies (SAIS) at The Johns Hopkins University (retired in June 2012) and more than 18 years serving in various staff and executive positions at The World Bank. Ms. Einhorn has extensive knowledge of policies and practices in international finance, economic development and government relations through her roles at the International Monetary Fund and The World Bank, membership on the boards of research and public policy institutions and her ongoing research interest in finance. She also brings experience as a member of the board of a major investment firm, BlackRock, Inc., and as an advisory board member of The Rock Creek Group, a global alternative asset manager.

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Proposal 1: Election of Directors

Carlos M. Gutierrez **Age 61** **Director since 2014**

Chair of Albright Stonebridge Group, a global strategy firm February 2014 to present.

Prior Professional Experience: Mr. Gutierrez served as Vice Chair of Albright Stonebridge Group from April 2013 to February 2014; Vice Chairman of the Institutional Clients Group at Citigroup Inc. from January 2011 to February 2013; a consultant at the Global Political Strategies division of APCO Worldwide Inc., a communications and public affairs consulting firm, from December 2009 to April 2013; Chairman of the Global Political Strategies division of APCO Worldwide Inc. from January 2010 to January 2011; the 35th U.S. Secretary of Commerce from February 2005 to January 2009; Kellogg Company's Chairman of the Board (from April 2000 to February 2005), Chief Executive Officer (from April 1999 to February 2005) and President (from 1998 to September 2003); and in various executive and non-executive positions at Kellogg Company from 1975 to 1998.

Public Company Directorships: Mr. Gutierrez serves as a director of MetLife, Inc. and Occidental Petroleum Corporation. During the past five years, Mr. Gutierrez also served as a director of Corning Incorporated, United Technologies Corporation and Lighting Science Group Corporation.

Key Skills and Qualifications: Mr. Gutierrez brings nearly 30 years of experience in leading, managing, and growing international business operations at Kellogg Company, a global consumer-focused company with international operations. At Kellogg Company, Mr. Gutierrez was responsible for major consumer brands in a complex worldwide business. As a result of this experience, Mr. Gutierrez brings significant knowledge of brand management, marketing and product development. He also brings leadership experience and knowledge of international commerce and government relations as former U.S. Secretary of Commerce.

Fred Hassan **Age 69** **Director since 2009**

Partner and Managing Director at Warburg Pincus LLC, a private equity firm
January 2011 to present.

Prior Professional Experience: Mr. Hassan served as Senior Advisor at Warburg Pincus from November 2009 through December 2010; Chairman and Chief Executive Officer of Schering Plough Corporation (now part of Merck & Co., Inc.) from 2003 to November 2009; Chairman and Chief Executive Officer of Pharmacia Corporation from 2001 to 2003; Chief Executive Officer of Pharmacia Corporation from 2000 to 2001; and Chief Executive Officer of Pharmacia & Upjohn, Inc. from 1997 to 2000.

Public Company Directorships: During the past five years, Mr. Hassan served as a director of Avon Products Inc. and Valeant Pharmaceuticals International, Inc.

Key Skills and Qualifications: Mr. Hassan brings more than 12 years of leadership and senior management experience as a former Chairman and/or Chief Executive Officer of major pharmaceutical companies with intellectual-property based business models and international operations, which provided him with strong and relevant operational and strategic experience. Because the pharmaceutical business is a highly regulated field, Mr. Hassan also has knowledge and experience in regulatory and government relations. As a partner and managing director at Warburg Pincus, Mr. Hassan also brings his knowledge of finance and investments to the Board and the Audit and Finance Committee. Mr. Hassan also brings his significant experience with large mergers and acquisitions to the Board. As Chairman and Chief Executive Officer of Schering Plough Corporation, he oversaw Schering Plough's merger with Merck & Co., Inc. and as Chairman and Chief Executive Officer of Pharmacia Corporation, he oversaw its sale to Pfizer, Inc.

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Proposal 1: Election of Directors

Kenneth J. Novack **Age 73** **Director since 2001**

Former Partner of Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, PC.

Prior Professional Experience: Mr. Novack served as Vice Chairman of the Company from January 2001 through December 2003; Vice Chairman of America Online, Inc. (now known as Historic AOL LLC) from 1998 to January 2001; and Of Counsel (from 1998 to 2001) and an attorney (from 1966 to 1998) at Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, PC. Mr. Novack served on the law firm's executive committee from 1972 until his retirement in 1998.

Other Directorships: Mr. Novack serves in the noted capacities at the following privately held companies: a director of Appleton Partners, Inc. and Leerink Partners LLC and an advisory board member of General Catalyst Partners. He also served as a director of a predecessor company of Time Warner from January 2000 to January 2001.

Key Skills and Qualifications: Mr. Novack has held key leadership and senior management roles at the Company and at Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, PC, a major law firm. With more than five years of experience serving as Vice Chairman of the Company or a predecessor company of Time Warner, he has an in-depth knowledge of the Company's businesses. In addition, Mr. Novack brings more than 30 years of legal, corporate governance and regulatory experience advising companies on a broad range of matters, including large corporate transactions, as a corporate attorney at Mintz, Levin. Mr. Novack also brings his experience in finance, investments and mergers and acquisitions through his service on the boards of privately held investment companies and experience practicing securities law for over 30 years.

Paul D. Wachter **Age 58** **Director since 2010**

Founder and Chief Executive Officer of Main Street Advisors, Inc., a private company that provides investment and financial advisory services to businesses and high net worth individuals 1997 to present.

Prior Professional Experience: Mr. Wachter served as Managing Director of Schroder & Co. Incorporated from 1993 to 1997; Managing Director of Kidder Peabody from 1987 to 1993; an investment banker at Bear, Stearns & Co., Inc. from 1985 to 1997; and an attorney at Paul, Weiss, Rifkind, Wharton and Garrison from 1982 to 1985.

Public Company Directorships: Mr. Wachter serves as a director of Avalanche Biotechnologies, Inc.

Other Directorships: Mr. Wachter serves in the noted capacities at the following privately held companies: a director of Haworth Marketing and Media Company, Oak Productions, Inc. and Content Partners LLC (Co-Chairman). Mr. Wachter also serves as Chairman of the Board of After-School All-Stars, a national non-profit organization that provides comprehensive after-school programs.

Key Skills and Qualifications: Mr. Wachter brings his knowledge of and experience in finance, investments and banking as the founder and Chief Executive Officer of Main Street Advisors, through serving as the Chairman of the Investment Committee of the Board of Regents of the University of California, and as a former Managing Director at several investment banks. Mr. Wachter also has a background in the entertainment and media industry as a former investment banker focusing on the entertainment and media industry, a former member of the board of managers of Beats Electronics, LLC and Beats Music, LLC (companies focused on headphones and related products and music streaming services, respectively, which are now part of Apple Inc.), and a director of

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Proposal 1: Election of Directors

Content Partners LLC (a company that acquires profit participations in films, television shows and music). Mr. Wachter also has experience in regulatory and government relations through his service on the Board of Regents of the University of California, as an adviser to the former Governor of California and through his work as a tax attorney at a major law firm.

Deborah C. Wright

Age 57

Director since 2005

Senior Fellow in the Economic Opportunity and Assets Division of the Ford Foundation and Non-Executive Chairman of Carver Bancorp, Inc. January 2015 to present.

Prior Professional Experience: Ms. Wright served as Chairman and Chief Executive Officer of Carver Bancorp, Inc. from February 2005 through December 2014; President and Chief Executive Officer of Carver Bancorp, Inc. and Carver Federal Savings Bank from 1999 to 2005; President and Chief Executive Officer of the Upper Manhattan Empowerment Zone Development Corporation from 1996 to 1999; Commissioner of the Department of Housing Preservation and Development from 1994 to 1996; a member of the New York City Housing Authority Board from 1992 to 1994; and a member of the New York City Planning Commission from 1990 to 1992.

Public Company Directorships: Ms. Wright serves as a director of Carver Bancorp, Inc. and Voya Financial, Inc. During the past five years, Ms. Wright also served as a director of Kraft Foods Inc. (now Mondelez International, Inc. and Kraft Foods Group Inc.).

Key Skills and Qualifications: Ms. Wright brings to the Board and to her role as Chair of the Audit and Finance Committee leadership, senior management and financial experience through her 15 years of service as the Chairman and/or Chief Executive Officer of Carver Bancorp., Inc. and Carver Federal Savings Bank and approximately 9 years of leadership roles at non-profit organizations or governmental bodies. Ms. Wright also brings to the Board her experience with businesses that provide products or services directly to customers gained through her service at Carver Bancorp., Inc. and Carver Federal Savings Bank, as well as her prior long-term service as a director of Kraft Foods Inc. Ms. Wright also has extensive experience in regulatory and government relations through her senior roles in government and non-profit organizations.

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Proposal 2: Ratification of Appointment of Independent Auditor

Proposal 2: Ratification of Appointment of

Independent Auditor

The Audit and Finance Committee of the Board of Directors (the **Audit Committee**) is responsible for overseeing the consolidated financial statements prepared by management. The Audit Committee also is responsible for the appointment, compensation and oversight of the Company's independent auditor.

The Audit Committee annually reviews the independent auditor's qualifications, performance, fees and independence. Following its review in December 2014, the Audit Committee appointed Ernst & Young LLP as the Company's independent auditor for 2015. Ernst & Young LLP has served as the Company's independent auditor since 2001, when the Company was formed through the merger of America Online, Inc. (now known as Historic AOL LLC) and Time Warner Inc. (now named Historic TW Inc.).

The Audit Committee believes it is important for the independent auditor to maintain its objectivity and independence. Accordingly, since 2004 the Audit Committee has reviewed on an annual basis whether the Audit Committee should have a policy requiring the regular rotation of the independent auditor and reports its conclusion to the Board. To date, the Audit Committee has determined not to adopt such a policy. In addition, in accordance with Securities and Exchange Commission (SEC) rules and the Company's Policy Regarding Audit Partner Rotation, audit partners are subject to limitations on the number of consecutive years that they may provide services to the Company. For the lead audit partner, the maximum number of consecutive years in that capacity is five years. Consistent with these requirements, a new lead audit partner was selected for the audit of the Company's 2014 financial statements. The Audit Committee and its Chairman are involved in the process for selecting the lead audit partner.

The Audit Committee and the Board believe that the appointment of Ernst & Young LLP as the Company's independent auditor is in the best interests of the Company and its shareholders, and the Company is requesting that the shareholders ratify the appointment of Ernst & Young LLP as the Company's independent auditor for 2015. Representatives of Ernst & Young LLP will be present at the Annual Meeting with the opportunity to make a statement if they desire to do so and to respond to appropriate questions from shareholders.

*The Board of Directors recommends a vote **FOR** the ratification of the appointment of
Ernst & Young LLP as independent auditor.*

Vote Required for Approval

The affirmative vote of a majority of the votes duly cast by the holders of Common Stock is required to ratify the appointment of Ernst & Young LLP. However, shareholder approval is not required for the appointment of Ernst & Young LLP because the Audit Committee is responsible for selecting the Company's independent auditor. No

determination has been made as to what action the Audit Committee or the Board would take if shareholders do not ratify the appointment.

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Proposal 3: Advisory Vote on NEO Compensation

Proposal 3: Annual Advisory Vote to Approve Named

Executive Officer Compensation

In accordance with SEC rules, Time Warner is asking shareholders to approve the following resolution at the Annual Meeting:

RESOLVED, that the Company's shareholders approve, on an advisory basis, the compensation paid to the Company's named executive officers, as disclosed in the Company's Proxy Statement for the 2015 Annual Meeting of Shareholders pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narratives.

2014 was a successful year for Time Warner. The Company made significant progress on achieving its key long-term strategic objectives and delivered strong financial results, including 18% growth in Adjusted EPS. The Company's Common Stock price increased 28% during 2014, and its one-year TSR was 30.0%, more than double the 13.7% TSR for the S&P 500 Index. The Compensation Committee and the Board believe the Company's compensation program effectively supports the execution of the Company's long-range plans and that the 2014 compensation for the NEOs appropriately reflects the Company's strong financial performance and the NEOs' individual performance.

The pay-for-performance design of the Company's compensation program, the Company's 2014 performance, the NEOs' individual performance, and the Compensation Committee's determination of the 2014 compensation paid to the NEOs are described in the Compensation Discussion and Analysis section of this Proxy Statement beginning on page 46. Shareholders are encouraged to read this section before deciding how to vote on this proposal. The next advisory vote on NEO compensation will take place at the 2016 Annual Meeting of Shareholders.

*The Board of Directors recommends a vote **FOR** the approval of the resolution.*

Vote Required for Approval

The affirmative vote of a majority of the votes duly cast by the holders of Common Stock is required to approve this proposal. However, the vote on executive compensation is advisory and, therefore, not binding on the Company, the Board or the Compensation Committee. The Board and the Compensation Committee will consider the outcome of the vote when making future executive compensation decisions.

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Shareholder Proposals

SHAREHOLDER PROPOSALS

In accordance with SEC rules, we have set forth below three shareholder proposals, along with the supporting statements of the shareholder proponents. The Company is not responsible for any inaccuracies these supporting statements may contain. As explained below, the Board unanimously recommends that you vote **Against** these shareholder proposals.

Proposal 4: Right to Act by Written Consent

Mr. Kenneth Steiner, 14 Stoner Ave., 2M, Great Neck, NY 11021, the beneficial owner of no less than 500 shares of Common Stock, has advised the Company that he intends to propose a resolution at the Annual Meeting. Mr. Steiner has appointed John Chevedden of 2215 Nelson Ave., No. 205 Redondo Beach, CA 90278, and/or his designee to act on his behalf in matters relating to the proposed resolution. The proposed resolution and statement in support are set forth below:

Proposal 4 Right to Act by Written Consent

Resolved, Shareholders request that our board of directors undertake such steps as may be necessary to permit written consent by shareholders entitled to cast the minimum number of votes that would be necessary to authorize the action at a meeting at which all shareholders entitled to vote thereon were present and voting. This written consent is to be consistent with applicable law and consistent with giving shareholders the fullest power to act by written consent consistent with applicable law. This includes shareholder ability to initiate any topic for written consent consistent with applicable law.

The shareholders of Wet Seal (WTSLA) successfully used written consent to replace certain underperforming directors in 2012. This proposal topic also won majority shareholder support at 13 major companies in a single year. This included 67%-support at both Allstate and Sprint. Hundreds of major companies enable shareholder action by written consent.

This proposal empowers shareholders by giving them the ability to effect change without being forced to wait until the annual meeting. Shareholders could replace a director using action by written consent. Shareholder action by written consent could save our company the cost of holding a shareholder meeting between annual meetings to consider urgent matters.

This proposal is especially important for Time Warner since TWX shareholders no longer have the right to call a special meeting.

A study by Harvard professor Paul Gompers supports the concept that shareholder disempowering governance features, including restrictions on shareholder ability to act by written consent, are significantly related to reduced shareholder value.

It may be possible to adopt this proposal by simply adding such brief words as these to our governance documents:

Any action required or permitted to be taken at any annual or special meeting of stockholders may be taken without a meeting, without prior notice and without a vote, if a consent in writing, setting forth the action so taken, shall be signed by stockholders having not less than a minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted. Prompt notice of the taking of the corporate action without a meeting by less than unanimous written consent shall be given to those stockholders who have not consented in writing.

Please vote to enhance shareholder value:

Right to Act by Written Consent Proposal X

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Shareholder Proposals

Company Recommendation

The Board of Directors recommends a vote **AGAINST** this proposal for the following reasons:

- (i) Without proper procedural protections, shareholder action by written consent (as described in the proposal) can deprive shareholders of information, a voice and a vote on the matter approved in the written consent and can also lead to abusive practices;
- (ii) Shareholder meetings are a better method to present important matters for consideration by shareholders, and holders of 15% of the Company's outstanding Common Stock have the right to request a special meeting of shareholders; and
- (iii) The Company's existing corporate governance policies and practices provide shareholders with meaningful access to the Board and significant rights and protections.

No Procedural Protections

Shareholder action by written consent as described in the proposal could prevent minority shareholders from having an opportunity to voice their views and vote on an action or even receiving information regarding the matter approved by written consent until after the action has been taken. The proposal provides no procedural protections and suggests specific language for written consent rights that clearly fails to provide safeguards for minority shareholders.

The proposal does not require any information to be provided to shareholders prior to the consent becoming effective, such as a description of the proposed action, the reasons for the proposed action and any potential conflicts of interest of the shareholder(s) seeking the action. Although the statement in support of the proposal includes language that would require [p]rompt notice of the taking of the corporate action without a meeting to those stockholders who have not consented in writing, notice after the fact is not adequate and does not protect the interests of the shareholders. Moreover, if multiple groups of shareholders are able to solicit written consents at any time and as often as they wish, the solicitation of written consents could create a considerable amount of confusion and disruption among the Company's shareholders, as well as divert the attention of the members of the Board, senior management and other employees from the Company's day-to-day operations.

The proposal also does not prevent or limit the potential for abuse in utilizing this method for approving corporate actions (*e.g.*, it would not limit the ability of a group of shareholders to accumulate a short-term voting position by borrowing shares from shareholders and then taking action without those shareholders knowing that their voting rights were being used to take such action). Shareholders who have loaned their stock are better able to take action to protect and exercise their voting rights at a shareholder meeting than if an action is permitted by written consent without appropriate procedural safeguards. In addition, a group of shareholders could also use a consent solicitation to remove and replace directors and effectively assume control of the Company without having to pay a control premium to shareholders.

Meetings Better Protect Rights of All Shareholders

The Board believes that a more open, transparent, and democratic way for shareholders to exercise their rights regarding important issues affecting the Company is through annual or special shareholder meetings, so that *all*

shareholders have the ability to voice their concerns, the issues can be fully discussed and *all* shareholders can vote on the issues.

Under Time Warner's By-laws, holders of 15% of the outstanding Common Stock may request that a special meeting of shareholders be held. As previously disclosed by the Company, the Board amended the By-laws in July 2014 to remove the provision authorizing shareholders to request special meetings due to the extraordinary circumstances the Company was facing, and at that time, the Board expressed its intention to reinstate the provisions by the 2015 Annual Meeting. The Board has reinstated the provisions in full. The Board's reasons for removing the special meeting provisions from the Company's By-laws are described on pages 28 to 29 of this Proxy Statement. The Board believes that the shareholders' right to request a special meeting is effective and meaningful.

Shareholders also have the right to bring business before the shareholders at annual meetings, as evidenced by this proposal and the other shareholder proposals included in this Proxy Statement.

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Shareholder Proposals

Shareholders Have Rights and Protections that Reduce the Need for Written Consent Rights

Time Warner believes that its shareholders have significant access to the Board and rights and protections that reduce the need to be able to act by written consent. For example:

Shareholders elect directors annually by majority vote in uncontested director elections, and any incumbent director who does not receive a majority of the votes cast for his or her election is required to offer to resign from the Board.

As stated above, holders of 15% of the outstanding Common Stock may request a special meeting of shareholders.

As stated above, shareholders may submit proposals for presentation at an annual meeting (including nominations of director candidates).

Shareholders may communicate directly with any director (including the Lead Independent Director), any Board committee or the full Board.

The Board consists of a substantial majority of independent directors (*i.e.*, all of the directors except the Company's CEO).

For the reasons stated above, the Board believes that the proposal is not in the best interests of Time Warner or its shareholders.

*The Board of Directors recommends a vote **AGAINST** the proposal.*

Vote Required for Approval

The affirmative vote of a majority of the votes duly cast by the holders of Common Stock is required to adopt this proposal.

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Shareholder Proposals

Proposal 5: Tobacco Depictions in Films

The Sisters of St. Francis of Philadelphia, 609 South Convent Road, Ashton, PA 19014, the beneficial owner of 111 shares of Common Stock, joined by seven other organizations whose names, addresses and shareholdings will be provided by the Company upon request, has advised the Company that they intend to propose a resolution at the Annual Meeting. The proposed resolution and statement in support are set forth below:

WHEREAS: Time Warner, a company where community and family values are integral to the company's promotion of its various brands, is also a leading distributor of films that are viewed by young people.

The 2012 US Surgeon General report, *Preventing Tobacco Use among Youth and Young Adults* concluded that there is a causal relationship between depictions of smoking in the movies and the initiation of smoking among young people.

In support of the Surgeon General's report, thirty-eight state Attorneys General wrote to the major studios urging elimination of tobacco depictions in youth-rated movies, stating: Each time the industry releases another movie that depicts smoking, it does so with the full knowledge of the harm it will bring children who watch it.

Based on a subsequent 2014 Surgeon General's report, the Centers for Disease Control and Prevention (CDC) concluded in 2014: Giving an R rating to future movies with smoking would be expected to reduce the number of teen smokers by nearly one in five (18%) and **prevent one million [1,000,000] deaths from smoking** among children alive today.

The need for appropriate corporate governance to address Time Warner's reputational risks arising from this public concern is reinforced by statements of The American Medical Association, American Heart Association, American Lung Association, American Academy of Pediatrics, and the World Health Organization, who have all publicly supported the above Surgeon General's statements.

Time Warner is mentioned by name in the Surgeon General's 2012 report and in media covering the release of the report. In recent years, the issues raised by the Surgeon General's report have been covered by a number of national publications including *The New York Times*, *The Los Angeles Times*, *The Boston Globe* and *USA Today*.

Community and family values are integral to Time Warner's brand. The above publications and statements have attracted significant publicity and linked Time Warner to concerns regarding young people's health. Shareholders are concerned about the management of these risks and consider that Board level oversight is warranted to address these concerns.

As a governance issue, consistent, appropriate, and transparent Board oversight is required to balance company actions that impact young people's well-being against the company's reputation and brand value. This responsibility appears appropriate for the Nominating and Governance Committee.

RESOLVED: Stockholders request that the Board amend the Nominating and Governance Committee Charter (or add an equivalent provision to another Board Committee Charter) to include:

Providing oversight and public reporting concerning the formulation and implementation of policies and standards to determine transparent criteria on which company products continue to be distributed that:

- 1) especially endanger young people's well-being;
- 2) have the substantial potential to impair the reputation of the Company; and/or
- 3) would reasonably be considered by many offensive to the family and community values integral to the Company's promotion of its brands

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Shareholder Proposals

Company Recommendation

The Board of Directors recommends a vote **AGAINST** this proposal for the following reasons:

- (i) Time Warner's film studios, Warner Bros. Pictures and New Line Cinema (the Studios), are industry leaders with respect to the reduction or elimination of tobacco depictions in feature films and were one of the first major film studios to adopt a policy regarding the depiction of smoking in their feature films; and
- (ii) The Company has strong policies and practices that address the governance-related aspects of the proposal.

Industry Leaders in Reducing and Eliminating Tobacco Depictions in Films

The Studios have been and continue to be industry leaders in establishing, implementing, and reporting on policies and practices to reduce or eliminate tobacco depictions in feature films, and those policies and practices have been highly effective. In addition, the Studios have had a long-standing and collaborative relationship with the proponents of the proposal, which has helped inform the Studios' Tobacco Depiction Policy described below.

The Studios were one of the first major film studios to adopt a policy regarding the depiction of smoking in their films when they adopted their Tobacco Depiction Policy in 2005, and the Studios' efforts under the Policy have been very effective. From the adoption of the Policy in 2005 through 2014, the Studios had no tobacco depictions in their G-rated films and achieved a 95% reduction of such depictions in their PG and PG-13-rated films. The Policy was reviewed and updated in 2014 and is available on the Company's website at www.timewarner.com/responsible-content.

Pursuant to the Policy, the Studios work closely with creative talent to produce and distribute for theatrical release feature films that appeal to a wide array of audiences. At the same time, the Studios strive to produce and distribute feature films in a responsible manner. Accordingly, the Studios endeavor to reduce or eliminate depictions of smoking and tobacco products/brands in their youth-rated and R-rated feature films distributed in the U.S. The Policy recognizes that some depictions of smoking, such as depictions of a literary character or actual historical figure known to have used tobacco products, may be acceptable to provide literary or historical accuracy in the film's storytelling. Depictions that are part of a conspicuous anti-smoking reference also may be acceptable under the Policy.

The Studios do not enter into any product placement or promotion arrangements with tobacco companies for any of their films. In addition, since 2008, the Studios have regularly included anti-smoking public service announcements on U.S.-distributed DVDs of their films containing tobacco depictions.

The Studios review each film they produce or distribute in the U.S. to confirm that depictions of smoking are consistent with the Policy and to seek to reduce further any depictions.

The Studios disclose information on the Company's website at www.timewarner.com/responsible-content about the total number of depictions in those films and the creative reasons for those depictions.

Strong Governance Policies and Practices

Time Warner has strong governance policies and practices that address the governance-related aspects of the proposal.

The Nominating and Governance Committee's charter states that the Committee is responsible for overseeing the Company's public policy and corporate social responsibility activities. The Committee receives reports from management regarding the Company's corporate social responsibility activities, which are informed by the Company's regular and longstanding engagement with stakeholders, including the proponents of this proposal.

The Board of Directors and the Audit Committee review an annual report from management on the risks the Company faces, including in the area of corporate social responsibility, management's actions to address those risks and the Company's risk management and mitigation processes.

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Shareholder Proposals

The Company reports on its corporate social responsibility activities on its website, including providing the information regarding tobacco depictions in the Studios' feature films and the creative reasons for those depictions, as described above.

The long-standing and collaborative discussions between the Company, including representatives from the Studios, and the proponents of the proposal have also helped inform the Company's processes outlined above. For the reasons stated above, the Board believes that the Company has implemented appropriate policies and procedures both operationally and at the Board and its committees on the subject of this proposal and that the actions advocated in the proposal are unnecessary and not in the best interests of the Company or its shareholders.

*The Board of Directors recommends a vote **AGAINST** the proposal.*

Vote Required for Approval

The affirmative vote of a majority of the votes duly cast by the holders of Common Stock is required to adopt this proposal.

Table of Contents**Shareholder Proposals****Proposal 6: Greenhouse Gas Emissions Reduction****Targets**

Green Century Equity Fund, 114 State Street, Suite 200, Boston, MA 02109, the beneficial owner of 13,596 shares of Common Stock, has advised the Company that it intends to propose a resolution at the Annual Meeting. The proposed resolution and statement in support are set forth below:

RESOLVED: Shareholders request Time Warner Inc. (TWX) adopt a company-wide, time-bound target for reducing absolute greenhouse gas (GHG) emissions (i.e. reduction in aggregate emissions over time), taking into consideration the most recent Intergovernmental Panel on Climate Change (IPCC) scientific guidance for reducing total GHG emissions and issue a report no later than 6 months after the company's annual meeting, at reasonable cost and omitting proprietary information, on its plan to achieve these goals.

Supporting Statement:

To mitigate the worst impacts of climate change, the IPCC estimates that a 50 percent reduction in GHG emissions globally is needed by 2050 (relative to 1990 levels) to stabilize global temperatures, entailing a U.S. reduction target of 80 percent. The proponent believes that the company's goals should meet or exceed the goal of reducing the total amount of GHG emissions emitted by all operations by 50 percent by 2050 compared with 1990 levels.

The potential costs of failing to address climate change could lead to a five percent loss in global GDP between 2010 and 2060, according to the Organization for Economic Cooperation and Development. *Risky Business*, a recent analysis of climate change impacts, reveals significant economic effects including property damage, shifting agricultural patterns, reduced labor productivity, and increased energy costs. These effects could impact a company's business model, operations, or revenues.

A growing number of companies have set GHG emissions reductions targets. As of 2013, 60 percent of Fortune 100 companies have GHG reduction targets and renewable energy commitments. A report called *The 3% Solution* by World Wildlife Fund and the Carbon Disclosure Project (CDP) found that four out of five companies capture greater returns from their carbon reduction investments than on their average investment portfolios. In aggregate, the 53 Fortune 100 companies reporting on GHG and renewable energy targets to the CDP are saving \$1.1 billion annually through their targets.

We are concerned that TWX may be lagging industry peers. The Walt Disney Company and Twenty-First Century Fox Corporation set targets for reducing their GHG emissions and reported significant savings. For example, the Walt Disney Company reported some energy efficiency investment payback periods equal to one year or less in its 2014 CDP questionnaire.

In contrast, TWX fails to disclose information about how it is managing its climate impacts. In the 2014 CDP, Time Warner Inc. scored 63 out of 100 points because it did not disclose GHG targets for its Scope 1 and Scope 2 emissions equaling 17,838 and 242,119 tons of GHG emissions, respectively, and generated by operational control of its offices and production facilities. Over 81 percent of companies in the Global 500 report to the CDP, which is supported by investors representing \$92 trillion.

We believe climate change poses significant risks to companies and their investors, and urge TWX to adopt goals for mitigating its GHG emissions and climate impacts with special consideration of IPCC scientific guidance.

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Shareholder Proposals

Company Recommendation

The Board of Directors recommends a vote **AGAINST** this proposal for the following reasons:

- (i) Time Warner has for many years taken action to increase its energy efficiency, use renewable energy sources and reduce greenhouse gas emissions;
- (ii) The Company's Global Energy Council focuses on best practices and effectively managing the usage, cost and environmental impact of the Company's building utilities (electricity, water, natural gas and steam);
- (iii) The Company discloses year-over-year greenhouse gas emissions data, including through the Carbon Disclosure Project; and
- (iv) The Company has consistently reduced its greenhouse gas emissions through these activities, and, while it intends to continue to reduce such emissions, it does not believe that establishing company-wide targets for future reductions and issuing a report within 6 months following the 2015 Annual Meeting on its plan to achieve the targets is necessary.

Focus on Energy Efficiency and Reducing Greenhouse Gas Emissions

Time Warner has been focused on increasing its energy efficiency, using renewable energy sources and reducing greenhouse gas emissions for many years, and has undertaken a variety of environment-focused initiatives throughout its businesses, including, among other things:

Using energy-efficient facilities, such as the world's first LEED Gold certified sound stage at Warner Bros. Studios in Burbank, California, which incorporates a number of sustainable elements, including a 100-kilowatt solar electrical system;

Making energy-efficient upgrades to the Company's buildings and offices to reduce energy usage, such as incorporating solar panels, installing energy efficient lighting and retrofitting HVAC systems with more efficient cooling systems and more precise, automated operations; and

Working both within the Company's studios and the media and entertainment industry to reduce the energy and resource consumption associated with film and television production.

Additional information about the Company's wide ranging environmental initiatives can be found in the Corporate Responsibility section of Time Warner's website at www.timewarner.com/environment.

Time Warner's Global Energy Council

Time Warner's commitment to improving its environmental practices is reflected in its Global Energy Council, which is composed of a company-wide team focused on effectively managing the usage, cost and environmental impact of the Company's building utilities (electricity, water, natural gas and steam) and identifying and implementing best practices. The Global Energy Council, among other things, (i) tracks and oversees initiatives to reduce the Company's energy use and carbon dioxide emissions; (ii) develops programs to increase energy use awareness among the Company's employees and thereby reduce waste; and (iii) reports on the Company's progress regularly to senior management.

Disclosure of Greenhouse Gas Emissions Data through the Carbon Disclosure Project

Time Warner discloses detailed greenhouse gas emissions data, including year-over-year data, in its responses to the annual questionnaire from the Carbon Disclosure Project, an international organization that provides a global system for companies to measure and disclose their greenhouse gas emissions. The Company's responses to the questionnaire are available at www.cdproject.net.

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Shareholder Proposals

Successfully Reducing Greenhouse Gas Emissions

Time Warner's long-standing efforts to increase its energy efficiency and reduce its greenhouse gas emissions have been successful. For example, the Company reported an almost 7% reduction in greenhouse gas emissions between 2011 and 2012, and a further 3% reduction between 2012 and 2013 (a portion of such reduction was due to a change in its methodology for calculating greenhouse gas emissions). In addition, the Company expects its carbon emissions in New York City will decrease further following the planned move in early 2019 of its corporate headquarters and New York City-based employees to a new LEED Gold certified building in the Hudson Yards development in New York City.

The Board recognizes Time Warner's shared role in preserving and protecting the environment and that it can achieve cost savings through investments in more efficient practices that also reduce emissions, but it believes the interests of shareholders are being served by the Company's robust reporting and environmental initiatives that continue to reduce greenhouse gas emissions and that establishing specific targets for future reductions and issuing a report on its plan to achieve those reductions are not necessary to serve those interests.

*The Board of Directors recommends a vote **AGAINST** the proposal.*

Vote Required for Approval

The affirmative vote of a majority of the votes duly cast by the holders of Common Stock is required to adopt this proposal.

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Corporate Governance

CORPORATE GOVERNANCE

Strong Governance Practices

Time Warner has strong corporate governance practices and policies, which help ensure the Board not only provides independent oversight over management, but also has the experience, expertise and information to work effectively with management in making strategic and other key business decisions for the Company. Because corporate governance practices evolve, the Board reviews its Corporate Governance Policy, committee charters, and other governance documents at least annually and updates them as necessary or appropriate. Some key examples of Time Warner's long-standing commitment to strong corporate governance policies and practices are the following:

Board Independence: All directors, other than the CEO, are independent, and each Board committee consists solely of independent directors. Under the Corporate Governance Policy, a substantial majority of the directors must be independent.

Board Qualifications and Ongoing Education: The Board believes the Company is best served by a board of directors whose members have a variety of complementary skills, professional experience and backgrounds, and who bring diverse viewpoints and perspectives to the Board. In its annual self-evaluation, the Board identified key qualifications for members: direct experience in media, technology, and consumer-facing businesses; significant experience in creating or managing large enterprises; and/or significant experience in making complex strategic, financial, and operational decisions. The Board's experience is reinforced through a robust ongoing director education program, including in-depth regular discussions and information (including from third parties) on the trends, competitive positioning, and emerging challenges and opportunities in the media and entertainment industry.

Board Tenure: To help ensure that the Board has an appropriate balance of experience and fresh perspectives, the Board believes it is well-served by having non-employee directors with a mix of tenures and, in July 2013, amended the Corporate Governance Policy to add a statement that it expects that average tenure of non-employee directors will generally not exceed 10 years.

Lead Independent Director has significant authority and responsibilities, including authority over meeting agendas. The Board Leadership Policy adopted in 2009 requires consideration of Board leadership at least annually, with disclosure to shareholders on factors reviewed (see 2015 report posted at www.timewarner.com/leadership).

Director Accountability: The Board is elected annually (no classified board) with a majority-vote standard in uncontested elections.

No Supermajority Voting Provisions in the Company's Charter or By-Laws

Stock Ownership Requirements: The Company has had stock ownership requirements for its executive officers and directors since 2003 and increased the CEO share ownership requirement in 2013.

No Hedging or Pledging: The Company prohibits executive officers and directors from engaging in hedging transactions with the Company's Common Stock, holding Common Stock in a margin account or pledging Common Stock as collateral for a loan.

Codes of Conduct: The Company has robust codes of conduct for its executive officers and directors.

No Shareholder Rights Plan

ESG Disclosure: The Company keeps the investment community informed about its activities relating to environmental, social and governance matters, including through updates on corporate social responsibility initiatives (additional details at www.timewarner.com/citizenship).

Special Meeting Rights: Shareholders have the right to request special meetings (15% threshold).

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In late July 2014, the Board amended the By-Laws to remove temporarily provisions permitting holders of 15% of the Company's outstanding Common Stock to request a special meeting of shareholders. The Board had proposed, and the Company's shareholders approved, the special meeting provisions in 2010. Accordingly, the Board fully recognized the importance that shareholders attach to the right to call special meetings.

At the same time, the Board recognized its fiduciary duty to act in the best interest of the Company and its shareholders overall. In June 2014, Twenty-First Century Fox, Inc. (Fox) had made an unsolicited offer to acquire Time Warner. The Board and senior management carefully and thoroughly evaluated the offer, consulting financial advisors and legal counsel, including experts in Delaware law. The Board considered, among other things: (i) its fiduciary duties under Delaware law, as well as its responsibilities and obligations under the Company's By-laws and corporate governance policies; (ii) the Company's strategy and 2014-2018 long-range plan (the 2014 LRP); (iii) the proposed transaction, including the form (mix of non-voting stock and cash) and amount of consideration; (iv) the strategic, operational, and regulatory risks to executing a combination with Fox, as well as the potential benefits of a transaction; and (v) Fox's governance profile. Following the Board's careful and thorough review, the Board determined that continuing to execute the Company's strategy, as reflected in the 2014 LRP, was in the best interests of shareholders and would create significantly more value for the Company and its shareholders than accepting the unsolicited offer. As a result, the Board determined to reject the unsolicited offer in early July 2014.

In light of the unique and extraordinary circumstances presented by the unsolicited offer, the Board concluded that removing the special meeting provisions was in the best interests of the Company's shareholders. The Board did not make this decision lightly. But following a Board meeting devoted to discussing the topic of the special meeting provisions including receiving the advice of outside counsel and considering shareholder policies on the topic of special meetings the Board concluded that the reasons to temporarily remove the special meeting provisions were compelling.

The Board noted that, given the composition of the Company's shareholder base, there was a risk that shareholders whose financial interests were more aligned with those of Fox than of the Company could trigger the calling of a special meeting, which would present several serious harms to the Company's shareholders overall:

It would significantly shorten the amount of time the Company's shareholders would have to consider the 2014 LRP and evaluate the Company's execution of the plan. The Company planned to host an investor event following the Time Separation to present the new company and highlight each of the Company's businesses, its operations, growth initiatives and prospects. The Board wanted to ensure that shareholders had an opportunity to hear the Company's presentation of the 2014 LRP, strategy and growth initiatives as well as time to evaluate the plan and the Company's performance executing the plan.

It would reduce the time available for the Company's shareholders to evaluate the value of the offer, which was substantially based on non-voting shares.

It would also reduce the amount of time available for the Company's shareholders to evaluate the regulatory, operational, and other risks associated with the offer during a period of significant change in the U.S. regulatory and competitive landscape, with major transactions involving consolidation of content distributors under review.

At the same time it amended the By-laws, the Board took steps to address the concerns of shareholders. The Company stated publicly the Board's intention to reinstate the provisions by the time of the 2015 Annual Meeting. Consistent with that stated intention, in March 2015 the Board reinstated the special meeting provisions in the same form as had been approved by shareholders and as had existed before the July 2014 amendment.

The Company engaged with shareholders representing approximately 40% of the outstanding shares of Common Stock in the weeks following the amendment of the By-laws to discuss the Board's rationale and its intention to reinstate the special meeting provisions prior to the 2015 Annual Meeting. The Company had further discussions with these and additional shareholders at the end of 2014 and in early 2015 to hear their views regarding the reinstatement of the By-law provisions. Shareholders expressed a range of views on the right to call special shareholder meetings (including appropriate ownership thresholds to call such meetings), the Board's removal of the provisions, and the steps they would like the Board to take. In general, the shareholders underscored that they

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view the right to call special meetings of shareholders as important and that they usually oppose the removal of such rights. At the same time, most of the shareholders indicated they understood the Board's reasons for removing the provisions in these exceptional circumstances and were pleased by the Board's concurrent commitment to reinstate the provisions. The shareholders also indicated they would view negatively the removal of the provisions in the future as well as the adoption of additional restrictions or requirements limiting their right to call special meetings. These discussions further informed, and supported, the Board's decision to reinstate the special meeting provisions without any change.

Highly Qualified and Independent Directors

Time Warner's Board consists of 12 highly qualified, skilled and dedicated directors, 11 of whom are independent. These directors possess a combination of qualifications, skills and experiences that enable them to provide effective oversight of the Company and senior management. For a detailed discussion of the qualifications, skill and experience of each of the directors, see "Background of Director Nominees" on page 9.

To conclude that a director is independent, the Board must determine that the director has no material relationship with the Company or its subsidiaries and that the director is free of any other relationship—whether with the Company or otherwise—that would interfere with the director's exercise of independent judgment. The Board has established guidelines on director independence that address employment and commercial relationships that may affect a director's independence, as well as categories of relationships that are not deemed material for purposes of director independence. In addition to applying these guidelines, which are included in the Company's Corporate Governance Policy, the Board considers the NYSE listing standards and the Company's By-laws. **As a result of its annual review of director independence, the Board determined that all of the current directors and all of the nominees for director are independent, except for Mr. Bewkes. Mr. Bewkes is an executive officer of the Company and thus cannot qualify as an independent director.** In determining the independence of the Company's directors, the Board considered relevant transactions, relationships and arrangements as required by the guidelines, NYSE listing standards and the Company's By-laws, as described on pages 35 and 36.

Board Leadership

The current leadership structure consists of one individual serving as Chairman of the Board and Chief Executive Officer and an independent director serving as Lead Independent Director with meaningful responsibilities and authority, who serve as part of a Board consisting of 12 strong and active directors, 11 of whom are independent. The Board's Policy on Determining the Leadership Structure of the Board of Directors provides the Board flexibility to select the appropriate leadership structure for the Company. In its annual review in January 2015, the Board concluded the current leadership structure is effective and continues to be the optimal structure for the Company.

Current Leadership Structure	
Chairman and CEO	Jeffrey L. Bewkes
Lead Independent Director	Stephen F. Bollenbach
Independent Directors	11 of 12 directors are independent
Board Committees	All members are independent

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Corporate Governance

Policy on Determining the Leadership Structure of the Board of Directors

For more than a decade, the Nominating Committee and Board have annually reviewed the leadership structure of the Board as part of the Board's self-evaluations. In January 2009, the Board enhanced and further documented the Company's practices in this area by adopting the Policy on Determining the Leadership Structure of the Board of Directors, which provides for the review of the Board's leadership structure and the performance of the individuals who serve in Board leadership positions annually and whenever there are changes in the individuals serving in Board leadership positions. As part of this review, the Nominating Committee evaluates:

Key leadership positions (*e.g.*, Chairman of the Board, Lead Independent Director and CEO, including whether the position of Chairman of the Board should be held by the CEO, an independent director, or a non-independent director other than the CEO).

Responsibilities of those positions.

Qualifications for those positions.

The Nominating Committee makes its recommendations to the Board, which is responsible for approving the leadership structure of the Board.

Determination of Current Leadership Structure 2015

In January 2015, upon the recommendation of the Nominating Committee, the Board determined that the current Board leadership structure is appropriate for Time Warner at this time. In reaching its determination, the Board considered a number of factors, including the following developments during 2014: the actions taken by the Board to enhance the responsibilities of the Lead Independent Director; the effectiveness of the Board's leadership structure during 2014, including in overseeing the development of the 2014 LRP, which was presented to shareholders and the investment community in October 2014; the results of the vote at the 2014 Annual Meeting on a shareholder proposal requesting the Board adopt a policy requiring an independent chairman; and the Company's continued strong operating and financial performance. **The report on the Board's determination of its leadership structure is posted on the Company's website at www.timewarner.com/leadership.**

As set forth in the report, the Board believes that having Mr. Bewkes serve as both Chairman and CEO has resulted in clear decision-making processes, leadership and accountability as the Company executes its strategy as a content-focused company, including driving the digital transformation and international expansion of its businesses, increasing its investment in programming to drive future ratings and revenue increases, and improving operating and capital efficiency. The Board also believes that having Mr. Bewkes serve as Chairman and CEO has continued to facilitate the flow of information to, and discussion among, members of the Board regarding the Company's businesses.

The Nominating Committee believes that Mr. Bollenbach is highly qualified to serve as the Lead Independent Director. The Committee also noted that the Lead Independent Director role has substantial responsibilities that enable Mr. Bollenbach to provide strong leadership of the independent directors and help the Board provide effective independent oversight of the Chairman and CEO.

Lead Independent Director s Authority and Responsibilities

The Lead Independent Director s authority and responsibilities include:

Presiding at meetings of the Board at which the Chairman of the Board is not present and at executive sessions of the Board (unless the matter under consideration is within the jurisdiction of one of the Board s committees).

Authority to call meetings of independent directors.

Serving as the liaison between the Chairman of the Board and the other directors.

Authority to approve the agenda (including the time allocated to items) and information for Board meetings.

Advising the Chairman of the Board with respect to consultants who may report directly to the Board.

Serving as interim Chairman of the Board in the event of the death or incapacitation of the Chairman.

Availability, as appropriate, for communication with the Company s shareholders.

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Corporate Governance

Selection of Lead Independent Director

The Board initially selected Mr. Bollenbach as Lead Independent Director in May 2012 and most recently reappointed him to the position in May 2014. Mr. Bollenbach has more than 15 years of leadership experience and extensive knowledge and experience in finance and accounting matters from senior roles at several major companies with international operations, including from serving as Chief Executive Officer of Hilton Hotels Corporation and Chief Financial Officer of The Walt Disney Company. Mr. Bollenbach also has deep knowledge of the Company from his 14 years of service as a director, including from serving as Chair of two of the Board's committees.

Board and Committee Responsibilities

Board Responsibilities and Oversight of Risk

The Board's primary responsibility is to seek to maximize long-term shareholder value. The Board selects senior management of the Company, oversees and monitors the performance of management and the Company, and provides advice and counsel to management. The Board reviews the Company's strategy and approves a long-range plan that includes an annual budget and capital plan annually, or more often as circumstances warrant. The Board reviews and approves transactions pursuant to guidelines the Board has established and reviews from time to time.

The Board also is charged with general oversight of the management of the Company's risks. The Board considers, as appropriate, risks to the Company among other factors in reviewing the Company's strategy, long-range plan, budget, capital plan and major transactions. The Board carries out its risk oversight function both as a whole and through delegating to the Board committees the oversight of risks that come within the committee's substantive areas, as set forth in the listing of committee responsibilities. In particular:

The Audit Committee reviews and discusses a report from management at least annually on the risks the Company faces, including cybersecurity risks, management's actions to address those risks, and the Company's risk management and mitigation processes. The report is also provided to the Board.

The Compensation Committee oversees risks related to the Company's compensation programs and policies. The Compensation Committee reviews and discusses at least annually management's report on such risks. See Executive Compensation Compensation Programs and Risk Management beginning on page 71.

In fulfilling the Board's responsibilities, directors have full access to the Company's management, internal and external auditors, and outside advisors selected by the Board or its committees.

The Company's independent directors generally meet by themselves, without management or any non-independent directors present, at each regularly scheduled Board meeting, and at other times upon the request of any independent director. These executive sessions are led by the Lead Independent Director, except when it is more appropriate for the Chair of the committee that has primary responsibility for the matter being discussed to lead the discussion.

Board Committees and Their Responsibilities

The Board has three standing committees: the Audit and Finance Committee (also referred to as the Audit Committee), the Nominating and Governance Committee (also referred to as the Nominating Committee) and the Compensation and Human Development Committee (also referred to as the Compensation Committee). All Board committee members are independent and satisfy the respective standards of independence applicable to such committees. The Board has also determined that each member of the Audit Committee is financially literate in accordance with the NYSE listing standards. In addition, the Board has determined that each of Ms. Wright and Messrs. Clark, Gutierrez and Hassan is an audit committee financial expert as defined under SEC rules.

Each of the Board's three standing committees meets periodically throughout the year, reports its actions and recommendations to the Board, evaluates its performance annually and holds regular executive sessions at which management is not present.

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Corporate Governance

Audit Committee. The Audit Committee assists the Board of Directors in fulfilling its responsibilities in connection with the following:

independent auditor appointment and oversight and related matters,

internal audit function,

ethics and compliance program,

earnings releases and guidance, financial statements and systems of disclosure controls and procedures and internal control over financial reporting,

capital structure and strategy, including financing and hedging matters and share repurchase program,

mergers & acquisitions, including strategy,

tax matters, including tax strategy,

risk management policies and processes, including cybersecurity risks,

insurance coverage,

retirement programs funding and performance of assets held in retirement plans, and

responses to regulatory actions involving financial, accounting and internal control matters.

Nominating Committee. The Nominating Committee is responsible for assisting the Board on the following:

corporate governance, including regulatory developments relating to corporate governance,

director nominations,

Board leadership structure,

Board committee structure and appointments,

Chairman and CEO performance evaluations and CEO succession planning,

annual Board performance evaluations,

non-employee director compensation,

shareholder proposals and communications,

related person transactions review and approval, and

the Company's public policy and corporate responsibility activities.

Compensation Committee. The Compensation Committee is responsible for the following:

compensation and benefit structure, programs and plans, including oversight of risks related to the Company's compensation programs and practices,

employment agreements of senior executives, including compensation and benefits provided under them,

long-term incentive program design, including performance measures and awards utilized,

disclosures regarding executive compensation matters, advisors retained by the Committee and risks related to the Company's compensation programs and practices,

shareholder advisory votes regarding NEO compensation,

responses to regulatory developments affecting compensation,

officer appointment recommendations, and

human development programs, including recruitment, retention, development, diversity and internal communication programs.

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Each committee is authorized to retain its own outside consultants, legal counsel and other advisors as it desires. The Compensation Committee's charter requires the Committee to assess the independence of any compensation consultant, legal counsel or other advisor prior to retaining the advisor or receiving advice from the advisor (subject to certain exceptions). The assessment considers factors relevant to such advisor's independence, including the factors specified in the NYSE listing standards. The Nominating Committee's charter contains similar requirements with respect to any consultant, legal counsel or other advisor who will provide the Committee advice regarding non-employee director compensation.

The Committees of the Board

Committee	Chair	Members	Number of Meetings in 2014
Audit Committee	Deborah C. Wright	Robert C. Clark Jessica P. Einhorn Carlos M. Gutierrez Fred Hassan	8
Nominating Committee	Robert C. Clark	Deborah C. Wright James L. Barksdale William P. Barr Stephen F. Bollenbach Robert C. Clark Jessica P. Einhorn Kenneth J. Novack	5
Compensation Committee	William P. Barr	William P. Barr Stephen F. Bollenbach Mathias Döpfner Fred Hassan Paul D. Wachter	7

Board Meetings and Attendance

Board Meetings. The Board generally meets at least seven times each year; during 2014, the Board met 10 times. The Board discusses the Company's progress on its long-term strategy at each regular Board meeting and also devotes one meeting each year solely to focus in depth on the Company's strategy.

Attendance. Each incumbent director attended at least 75% of the aggregate of (i) the total number of Board meetings during 2014 and (ii) the total number of meetings of committees on which such member served during 2014 (or the period of 2014 during which the director was a member of the committee, if less than the full year). The Company's directors are encouraged and expected to attend the annual meetings of the Company's shareholders. Each of the 12 directors nominated for election at the 2014 Annual Meeting of Shareholders attended that meeting.

Other Corporate Governance Matters

Corporate Responsibility

As part of its commitment to effective corporate governance, Time Warner keeps shareholders, the investment community and others informed of the Company's activities relating to environmental, social and governance matters. The Company's corporate responsibility activities are overseen by the Nominating Committee. To learn more about Time Warner's corporate responsibility activities, including in the areas of workforce diversity and environmental sustainability, please visit the Company's website at www.timewarner.com/citizenship. The Company updates the information about its corporate responsibility activities regularly as appropriate on its website to provide shareholders with information in a dynamic and timely manner.

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Corporate Governance

Ethical Sourcing Guidelines

The Time Warner Ethical Sourcing Guidelines set forth the standards in areas such as employment, health, safety and the environment that the Company expects its vendors and licensees to follow. The Company expects that its vendors will establish and actively review, monitor and modify their management processes and business operations so that their operations align with the principles set forth in the Guidelines. The failure to follow the Guidelines may, among other things, impact a vendor's ability to continue to do business with the Company. The Guidelines are posted on the Company's website at www.timewarner.com/citizenship under the heading "Leading Responsibly" and sub-heading "Ethical Sourcing And Supply Chain."

Political Activity Policies, Oversight and Disclosure

The Nominating Committee is responsible for overseeing the Company's public policy activities, which includes policies and practices regarding political contributions and expenditures by the Company, its political action committee (PAC), and trade associations. The Company has processes for prior review of corporate political contributions and the use of Company resources in support of the Company's political activities. In addition, Time Warner discloses at least annually all corporate and PAC political contributions (including, if any, independent expenditures made without coordination with any candidate, campaign or their authorized agents) and payments to trade associations and other tax-exempt organizations that are used for political expenditures. These disclosures can be found on the Company's website at www.timewarner.com/citizenship under the heading "Leading Responsibly" and sub-heading "Political Activities." **In 2014, the Company was again ranked in the top tier of companies in the Center for Political Accountability's CPA-Zicklin Index of Corporate Political Disclosure and Accountability, which measures corporate disclosure and accountability for political spending.**

Corporate Governance Documents and Website

The Company has a corporate governance website at www.timewarner.com/governance. The following documents are available on this website and are also available in print to any shareholder who requests them by writing to the Office of the Corporate Secretary, Time Warner Inc., One Time Warner Center, New York, New York 10019-8016:

By-laws

Corporate Governance Policy

Charters of the Board's three standing committees

Policy and Procedures Governing Related Person Transactions

Policy Statement Regarding Director Nominations

Policy on Determining the Leadership Structure of the Board of Directors

Most recent Report on Determination of Current Board Leadership Structure

Standards of Business Conduct, which apply to the Company's employees

Code of Ethics for Our Senior Executive and Senior Financial Officers, which applies to certain senior executives of the Company, including the Chief Executive Officer, Chief Financial Officer and Controller, and serves as a supplement to the Standards of Business Conduct

Guidelines for Non-Employee Directors, which serves as a code of conduct for the Company's non-employee directors

There were no waivers in 2014 under either the Code of Ethics for Our Senior Executive and Senior Financial Officers or the Standards of Business Conduct with respect to any of the Time Warner senior executives covered by the Code of Ethics for Our Senior Executive and Senior Financial Officers.

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Table of Contents**Corporate Governance****Transactions Considered in Making Independence Determinations**

In determining the independence of each current director other than Mr. Bewkes, the Board considered the transactions described below, all of which it determined were immaterial to the directors' independence.

Business Transactions. Under the Board's categorical standards for director independence, transactions in the ordinary course between the Company and another entity with which a director or a member of a director's family is affiliated shall generally be deemed not to create a material relationship unless they occurred within the last three years and (i) the director is an executive officer, employee or substantial owner, or the director's immediate family member is an executive officer, of the other entity and (ii) such transactions represent (A) more than 5% of the Company's consolidated gross revenues for the prior fiscal year or (B) more than \$250,000 and 2% of the other entity's gross revenues for the prior fiscal year.

The Company did not have any transactions that were outside the ordinary course of business or that surpassed the numerical thresholds contained in the Company's categorical standards for director independence, other than the ordinary course business transactions with CNN Films and Home Box Office discussed below under Related Person Transactions Policy and Related Person Transactions.

The Board also considered ordinary course business transactions involving Harvard University and Time Warner Foundation Inc., a non-profit corporation of which the Company is the sole member, even though the transactions did not raise any independence issues under the NYSE listing standards and the amount involved was well below the numerical thresholds contained in the Company's categorical standards for director independence. In 2014, the Company received advertising revenues in the ordinary course of business from Harvard University (where Mr. Clark is a Distinguished Service Professor) that were less than 0.002% of the Company's total revenues in 2014. Time Warner Foundation Inc. holds one certificate of deposit for approximately \$311,000 at Carver Federal Savings Bank (where Ms. Wright serves as Non-Executive Chairman and served as Chairman and Chief Executive Officer through December 2014), which was approximately 0.06% of Carver Federal Savings Bank's total deposits as of December 31, 2014 and earned interest at a market rate during 2014.

Charitable Contributions. Under the Board's categorical standards for director independence, discretionary charitable contributions by the Company to established non-profit entities with which a director or a member of the director's family is affiliated shall generally be deemed not to create a material relationship (i) if they occurred more than three years prior to the determination of materiality or (ii) if they are consistent with the Company's philanthropic practices, unless (a) the director, spouse or domestic partner is an executive officer or director of the organization and (b) the Company's contributions represent, for the most recent fiscal year, more than the greater of \$100,000 or 10% of any individual organization's annual gross revenues (for organizations with gross revenues up to \$10 million per year), or the greater of \$1 million or 2% of any individual organization's annual gross revenues (for organizations with gross revenues of more than \$10 million per year), or the greater of \$1 million or 2% of all such organizations' annual gross revenues in the aggregate.

No charitable contributions by the Company raised any independence issues. During 2014, the Company's largest aggregate charitable contribution to a non-profit entity with which a director or a member of the director's family is affiliated was approximately \$110,000 to Harvard University. The contributions primarily supported a conference on Latino leadership and research fellowships in African and African American studies.

Other Matters. As the Company has disclosed for the past several years, Mr. Novack has been a retired partner of Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, PC (Mintz, Levin) since 1998. As a retired partner, Mr. Novack does not practice law or have a direct or indirect financial interest in the legal services provided by Mintz, Levin to the Company, which are unrelated to Mr. Novack's service on the Board or to matters involving the Board.

Table of Contents**Corporate Governance****Related Person Transactions Policy and Related Person Transactions**

The Board has adopted the Time Warner Inc. Policy and Procedures Governing Related Person Transactions, which is a written policy that sets forth procedures for the review and approval or ratification of transactions involving related persons, which consist of directors, director nominees, executive officers, holders of more than 5% of any outstanding class of the Company's voting securities, and immediate family members or certain affiliated entities of any of the foregoing persons. The Nominating Committee (or its Chair, under certain circumstances) is responsible for applying the policy with the assistance of the General Counsel or his designee (if any). The General Counsel or his designee assesses whether a proposed transaction involving a related person is a related person transaction covered by the policy. If so, the transaction is presented to the Nominating Committee for review and consideration at its next meeting or, in certain instances when waiting until the next meeting is not advisable, to the Chair of the Nominating Committee. In determining whether to approve or ratify a related person transaction covered by the policy, the Nominating Committee may review such facts and circumstances and take into account such factors as it deems appropriate, including the related person's interest and role in the transaction, the terms of the transaction and the benefits of the transaction to the Company.

Transactions covered by the policy consist of any financial transaction, arrangement or relationship or series of similar transactions, arrangements or relationships, in which (i) the aggregate amount involved will or may be expected to exceed \$120,000 in any calendar year, (ii) the Company is, will or may be expected to be a participant, and (iii) any related person has or will have a direct or indirect material interest. The policy also specifies categories of transactions identified by the Board as having no significant potential for an actual or apparent conflict of interest or improper benefit to a related person (such as ordinary course transactions, regulated transactions with common carriers or public utilities and director compensation disclosed in the proxy statement), and thus are not subject to review by the Nominating Committee. The policy is posted on the Company's website at www.timewarner.com/governance.

The following related person transactions were subject to the Time Warner Inc. Policy and Procedures Governing Related Person Transactions and were approved or ratified by the Nominating Committee or its Chair.

From 2008 through early 2015, Mr. Averill's daughter, Kimberly Kuwata, was employed in an advertising sales position at a subsidiary of Turner. Ms. Kuwata's 2014 compensation, including salary, bonus and commissions, was approximately \$157,000.

Andrew Rossi, the son-in-law of Kenneth Novack, is an established documentary film producer who occasionally enters into transactions with Home Box Office and CNN Films related to the production of documentary films. As the Company disclosed in its proxy statements for the 2013 and 2014 annual meetings of shareholders, in January 2013, CNN Films entered into an ordinary course transaction with a production company controlled by Mr. Rossi related to a documentary regarding higher education. CNN Films agreed to pay the production company \$864,000. Similarly, in early 2015, Home Box Office agreed to pay a production company controlled by Mr. Rossi approximately \$600,000 for a new documentary. Both transactions (i) occurred on an arm's length basis in the ordinary course of business, (ii) were for amounts not material to either Turner's or Home Box Office's (as applicable) annual programming expenses, and (iii) were negotiated

without the involvement of any of Mr. Novack, the Board of Directors or senior management of Time Warner; and Mr. Novack has no direct or indirect interest in the transactions or the production companies.

Communicating with the Board of Directors

The Board of Directors has established processes to help ensure that communications to the Board, any of its committees, or an individual member of the Board reach the intended recipient efficiently. Under a policy statement adopted by the Company's independent directors, shareholders, employees and other interested parties who wish to communicate directly with the Board, any of the Board's committees, the non-employee directors as a group, the Chairman of the Board or any individual non-employee director should write to the address below:

[Name of Director or Director Committee/Group]

c/o Office of the Corporate Secretary

Time Warner Inc.

One Time Warner Center

New York, NY 10019-8016

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Director Compensation

DIRECTOR COMPENSATION

Nominating Committee's Review of Non-Employee

Director Compensation

Under its charter, the Nominating Committee is responsible for reviewing compensation of the Company's non-employee directors and making recommendations regarding director compensation to the Board for its approval. In carrying out this responsibility, the Nominating Committee is guided by the following key objectives and principles:

Compensation should be generally consistent with the Company's broader compensation philosophy for the Company's employees.

Compensation should be competitive and structured with a balanced mix of cash and equity compensation so the Company can attract and retain directors from diverse professional and personal backgrounds.

Compensation should be simple to administer and support the smooth functioning of the Board.

Compensation should be cost-effective and consistent with investor policies and expectations.

Compensation should be in compliance with all regulatory requirements.

Under the Corporate Governance Policy, the Nominating Committee reviews the compensation paid to non-employee directors at least every two years to help ensure that it continues to meet the objectives and principles described above. Final decisions regarding non-employee director compensation are made by the Board, based on recommendations by the Nominating Committee.

2014 Non-Employee Director Compensation

For 2014, each non-employee director received \$290,000 in total compensation, consisting of a \$145,000 cash retainer and an equity grant with an aggregate grant date fair value of approximately \$145,000 (consisting of approximately \$100,000 in restricted stock units (RSUs) and approximately \$45,000 in stock options). No additional compensation is paid for service as Lead Independent Director, a committee chair or member or for attendance at meetings of the Board or any Board committee. A new director who joins the Board other than at an annual meeting of shareholders will receive the above compensation on a pro-rated basis.

Cash Retainer

The \$145,000 cash retainer is intended to provide a balance between cash and equity compensation, as well as to provide the non-employee directors sufficient cash to pay income taxes on their RSUs as they vest without having to sell shares. Non-employee directors can elect to defer a portion of the annual cash retainer pursuant to the Time Warner Inc. Non-Employee Directors Deferred Compensation Plan (as described below).

Equity Grants

The RSUs granted to non-employee directors in June 2014 vest June 1, 2015 (the anniversary of the first day of the month in which the RSUs were granted) or immediately if the director ceases to serve as a director of the Company as a result of certain designated circumstances, including (i) retirement either due to a mandatory retirement policy or after serving at least five years as a director, (ii) failure to be re-elected by the shareholders after nomination, (iii) resignation after receiving fewer than a majority for votes in the votes cast in an uncontested election of directors, (iv) death or disability, (v) the occurrence of certain transactions involving a change in control of the Company, or (vi) under certain other designated circumstances, with the approval of the Board on a case-by-case basis. If a non-employee director leaves the Board for any other reason, then his or her unvested RSUs are forfeited to the Company. The aggregate grant date fair value of the RSUs granted is based on the closing sale price of a share of Common Stock on the date of grant or the last trading day preceding the date of grant if the grant date is a non-trading day.

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Director Compensation

The stock options granted to non-employee directors in 2014 have an exercise price equal to the closing sale price of a share of Common Stock on the date of grant or the last trading day preceding the date of grant if the grant date is a non-trading day, expire 10 years from the grant date and vest on June 14, 2015 (the first anniversary of the date of grant) or immediately if the director ceases to serve as a director of the Company as a result of certain designated circumstances, including because the director is not nominated by the Board to stand for re-election at the annual meeting of shareholders, is not re-elected by the shareholders at the annual meeting, or resigns after receiving fewer than a majority for votes in the votes cast in an uncontested election of directors. The aggregate grant date fair value of the stock options granted is based on the Black-Scholes methodology of valuing options.

RSUs and options do not have any voting rights. Non-employee directors receive dividend equivalents on the RSUs in an amount equal to the regular quarterly cash dividends declared and paid by the Company at the same time that the dividends are paid on outstanding shares of Common Stock.

2015 Non-Employee Director Compensation

In 2014, the Nominating Committee reviewed the non-employee directors' compensation and, in December 2014, the Nominating Committee recommended, and the Board approved, offering non-employee directors the ability to elect to receive an alternative compensation program beginning with compensation to be earned in 2015. The base compensation program for non-employee directors will remain the same as in effect for 2014 (described above). The alternative compensation program provides the same amount of total compensation but is weighted more heavily toward equity, with a \$100,000 cash retainer and equity grants with an aggregate grant date fair value of approximately \$190,000 (consisting of approximately \$95,000 in RSUs and approximately \$95,000 in stock options). The Nominating Committee and Board determined that the base program was at an appropriate level and was generally effective in compensating non-employee directors for their service. The Nominating Committee and Board concluded that having an alternative program with a higher percentage of compensation delivered through equity grants than in cash and with equal amounts from RSUs and stock options would promote further alignment of the directors' interests with shareholders. An election to receive the alternative compensation program must be made prior to the start of the year in which the compensation is earned and cannot be changed.

Stock Ownership Guidelines

Each non-employee director is expected to own, within five years of joining the Board, the lesser of at least 10,000 shares of Common Stock or shares of Common Stock with a value equal to four times the annual cash retainer under the base compensation program, regardless of whether the non-employee director elects to receive the base or alternative compensation program. Each non-employee director who has been a member of the Board for at least five years meets these stock ownership guidelines.

Expenses

Non-employee directors are reimbursed for expenses (including costs of travel, food and lodging) incurred in attending Board, committee and shareholder meetings. While travel to such meetings may include the use of Company aircraft, if available and appropriate under the circumstances, the directors generally use commercial air or rail transportation services. Non-employee directors are also reimbursed for reasonable expenses associated with other Company-related business activities, including participation in director education programs.

The Company provides non-employee directors with representative samples of the Company's products (such as films and television programs on DVDs and Blu-ray Discs), promotional items and other merchandise. The Company also periodically invites and provides for directors and their spouses, domestic partners or guests to attend Company-sponsored events, such as film premieres, screenings, cultural events and the annual meeting of shareholders. For the year ended December 31, 2014, the aggregate incremental cost to the Company for providing non-employee directors these Company products and the attendance of non-employee directors and their spouses, domestic partners or guests at Company events was well below \$10,000 per director. The Company also reimburses each non-employee director for the estimated taxes incurred in connection with any income recognized by the director as a result of the attendance by the director, spouse, domestic partner or guest at such events. From time to time, spouses, domestic partners or guests may also join non-employee directors on Company aircraft when a non-employee director is traveling to or from Board or committee meetings, which may result in the non-employee director recognizing income for tax purposes.

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Table of Contents**Director Compensation****Deferred Compensation Plan**

Under the Time Warner Inc. Non-Employee Directors' Deferred Compensation Plan, non-employee directors may elect each year to defer receipt of 10% to 100% of their cash compensation payable during the next calendar year. An election to defer must be made prior to the start of the year in which the retainer is payable and cannot be changed with respect to that year. Each non-employee director can elect from the following crediting alternatives to determine the amounts that will be paid after the deferral period: (i) the amount deferred plus annual interest at the prime rate in effect on May 1 of each annual period plus 2%, (ii) the value of a hypothetical investment in shares of Common Stock made at the time of the deferral, plus the notional reinvestment of dividend equivalents based on any regular cash dividends paid by the Company on the Common Stock, or (iii) an allocation of 50% of the amount deferred to each of the crediting alternatives. Amounts deferred are payable in cash in a lump sum or in installments after a non-employee director leaves the Board, based on the director's election made at the time the director elected to defer receipt of the compensation.

Retirement and Prior Deferred Compensation Program

The Company does not currently maintain a retirement plan for its non-employee directors. Mr. Novack receives retirement benefits under the terms of the Company's retirement plans as a result of his past service as an employee of the Company.

The Company maintains a prior deferred compensation plan for non-employee directors under which non-employee directors previously could elect to defer all or a portion of their cash compensation until the director reached age 70 or left the Board (the "distribution event"). Mr. Bollenbach is the only current director who had deferred amounts pursuant to this plan, and he elected to receive a payout of the account in annual installments over 10 years following the distribution event. Amounts deferred were tracked by two separate calculation methods to determine which method resulted in the greater value at the time the distribution event occurred: (i) applying the average seven-year Treasury constant maturity bond rate for the year at the end of the year to the amount in the account or (ii) the hypothetical investment of the amounts deferred in shares of Common Stock and reinvestment of any dividends that would be earned thereon. During the payout period, the account accrues interest based on the Treasury rate method. Mr. Bollenbach reached age 70 during 2012 and, as a result, the amount credited to his account became payable in annual installments over ten years beginning in 2013.

Table of Contents**Director Compensation****Director Compensation Table**

The table below sets forth 2014 compensation information regarding the Company's non-employee directors. Mr. Bewkes is the only director who is an officer and employee of the Company, and he does not receive any additional compensation for his Board service.

DIRECTOR COMPENSATION FOR FISCAL YEAR 2014

Name	Fees Earned				Total
	or Paid in Cash	Stock Awards ⁽¹⁾⁽²⁾	Option Awards ⁽²⁾⁽³⁾	All Other Compensation ⁽⁴⁾	
James L. Barksdale	\$ 145,000	\$ 99,996	\$ 43,693	\$42	\$ 288,731
William P. Barr	\$ 145,000	\$ 99,996	\$ 43,693	\$0	\$ 288,689
Stephen F. Bollenbach	\$ 145,000	\$ 99,996	\$ 43,693	\$0	\$ 288,689
Robert C. Clark	\$ 145,000	\$ 99,996	\$ 43,693	\$0	\$ 288,689
Mathias Döpfner	\$ 145,000	\$ 99,996	\$ 43,693	\$0	\$ 288,689
Jessica P. Einhorn	\$ 145,000	\$ 99,996	\$ 43,693	\$3,315	\$ 292,004
Carlos M. Gutierrez	\$ 145,000	\$ 99,996	\$ 43,693	\$0	\$ 288,689
Fred Hassan	\$ 145,000	\$ 99,996	\$ 43,693	\$0	\$ 288,689
Kenneth J. Novack	\$ 145,000	\$ 99,996	\$ 43,693	\$3,315	\$ 292,004
Paul D. Wachter	\$ 145,000	\$ 99,996	\$ 43,693	\$42	\$ 288,731
Deborah C. Wright	\$ 145,000	\$ 99,996	\$ 43,693	\$85	\$ 288,774

(1) The amounts set forth in the Stock Awards column represent the aggregate grant date fair value of RSUs granted by the Company to non-employee directors in 2014. On June 14, 2014, the Company awarded 1,474 RSUs to each of the non-employee directors serving on that date. Because the grant date occurred on a non-trading day, the grant date fair value of each RSU award was determined using the closing sale price of the Common Stock on the NYSE Composite Tape on the last trading day preceding the grant date. The actual value, if any that is realized by a director from any RSU award will depend on the market price of the Common Stock in future years. For information about the weighted average grant date fair value of the RSUs granted in 2014, see Note 12 to the Company's consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014 (the 2014 Form 10-K).

- (2) Presented below is the aggregate number of outstanding stock awards and stock option awards held by the non-employee directors on December 31, 2014. Outstanding stock option awards that were granted prior to June 6, 2014, have been adjusted to reflect the Time Separation.

Name	Total Stock Awards	
	(Restricted Stock and RSUs) Outstanding at 12/31/14	Total Option Awards Outstanding at 12/31/14
James L. Barksdale	1,474	41,913
William P. Barr	1,474	25,837
Stephen F. Bollenbach	1,836	37,894
Robert C. Clark	1,474	25,837
Mathias Döpfner	1,474	36,888
Jessica P. Einhorn	1,474	24,148
Carlos M. Gutierrez	1,474	2,898
Fred Hassan	1,474	25,837
Kenneth J. Novack	1,474	12,232
Paul D. Wachter	1,474	19,205
Deborah C. Wright	1,474	29,856

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Director Compensation

- (3) The amounts set forth in the Option Awards column represent the aggregate grant date fair value of stock options granted by the Company in 2014. On June 14, 2014, the Company awarded options to purchase 2,898 shares of Common Stock to each of the non-employee directors serving on that date.

The grant date fair value of the stock options awarded to the non-employee directors on June 14, 2014 was calculated using the Black-Scholes option pricing model based on the following assumptions: an expected volatility of 26.58%, an expected term to exercise of 5.52 years from the date of grant, a risk-free interest rate of 1.92%, and a dividend yield of 1.87%. For information about the weighted-average assumptions used to determine the grant date fair value of options granted in 2014, see Note 12 to the Company's consolidated financial statements included in the 2014 Form 10-K. The discussion in Note 12 reflects weighted-average assumptions on a combined basis for both retirement-eligible and non-retirement eligible employees and non-employee directors.

The actual value, if any, that is realized by a non-employee director from any stock option will depend on the amount by which the market value of the Common Stock exceeds the exercise price of the stock option on the date the stock option is exercised. Accordingly, there is no assurance that the value realized by a non-employee director will be at or near the grant date fair value presented above. These amounts should not be used to predict stock performance.

- (4) The amounts set forth in the All Other Compensation column consist of the Company's payments made in 2014 for the estimated taxes incurred in 2014 for income recognized by Mses. Einhorn and Wright and Messrs. Barksdale, Novack and Wachter due to attendance by a family member at a Company event in 2014.

Table of Contents**Security Ownership****SECURITY OWNERSHIP****Security Ownership of the Board of Directors and****Executive Officers**

The following table sets forth information concerning the beneficial ownership of Time Warner Common Stock as of February 28, 2015 for each current director, each nominee for election as a director, each of the persons named in the Summary Compensation Table and for all current directors and executive officers as a group. None of the foregoing persons beneficially owned any equity securities of the Company's subsidiaries as of February 28, 2015. All amounts representing shares of Common Stock to be issued upon the exercise of stock options that were outstanding on June 6, 2014 have been adjusted to reflect the Time Separation.

Time Warner Common Stock Beneficially Owned ⁽¹⁾			
Name of Beneficial Owner	Number of Shares	Option Shares ⁽²⁾	Percent of Class
Howard M. Averill	28,809	83,385	*
James L. Barksdale	57,036	39,015	*
William P. Barr ⁽³⁾	40,849	22,939	*
Jeffrey L. Bewkes ⁽⁴⁾	434,719	4,249,093	*
Stephen F. Bollenbach ⁽⁵⁾	25,804	34,996	*
Paul T. Cappuccio ⁽⁴⁾	101,557	420,085	*
Robert C. Clark	26,403	22,939	*
Mathias Döpfner	12,966	33,990	*
Jessica P. Einhorn	19,441	21,250	*
Gary L. Ginsberg	17,300	87,274	*
Carlos M. Gutierrez	2,152		*
Fred Hassan	42,980	22,939	*
Kenneth J. Novack ⁽⁶⁾	30,758	9,334	*
Olaf Olafsson	9,475	329,546	*
Paul D. Wachter ⁽⁷⁾	18,686	16,307	*
Deborah C. Wright	19,774	26,958	*
All current directors and executive officers (18 persons)			
as a group ⁽³⁾⁻⁽⁸⁾	976,843	5,535,641	*

* Represents beneficial ownership of less than one percent of the outstanding Common Stock as of February 28, 2015.

(1) Beneficial ownership has been determined in accordance with Rule 13d-3 of the Exchange Act. Unless otherwise indicated, beneficial ownership represents both sole voting and sole investment power. This table does not include, unless otherwise indicated, any shares of Common Stock or other equity securities of the Company that may be held by pension and profit-sharing plans of other corporations or endowment funds of educational and charitable institutions for which various directors and officers serve as directors or trustees.

Under some of the Company's deferred compensation programs, a participant may elect to have the value of the participant's deferred compensation paid out based on an assumed investment in the Common Stock during the deferral period. Participants do not have any right to vote or receive any Common Stock in connection with these assumed investments, which are represented by share equivalents, or phantom units, but are ultimately paid in cash. Under the Company's deferred compensation programs, Mr. Bewkes has been credited with 22,412 share equivalents and Mr. Bollenbach has been credited with 39,841 share equivalents. These share equivalents are not included in the table above.

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Table of Contents**Security Ownership**

- (2) Reflects shares of Common Stock underlying stock options awarded by the Company that were exercisable within 60 days of February 28, 2015. These shares are not included in the Number of Shares column.
- (3) The number of shares includes 3,845 shares of Common Stock held by the Barr Family LLC, of which Mr. Barr is the manager and he and his spouse collectively own a 1% interest and his three adult children collectively own a 99% interest.
- (4) The number of shares includes the following individuals' interests in shares of Common Stock held by a trust under the Time Warner Savings Plan: Mr. Bewkes (approximately 36,643 shares); and Mr. Cappuccio (approximately 275 shares).
- (5) The number of shares held by Mr. Bollenbach includes 362 shares of restricted stock.
- (6) Includes 175 shares of Common Stock held by the Novack Family Foundation, of which Mr. Novack and his wife are two of nine trustees who share voting power with respect to the shares. Mr. Novack disclaims beneficial ownership of shares held by the Novack Family Foundation.
- (7) Includes 11,000 shares of Common Stock held by the Wachter Family Trust, of which Mr. Wachter and his spouse are the trustees and beneficiaries. Mr. Wachter and his spouse share voting and investment power with respect to the shares.
- (8) The number of shares held by all current directors and executive officers as a group includes (i) aggregate interests in approximately 37,276 shares of Common Stock held by a trust under the Time Warner Savings Plan and (ii) an aggregate of approximately 6,448 shares of Common Stock held directly by or in the 401(k) plan of an executive officer's spouse, for which the executive officer disclaims beneficial ownership.

Security Ownership of Certain Beneficial Owners

Based on a review of filings with the SEC, the Company has determined that the following entities hold more than 5% of the outstanding shares of Common Stock as of December 31, 2014:

Name and Address of Beneficial Owner	Shares of Stock Beneficially Owned	Percent of Class
BlackRock, Inc. ⁽¹⁾	48,359,701	5.8%

55 East 52nd Street

New York, NY 10022

Massachusetts Financial Services Company⁽²⁾

111 Huntington Avenue

Boston, MA 02199

The Vanguard Group⁽³⁾

45,420,346

5.4%

100 Vanguard Boulevard

Malvern, PA 19355

43,009,873

5.12%

(1) Based solely on an amendment to Schedule 13G filed by BlackRock, Inc. with the SEC on February 9, 2015.

(2) Based solely on a Schedule 13G filed by Massachusetts Financial Services Company with the SEC on February 3, 2015.

(3) Based solely on a Schedule 13G filed by The Vanguard Group with the SEC on February 10, 2015.

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Audit-Related Matters

AUDIT-RELATED MATTERS

Report of the Audit and Finance Committee

In accordance with its charter, the Audit Committee assists the Board in fulfilling its responsibilities in a number of areas. These responsibilities are described above under *Corporate Governance – Board Committees and Their Responsibilities* beginning on page 31 and in the Audit Committee’s charter, which is posted on the Company’s website at www.timewarner.com/governance.

In connection with its review of the Company’s 2014 financial statements, the Audit Committee reviewed and discussed with management and the independent auditor the audited consolidated financial statements, management’s assessment of the effectiveness of the Company’s internal control over financial reporting and the independent auditor’s evaluation of the effectiveness of the Company’s internal control over financial reporting. Management represented to the Audit Committee that the Company’s consolidated financial statements were prepared in accordance with U.S. generally accepted accounting principles. The Audit Committee also discussed with the independent auditor the matters required to be discussed by the Statement on Auditing Standards No. 61 (Communications with Audit Committees), as amended and as adopted by the Public Accounting Oversight Board in Rule 3200T, including the quality and acceptability of the Company’s accounting policies, financial reporting processes and controls.

In addition, the Audit Committee received the written disclosures and the letter from the independent auditor required by the Public Company Accounting Oversight Board Ethics and Independence Rule 3526, *Communication with Audit Committees Concerning Independence*, regarding the independent auditor’s communications with the Audit Committee concerning independence. The Audit Committee also discussed with the independent auditor the auditor’s independence from the Company and its management. In determining that the auditor is independent, the Audit Committee also considered whether the provision of any of the non-audit services described below under *Fees of the Independent Auditor* is not compatible with maintaining their independence.

In performing its functions, the Audit Committee acts only in an oversight capacity and necessarily relies on the work and assurances of the Company’s management and independent auditor, which, in their reports, express opinions on the fair presentation of the Company’s annual consolidated financial statements in conformity with U.S. generally accepted accounting principles and the effectiveness of the Company’s internal control over financial reporting. In reliance on the reviews and discussions referred to in this Report of the Audit and Finance Committee and in light of its role and responsibilities, the Audit Committee recommended to the Board of Directors, and the Board approved, that the audited consolidated financial statements of the Company be included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC.

Members of the Audit and Finance Committee

Deborah C. Wright (Chair)

Robert C. Clark

Jessica P. Einhorn

Carlos M. Gutierrez

Fred Hassan

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Audit-Related Matters

Policy Regarding Pre-Approval of Services Provided

by the Independent Auditor

The Audit Committee has established a policy (the Pre-Approval Policy) requiring its pre-approval of all audit services and permissible non-audit services provided by the independent auditor, along with the fees for those services. The Pre-Approval Policy provides for the annual pre-approval of specific types of services pursuant to policies and procedures adopted by the Audit Committee, and gives detailed guidance to management as to the specific services that are eligible for such annual pre-approval. The Pre-Approval Policy requires the specific pre-approval of all other permitted services. The Audit Committee has delegated to its Chair the authority to address certain requests for pre-approval of audit and permissible non-audit services between meetings of the Audit Committee and the Chair must report her pre-approval decisions to the Audit Committee at its next regular meeting.

Services Provided by the Independent Auditor

The aggregate fees for services provided by Ernst & Young LLP to the Company with respect to the years ended December 31, 2014 and 2013 are as set forth below.

FEES OF THE INDEPENDENT AUDITOR

Type of Fees	2014
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7. OPERATIONS

Overview

Open surgery remains the predominant form of surgery and is used in almost every area of the body. However, the large incisions required for open surgery create trauma to the patient, typically resulting in longer hospitalization and recovery times, increased hospitalization costs and additional pain and suffering relative to MIS, where MIS is available. Over the past two decades, MIS has reduced trauma to the patient by allowing selected surgeries to be performed through small ports rather than large incisions. MIS has been widely adopted for certain surgical procedures, but it has not been widely adopted for complex reconstructive surgeries.

The da Vinci Surgical System enables surgeons to extend the benefits of MIS to many patients who would otherwise undergo a more invasive surgery by using computational, robotic and imaging technologies to overcome many of the limitations of conventional MIS. Surgeons using the da Vinci system operate while seated comfortably at a console viewing a Three Dimensional ("3-D"), High Definition ("HD") image of the surgical field. This immersive visualization connects surgeons to the surgical field and their instruments. While seated at the console, the surgeon manipulates instrument controls in a natural manner, similar to the more intuitive open surgery technique. Our multi-port technology is designed to provide surgeons with a range of motion in the surgical field analogous to the motions of a human wrist, while filtering out the tremor inherent in a surgeon's hand. In designing our products, we focus on making our technology easy to use.

Our products fall into four broad categories - da Vinci Surgical Systems, InSite and Firefly Fluorescence imaging systems ("Firefly"), instruments and accessories (e.g., EndoWrist, EndoWrist One Vessel Sealer, da Vinci Single-Site and EndoWrist Stapler 45) and training technologies. We have commercialized three generations of da Vinci Surgical Systems; the first is our standard da Vinci Surgical System, first commercialized in 1999, the second is our da Vinci S Surgical System, commercialized in 2006, and the third and most current is our da Vinci Si Surgical System, commercialized in 2009. Systems include a surgeon's console (or consoles), imaging electronics, a patient-side cart and computational hardware and software.

Instruments and accessories are used with systems to allow surgeons the flexibility in choosing the types of tools needed in a particular surgery. In the fourth quarter of 2011, we introduced our Single-Site instruments in the U.S. for use in cholecystectomy procedures utilizing the da Vinci Si Surgical System. During the first quarter of 2013, Single-Site instruments were FDA cleared in the U.S. for use in benign hysterectomies and salpingo oophorectomies. Single-Site instruments enable surgeons to perform surgery through a single port via the patient's belly button, resulting in virtually scarless patient outcomes. Single-Site instruments were Conformité Européenne ("CE") marked and introduced in Europe in the first quarter of 2011. Training technologies include our recently developed da Vinci Connect remote case observation and mentoring tool, our da Vinci Skills Simulator and our dual console for use in surgeon proctoring and collaborative surgery.

Procedures

We model patient value as equal to procedure efficacy / invasiveness. In this equation procedure efficacy is defined as a measure of the success of the surgery in resolving the underlying disease and invasiveness is defined as a measure of patient pain and disruption of regular activities. When the patient value of a da Vinci procedure is greater than that of alternative treatment options, patients may benefit from seeking out surgeons and hospitals that offer da Vinci surgery, which potentially could result in a local market share shift. Adoption occurs procedure by procedure, and is driven by the relative patient value of da Vinci procedures compared to alternative treatment options for the same disease state.

Worldwide Procedures

The adoption of da Vinci surgery has the potential to grow for those procedures that offer greater patient value than non da Vinci alternatives. We focus our organization and investments on developing, marketing and training for those products and procedures where da Vinci can bring significant patient value relative to alternative treatment options. In 2013, da Vinci was used primarily in gynecology, urology, general surgery, cardiothoracic surgery and head and neck surgery. Target procedures in gynecology include da Vinci Hysterectomy ("dVH"), sacrocolpopexy, myomectomy and endometriosis resection. Target procedures in urology include da Vinci Prostatectomy ("dVP"), partial nephrectomy and pyeloplasty. Target procedures in general surgery include Single-Site Cholecystectomy, colorectal procedures, and a

broad base of other general surgery procedures. In cardiothoracic surgery, target procedures include da Vinci Lobectomy and da Vinci Mitral Valve Repair. In head and neck surgery, target procedures include da Vinci Trans-oral Robotic-Assisted Surgery (“TORS”) for throat and base of tongue cancers.

In 2013, approximately 523,000 surgical procedures were performed with the da Vinci Surgical System, compared to approximately 450,000 and 359,000 procedures performed in 2012 and 2011, respectively. The growth in our overall procedure volume in 2013 was driven by the growth in U.S. general surgery procedures, U.S. gynecologic procedures and urology procedures outside of the U.S.

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U.S. Procedures

Overall U.S. procedure volume grew to approximately 422,000 in 2013, compared to approximately 367,000 in 2012, and 292,000 in 2011.

Gynecology is our largest U.S. surgical specialty. Overall U.S. gynecology procedure volume grew from approximately 170,000 cases in 2011 to approximately 222,000 in 2012 and to approximately 240,000 in 2013. The growth was driven by adoption of dVH, our highest volume procedure, and other gynecologic procedures, including sacrocolpopexy and myomectomy. U.S. dVH procedure volume grew from approximately 140,000 cases in 2011 to approximately 176,000 cases in 2012 to approximately 191,000 cases in 2013, of which approximately 41,000 were for the treatment of cancer and approximately 150,000 were related to benign conditions. The lower 2013 U.S. gynecology procedure growth rate reflected a number of factors including, but not limited to, dVH for cancer approaching standard of care penetration levels, apparent pressure on benign gynecology hospital admissions, negative media reports, and a trend by payers toward encouraging conservative disease management and treatment in outpatient settings. We estimate the total annual U.S. addressable robotic hysterectomy market to consist of approximately 300,000 procedures previously performed via open surgery, of which approximately 50,000 are for cancer.

Based upon procedure run rates exiting 2013, general surgery is now our second largest and fastest growing specialty in the U.S. Overall U.S. general surgery procedure volume grew from approximately 15,000 cases in 2011 to approximately 42,000 in 2012 and to approximately 81,000 in 2013. Over 800 customers have purchased da Vinci Single-Site instrumentation through the end of 2013.

U.S. urology procedure volume was approximately 85,000 in 2013, compared to approximately 88,000 in 2012, and 93,000 in 2011. We consider dVP to be the standard of care for the surgical treatment of prostate cancer in the U.S. About 58,000 dVPs were performed in 2013, compared to 62,000 in 2012, and 73,000 in 2011. The approximately 15% reduction in 2012 dVP procedures in the U.S. were caused by the U.S. Preventive Services Task Force recommendation against prostate-specific antigen (“PSA”) screening, as well as changes in treatment pattern for low risk prostate cancer away from definitive treatment. U.S. dVP volumes appear to have stabilized throughout 2013.

International Procedures

Overall international procedure volume grew to approximately 101,000 in 2013, compared to approximately 83,000 in 2012 and 68,000 in 2011. dVP accounted for the majority of international procedures, having grown from about 40,000 in 2011, to 47,000 in 2012, and to 56,000 in 2013. Growth in international dVP was driven by higher procedure volumes in Japan, Italy, the United Kingdom and Australia.

Procedure Seasonality

The majority of da Vinci procedures performed are now for benign conditions, most notably benign hysterectomies. The proportion of these benign procedures is growing in relation to the total number of procedures performed. Hysterectomies for benign conditions and other short-term elective procedures tend to be more seasonal than cancer operations and surgeries for other life threatening conditions. Seasonality for these benign procedures results in higher fourth quarter procedure volume when more patients have met annual deductibles and lower first quarter procedure volume when deductibles are reset. Third quarter activity is also slower given vacation periods, particularly in Europe. As we achieve deeper penetration in certain procedures, seasonality has a more substantial impact on our business.

Business Model

We generate revenue from both the initial capital sales of da Vinci Surgical Systems as well as recurring revenue, derived from sales of instruments, accessories and service. The da Vinci Surgical System generally sells for between \$1.0 million and \$2.3 million, depending upon configuration and geography, and represents a significant capital equipment investment for our customers. We generate recurring revenue as our customers consume our EndoWrist and Single-Site instruments and accessory products used in performing procedures with the da Vinci Surgical System. Our instruments and accessories have a limited life and will either expire or wear out as they are used in surgery, at which point they are replaced. We also generate recurring revenue from ongoing system service. We typically enter into service contracts at the time systems are sold at an annual rate of approximately \$100,000 to \$170,000 per year, depending upon the configuration of the underlying system. These service contracts have generally been renewed at the end of the initial contractual service periods.

Recurring revenue has generally grown at a faster rate than the rate of growth of system revenue. Recurring revenue increased from \$979.5 million, or 56% of total revenue in 2011 to \$1,245.9 million, or 57% of total revenue in 2012 to \$1,430.2 million, or 63% of total revenue in 2013. The increase in recurring revenue relative to system revenue reflects lower 2013 system sales and continuing adoption of procedures on a growing base of installed da Vinci Surgical Systems. The installed base of da Vinci Surgical Systems has grown to 2,966 at December 31, 2013, compared with 2,585 at December 31, 2012, and 2,132 at December 31, 2011.

We provide our products through a direct sales organization in the U.S. and in Europe, excluding Spain, Italy, Greece and Eastern European countries. In January 2012, we acquired our Korean distributor and began selling directly to Korean customers.

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Beginning in 2013, we began to provide our products through a direct sales organization in the Czech Republic, Slovakia and Hungary, whereas prior to 2013, these markets were served by a distributor. In the remainder of our world markets, we provide our products through distributors.

Regulatory Activities

We believe that we have obtained the clearances required to market our multiport products to our targeted surgical specialties within the U.S. and most of Europe. As we make additions to target procedures and introduce new products, we will continue to seek necessary clearances. In February 2013, we received FDA clearance to market our Single-Site instruments for benign hysterectomy and salpingo oophorectomy procedures. FDA clearance for Single-Site Cholecystectomy was received in December 2011.

In September 2013, we received FDA clearance to expand the indication for use for Firefly to include visual assessment of at least one of the major extra-hepatic bile ducts (cystic duct, common bile duct and common hepatic duct), using near infrared imaging. Fluorescence imaging of biliary ducts with the da Vinci Fluorescence Imaging Vision System is intended for use with standard of care white light and, when indicated, intraoperative cholangiography. The device is not intended for standalone use for biliary duct visualization. We believe that the use of Firefly during cholecystectomy procedures will enhance the ability of surgeons to identify key anatomical structures during the surgery.

In November 2009, we received Shonin approval from the Japanese Ministry of Health, Labor, and Welfare (“MHLW”) for our da Vinci S Surgical System in Japan. Until April 2012, we had partnered with the experienced regulatory team from Johnson & Johnson K.K. Medical Company (“JJKK”) to assist in navigating the Japanese regulatory process. In April 2012, the Marketing Authorization Application for da Vinci products was transferred to Intuitive Surgical Japan from JJKK, and Intuitive Surgical Japan now has primary responsibility for regulatory support of our products in Japan. We continue to partner with Adachi Co., Ltd as our separate independent distribution partner for marketing, selling, and servicing our products in Japan. Effective April 2012, we obtained national reimbursement for the dVP procedures in Japan, our only reimbursed procedure to date. In Japan additional procedures are considered for reimbursed status in April of even numbered years as the MHLW considers recommendations and data brought forth from Japanese surgical societies. We do not expect any additional procedures to be granted reimbursement status in the April 2014 cycle. We are supporting the Japanese surgical societies to gather the necessary data for MHLW consideration for reimbursement of additional procedures in the April 2016 cycle. In October 2012, we obtained MHLW approval for da Vinci Si Surgical Systems in Japan. If we are not successful in obtaining additional regulatory clearances, importation licenses, and adequate procedure reimbursements for future products and procedures, then the demand for our products in Japan could be limited.

FDA Inspection

A FDA inspection of the Company’s facilities occurred in April-May 2013 and the FDA issued a Form FDA 483 listing four observations relating to the reporting of field corrections, information which is to be included on reports of field corrections, written procedures for changes to certain product labeling, and design input documentation. We responded to each observation with corrective actions during the course of the inspection and provided additional evidence of corrective actions to the FDA in response to the Form FDA 483. The FDA issued a Warning Letter, dated July 16, 2013, related to two of the four Form FDA 483 observations asking for additional corrective actions and indicated their intent to perform a follow-up inspection. We have responded to the Warning Letter with plans for corrective action, and continue to provide supplemental responses with objective evidence of corrections as they are completed. In addition, the FDA collected electronic samples of all our advertising and promotional material for review, and to date have taken no action in connection therewith. However, we cannot assure that, upon re-inspection, the FDA will find that our corrective actions are acceptable or that they have been adequately implemented. We also cannot assure that the FDA will not find other observations. The FDA previously inspected our Sunnyvale, CA facilities in January 2012 and did not issue a Form FDA 483 as a result of this inspection.

The receipt of a Warning Letter places certain limits on the ability to obtain FDA issued Certificates to Foreign Government used for new and re-registration of products in certain foreign countries.

Medical Device Reporting

In September of 2012 we contacted the Office of Surveillance and Biometrics (“OSB”) in the FDA Center for Devices and Radiological Health (“CDRH”) regarding proposed changes to our reporting practices for non-injury malfunction Medical Device Reports (“MDRs”). In addition we discussed summary reporting for well characterized events. As a result of the proposed changes, we have increased our reports of device malfunction MDRs, the vast majority of which are related to instruments and not to systems. By definition, none of these device malfunction MDRs involve reportable injuries or deaths. These MDRs are posted on the FDA Manufacturer and User Facility Device Experience (“MAUDE”) database.

In addition, claims brought to our attention by plaintiffs’ attorneys, which contain allegations of patient injury, are required to be investigated. In those cases in which da Vinci was used and the system cannot yet be ruled out as a cause of the alleged injury, these cases are reported to the FDA as MDRs. This has led to increases in MDRs.

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We will continue to work with the FDA, CDRH and OSB to establish agreement on reporting criteria and to complete any retrospective reporting that may be required as a result of new criteria. We cannot predict when this work will be completed as it is highly dependent on FDA questions and the acceptance of our responses and data.

Recalls and Corrections

Medical device companies have regulatory obligations to correct or remove medical devices in the field which have factors which could pose a risk to health. The definition of Recalls and Corrections is expansive and includes repair, replacement, inspections, re-labeling and issuance of new, added or reinforcement of instructions for use and training when such actions are taken for specific reasons of safety or compliance. These field actions require stringent documentation, reporting and monitoring worldwide. There are other actions which a medical device manufacturer may take in the field without reporting, including routine servicing, the introduction of new products, new indications for use and stock rotations.

As we determine whether a field action is reportable in any regulatory jurisdiction, we prepare and submit notifications to the appropriate regulatory agency for the particular jurisdiction. In general, upon submitting required notifications to regulators regarding a field action which is a recall or correction, we will notify customers regarding the field action, provide any additional documentation required in their national language and arrange, as required, return or replacement of the affected product or a field service visit to perform the correction. In some cases actions taken us that we believed to be routine or not reportable may be retrospectively classified by regulators as reportable, resulting in the reporting of additional field actions, which in some cases may have already been completed. In addition, regulators can require the expansion, reclassification or change in scope and language of the field action. Field actions can result in adverse effects on the business including damage to reputation, delays by customers of purchase decisions, reduction or stoppage of use of installed systems, and reduced revenue as well as increased expenses to complete field actions.

2013 Business Events and Trends

Procedures

Overall. During the year ended December 31, 2013, total da Vinci procedures grew approximately 16% compared with 2012, driven by growth in general surgery and gynecology procedures in the U.S. and international urology procedures, partially offset by an approximately 6% reduction in dVP procedures in the U.S.

dVP. We believe the U.S. Preventive Services Task Force recommendation against PSA screening, as well as changes in treatment patterns for low risk prostate cancer away from definitive treatment, have led to a decline in our dVP business. During 2013, U.S. dVP procedure volumes appear to have stabilized, with a gradually decreasing trend. These treatment patterns have also impacted our European dVP procedure volumes. dVP is at earlier market penetration stages in the European markets; therefore, we are unable to precisely estimate the extent to which these recommendations and treatment pattern changes may have been adopted by governments or clinicians within non-U.S. jurisdictions.

Benign Gynecology Procedure Adoption Trends. During the year ended December 31, 2013, we experienced lower growth rates in the category of U.S. benign gynecologic procedures than in prior years. The slower 2013 growth rate in the category of U.S. benign gynecologic procedures reflected a number of factors including, but not limited to, apparent pressure on benign gynecology hospital admissions, negative media reports, and a trend by payers toward encouraging conservative disease management and treatment in outpatient settings. We still have a significant remaining market opportunity in benign gynecologic procedures since a large number are still done via open technique. However, as we penetrate more deeply into benign gynecologic procedures, our pace of capturing or consolidating the remaining market is progressing at a slower rate than previously.

Monopolar Curved Scissors Field Action. During early May 2013, we issued a field notice informing customers of the potential for micro-crack formations in certain of our EndoWrist Monopolar Curved Scissors ("MCS"). We decided to stop shipment of these versions until a replacement product was made available. However, as the risk of injury to patients from the recalled product was extremely low, customers were notified that they could continue to use the recalled product; which most did. To date, we have no confirmed evidence of patient injury attributable to this issue. The replacement MCS product began shipping on May 31, 2013. We do not believe that this field action materially impacted our 2013 procedure volume and customer returns of the recalled product have not been material.

Environment and Demand for Our Products

During the year ended December 31, 2013, there have been a number of factors that have resulted in slowing growth rates in U.S. benign gynecologic procedures as noted previously. We expect growth in benign procedures to continue at a level below 2012 and could decline further depending on changes in hospital admissions, payer behavior, the impact of the Affordable Care Act and other factors. In the future, demand for da Vinci systems will be impacted by factors including procedure growth rates, economic pressure and uncertainty at hospitals associated with the Affordable Care Act, evolving system utilization and point of care dynamics, likely variability in the timing of Japanese systems sales given the time until potential additional da Vinci procedures will be considered for reimbursement, anticipated in 2016, and changing economic and geopolitical factors. The European credit

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and sovereign debt issues have slowed capital sales and curtailed procedure growth during 2012 and through 2013. European uncertainties could adversely impact demand for our products globally.

New Product Introductions

da Vinci Single-Site Instruments. da Vinci Single-Site is a set of non-wristed instruments and accessories that allow the da Vinci Si systems to work through a single incision, typically in the umbilicus, rather than multiple incisions. Single incision surgery is intended to minimize invasiveness to patients by reducing the number of ports required to enter the body and is typically utilized for less complex surgery than multi-port surgery. Non-robotic single incision surgery today is typically performed with modified laparoscopic instruments. Early clinical adoption of this manual technique has been mostly positive, although physicians have reported that manual single incision surgery is technically and ergonomically challenging. da Vinci Single-Site instruments and accessories were designed to address these issues. In February 2011, we received the CE mark for our da Vinci Single-Site instrument kit and began selling these new products in Europe. The majority of da Vinci Single-Site procedures performed in Europe to date have been cholecystectomies. In December 2011, we received U.S. FDA regulatory clearance to market our Single-Site instrumentation in the U.S. for laparoscopic cholecystectomy procedures. In February 2013, we received FDA clearance to market our Single-Site instruments for benign hysterectomy and salpingo oophorectomy procedures. We are encouraged by hospital, surgeon, and patient interest in da Vinci Single-Site, with over 800 U.S. customers having purchased da Vinci Single-Site kits as of December 31, 2013. However, as these are our initial products targeted towards procedures already highly penetrated by manual MIS techniques, we are not able to predict the extent or pace that da Vinci Single-Site may be adopted.

da Vinci Firefly Fluorescence Imaging. In the first quarter of 2011, we launched our Firefly product for use with the da Vinci Si Surgical System. This imaging capability combines a fluorescent dye with a specialized da Vinci camera head, endoscope and laser-based illuminator to allow surgeons to identify vasculature in three dimensions beneath tissue surfaces to visualize critical anatomy. Adoption of Firefly is progressing with use across the categories of urology, gynecology and general surgery. In September 2013, we received FDA 510(k) clearance to market our Firefly fluorescence imaging product for real-time imaging of bile ducts (cystic duct, common bile duct and common hepatic duct). We believe that the use of Firefly during cholecystectomy procedures will enhance the ability of surgeons to identify key anatomical structures during the surgery.

EndoWrist One Vessel Sealer. In December 2011, we received FDA clearance for the EndoWrist One Vessel Sealer. The EndoWrist One Vessel Sealer is a wristed, single-use instrument intended for bipolar coagulation and mechanical transection of vessels up to 7 mm in diameter and tissue bundles that fit in the jaws of the instrument. This instrument enables da Vinci Si surgeons to fully control vessel sealing, while providing the benefits of da Vinci Surgery. This instrument is designed to enhance surgical efficiency and autonomy in a variety of general surgery and gynecologic procedures. Clinical response to the EndoWrist One Vessel Sealer has been encouraging, with positive commentary on precision, articulation, vessel sealing quality and thermal spread. We expect applications for the EndoWrist One Vessel Sealer to be centered on general surgery and gynecologic oncology procedures. EndoWrist One Vessel Sealer utilization rates have increased steadily in 2013.

EndoWrist Stapler 45. In October 2012, we received FDA clearance for the EndoWrist Stapler 45 instrument with Blue and Green 45 mm reloads. The EndoWrist Stapler 45 is a wristed, stapling instrument intended for resection, transection and/or creation of anastomoses in general, gynecologic and urologic surgery. This instrument enables operators of the da Vinci Si to precisely position and fire the stapler. We expect its initial surgical use to be directed towards colorectal procedures. During fiscal 2013, the EndoWrist Stapler was used by a limited and gradually increasing number of customers. We expect to continue to expand to a broadening set of customers in 2014. Although our first customer experiences have been positive, we are in the early stages of selling EndoWrist Stapler 45 and we are not able to predict the extent to which the instrument may be adopted.

Recent Media and Lawsuits

Prior to and during the twelve months ended December 31, 2013, various print, television, and internet media have released pieces questioning the patient safety and efficacy associated with da Vinci Surgery, the cost of da Vinci Surgery relative to other disease management methods, the adequacy of surgeon training, and the Company's sales and marketing practices. In addition, as further described below in "Part I, Item 3. Legal Proceedings," we are currently

named as a defendant in about 76 individual product liability lawsuits. Plaintiffs' attorneys are engaged in well-funded national advertising campaigns soliciting clients who have undergone da Vinci surgery and claim to have suffered an injury, and we have seen a substantial increase in these claims. We believe that da Vinci Surgery continues to be a safe and effective surgical method, as supported by a substantial and growing number of scientific studies and peer reviewed papers. We also believe that the training we provide to surgeons helps to ensure that they are able to operate our systems with the requisite skill and expertise. However, the recent negative media publicity likely has and may continue to delay or adversely impact procedure adoption, system sales, and our revenue growth in future periods. We are not able at this time to reasonably estimate the financial impact of this recent negative media publicity.

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2013 Financial Highlights

Total revenue increased 4% to \$2,265.1 million during the year ended December 31, 2013, from \$2,178.8 million during the year ended December 31, 2012.

Approximately 523,000 da Vinci procedures were performed during the year ended December 31, 2013, up approximately 16% from the year ended December 31, 2012.

Instruments and accessories revenue increased 14% to \$1,032.9 million during the year ended December 31, 2013 from \$903.3 million during the year ended December 31, 2012.

Recurring revenue increased 15% to \$1,430.2 million during the year ended December 31, 2013, representing 63% of total revenue, from \$1,245.9 million during the year ended December 31, 2012, representing 57% of total revenue.

We sold 546 da Vinci Surgical Systems during the year ended December 31, 2013, compared with 620 for the year ended December 31, 2012.

System revenue decreased 11% to \$834.9 million during the year ended December 31, 2013 from \$932.9 million during the year ended December 31, 2012.

As of December 31, 2013, we had a da Vinci Surgical System installed base of 2,966 systems - 2,083 in the U.S., 476 in Europe, 159 in Japan and 248 in the rest of the world.

Operating income decreased 3% to \$852.5 million during the year ended December 31, 2013 compared with \$878.1 million during the year ended December 31, 2012. Operating income included \$168.9 million and \$153.3 million during the years ended December 31, 2013 and 2012, respectively, of share-based compensation expense related to employee stock programs.

We ended fiscal 2013 with \$2,753.9 million in cash, cash equivalents and investments. Cash, cash equivalents, and investments decreased by \$166.6 million during 2013 driven by \$1,109.2 million used to repurchase and retire 2.6 million shares of common stock and \$104.6 million used for capital expenditures, partially offset by cash flow from operations and \$160.6 million generated from employee stock programs.

We ended fiscal 2013 with 2,792 employees, compared to 2,362 at the end of fiscal 2012. Headcount additions were made predominantly to our manufacturing, R&D organizations and field sales organizations.

Technology and Other Acquisitions

We continue to make strategic acquisitions of intellectual property and related technologies. Total investments in intellectual property and related technologies during the year ended December 31, 2013 were \$2.0 million, compared with \$41.6 million during the year ended December 31, 2012. Amortization expense related to purchased intellectual property for the years ended December 31, 2013 and 2012 were \$21.3 million and \$23.1 million, respectively.

On January 11, 2012, we completed the acquisition of our Korean distributor. The total purchase consideration of the acquisition was not material, and the acquisition has not had a material impact on the results of our operations.

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Results of Operations

The following table sets forth, for the years indicated, certain Consolidated Statements of Income information (in millions):

	Years Ended December 31,							
	2013	% of total revenue	2012	% of total revenue	2011	% of total revenue		
Revenue:								
Product	\$1,867.8	82	% \$1,836.2	84	% \$1,478.9	84	%	
Service	397.3	18	% 342.6	16	% 278.4	16	%	
Total revenue	2,265.1	100	% 2,178.8	100	% 1,757.3	100	%	
Cost of revenue:								
Product	543.4	24	% 495.3	23	% 382.3	22	%	
Service	127.5	6	% 113.2	5	% 101.2	6	%	
Total cost of revenue	670.9	30	% 608.5	28	% 483.5	28	%	
Product gross profit	1,324.4	58	% 1,340.9	61	% 1,096.6	62	%	
Service gross profit	269.8	12	% 229.4	11	% 177.2	10	%	
Gross profit	1,594.2	70	% 1,570.3	72	% 1,273.8	72	%	
Operating expenses:								
Selling, general and administrative	574.0	25	% 522.2	24	% 438.8	25	%	
Research and development	167.7	7	% 170.0	8	% 140.2	8	%	
Total operating expenses	741.7	32	% 692.2	32	% 579.0	33	%	
Income from operations	852.5	38	% 878.1	40	% 694.8	39	%	
Interest and other income, net	18.4	1	% 15.8	1	% 14.9	1	%	
Income before taxes	870.9	39	% 893.9	41	% 709.7	40	%	
Income tax expense	199.9	9	% 237.3	11	% 214.6	12	%	
Net income	\$671.0	30	% \$656.6	30	% \$495.1	28	%	

Total Revenue

Total revenue increased by 4% during the year ended December 31, 2013 from the year ended December 31, 2012, and by 24% during the year ended December 31, 2012 from the year ended December 31, 2011. Total revenue increased to \$2,265.1 million during the year ended December 31, 2013, from \$2,178.8 million during the year ended December 31, 2012, and from \$1,757.3 million during the year ended December 31, 2011. Total revenue growth for these periods was driven by the continued adoption of da Vinci Surgery, resulting largely from growth in U.S. general surgery procedures, including Cholecystectomy and Colorectal procedures; U.S. gynecologic procedures, including dVH, Sacrocolpopexy and Myomectomy; and dVP in international markets, partially offset by a decline of approximately 15% in dVP procedures in the U.S. in 2012 and 6% in 2013. Our lower 2013 revenue growth rate was driven by slower growth in U.S. benign gynecology procedures, which grew at approximately 9% in 2013 compared to approximately 30% in 2012, and lower U.S. da Vinci system sales. The lower 2013 U.S. gynecology procedure growth rate reflected a number of factors including, but not limited to apparent pressure on benign gynecology hospital admissions, negative media reports, and a trend by payers toward encouraging conservative disease management and treatment in outpatient settings. Our lower US system sales were driven by reduced gynecology procedure growth rates and an elongation of the capital sales cycle. We believe the reduction in dVP procedures in the U.S. reflects pressures from reduced levels of PSA testing and increased use of non-surgical disease management. U.S. dVP volumes appear to have stabilized throughout 2013, with a gradually decreasing trend.

Revenue generated in the U.S. accounted for 72%, 79% and 78% of total revenue during the years ended December 31, 2013, 2012 and 2011, respectively. We believe domestic revenue has accounted for the large majority of total revenue primarily due to the ability of patients to choose their provider and method of treatment in the U.S. Our international revenue grew in proportion to U.S. revenue in 2013, primarily due to higher system sales in the Japanese and European markets, higher international instrument and accessory sales driven by increased procedures

and lower 2013 system sales in the U.S.

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The following table summarizes our revenue and da Vinci Surgical System unit sales information for the years indicated (in millions, except unit sales and percentages):

	Years Ended December 31,			
	2013	2012	2011	
Revenue				
Instruments and accessories	\$1,032.9	\$903.3	\$701.1	
Systems	834.9	932.9	777.8	
Total product revenue	1,867.8	1,836.2	1,478.9	
Services	397.3	342.6	278.4	
Total revenue	\$2,265.1	\$2,178.8	\$1,757.3	
Recurring revenue	\$1,430.2	\$1,245.9	\$979.5	
% of total revenue	63	% 57	% 56	%
Domestic	\$1,625.9	\$1,726.9	\$1,378.7	
International	639.2	451.9	378.6	
Total revenue	\$2,265.1	\$2,178.8	\$1,757.3	
% of Revenue—Domestic	72	% 79	% 78	%
% of Revenue—International	28	% 21	% 22	%
Unit Sales by Region:				
Domestic Unit Sales	342	476	400	
International Unit Sales	204	144	134	
Total Unit Sales	546	620	534	
Unit Sales by Model:				
da Vinci Si-e—Single console Unit Sales (3 arm)	30	26	16	
da Vinci Si—Single console Unit Sales (4 arm)	365	449	384	
da Vinci Si—Dual console Unit Sales	145	105	95	
Total da Vinci Si Unit Sales	540	580	495	
da Vinci S Unit Sales	6	40	39	
Total Unit Sales	546	620	534	
Unit Sales involving System Trade-ins:				
Unit sales involving trade-ins of standard da Vinci Surgical Systems	28	51	65	
Unit sales involving trade-ins of da Vinci S Surgical Systems	126	116	88	
Total unit sales involving trade-ins	154	167	153	
Unit Sales not involving trade-ins	392	453	381	
Total Unit Sales	546	620	534	

Product Revenue

Product revenue increased to \$1,867.8 million during the year ended December 31, 2013, from \$1,836.2 million during the year ended December 31, 2012.

Instruments and accessories revenue increased to \$1,032.9 million for the year ended December 31, 2013, up 14% compared with \$903.3 million for the year ended December 31, 2012. The increase in revenue was driven by an approximate 16% increase in procedure volume and, to a lesser extent, higher initial instrument and accessory orders associated with recently released products, including da Vinci Single-Site, the EndoWrist One Vessel Sealer, and Firefly Fluorescence Imaging products, partially offset by lower initial instrument and accessory stocking orders associated with lower 2013 system units sales and procedure mix.

The growth in our overall procedure volume was driven by growth in U.S. general surgery procedures, U.S. gynecologic procedures and international urology procedures, partially offset by a decline of approximately 6% in U.S. dVP procedures.

Systems revenue decreased to \$834.9 million during the year ended December 31, 2013, down 11% from \$932.9 million during the year ended December 31, 2012, primarily due to lower U.S. da Vinci Surgical System unit sales,

partially offset by higher international system unit sales. During 2013, 342 systems were sold into the U.S., 82 into Europe, 79 into Japan, and 43 into other markets, compared with 476 systems sold into the U.S., 64 into Europe, 40 into Japan, and 40 into other markets in 2012. The demand for systems is ultimately driven by da Vinci surgical procedure volume and is highly sensitive to changes in procedure growth rates. The decline in U.S. system sales in 2013 was largely driven by moderating growth in the category of

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benign gynecologic procedures (as described in the Procedures section) resulting in fewer systems sales required to be sold into the installed base to expand capacity. In addition, hospital capital spending appears to have been impacted by strategic uncertainties surrounding the Affordable Care Act, economic pressures, and negative media reports. The 2013 average selling price (“ASP”) of approximately \$1.52 million was slightly higher than last year’s ASP of approximately \$1.49 million driven by product and geographic mix.

Product revenue increased to \$1,836.2 million during the year ended December 31, 2012, from \$1,478.9 million during the year ended December 31, 2011.

Instruments and accessories revenue increased to \$903.3 million for the year ended December 31, 2012, up 29% compared with \$701.1 million for the year ended December 31, 2011. The increase in revenue was driven by an approximate 25% increase in procedure volume and, to a lesser extent, higher initial instrument and accessory stocking orders associated with recently released instrument and accessory products, including da Vinci Single-Site, the EndoWrist One Vessel Sealer, and Firefly Fluorescence Imaging products, as well as higher initial instrument and accessory stocking orders associated with higher 2012 system units sales.

The growth in our overall procedure volume was driven by growth in U.S. gynecologic procedures, U.S. general surgery procedures, and international dVP procedures, partially offset by a decline of approximately 15% in U.S. dVP procedures.

Systems revenue increased to \$932.9 million during the year ended December 31, 2012, up 20% from \$777.8 million during the year ended December 31, 2011, primarily due to the sale of 86 more systems in 2012. 620 da Vinci Surgical Systems were sold in 2012, compared to 534 in 2011. The 2012 ASP of approximately \$1.49 million was higher than 2011’s ASP of approximately \$1.44 million driven by product, geographic, and trade-in mix. A higher proportion of 2012 system sales included Firefly Fluorescence Imaging configurations, which have higher prices than standard HD vision configurations. 167 used da Vinci models were traded in as part of 2012 system sales transactions, compared to 153 in 2011.

Service Revenue

Service revenue, comprised primarily of system service and customer training, increased 16% to \$397.3 million for the year ended December 31, 2013, from \$342.6 million for the year ended December 31, 2012. We typically enter into service contracts at the time systems are sold. These service contracts have been generally renewed at the end of the service period. Higher service revenue in 2013 was driven by a larger base of da Vinci Surgical Systems producing contract service revenue.

Service revenue, comprised primarily of system service and customer training, increased 23% to \$342.6 million for the year ended December 31, 2012, from \$278.4 million for the year ended December 31, 2011. Higher service revenue for 2012 was driven by a larger base of da Vinci Surgical Systems producing contract service revenue.

Gross Profit

Product gross profit during the year ended December 31, 2013 decreased 1% to \$1,324.4 million, or 70.9% of product revenue, compared with \$1,340.9 million, or 73.0% of product revenue, during the year ended December 31, 2012. The lower 2013 product gross margin largely reflected the impact of the new U.S. medical device excise tax and lower gross margins earned on recently released instrument and accessory products. Product cost of revenue for the twelve months ended December 31, 2013 included \$21.0 million related to the U.S. medical device excise tax, which became effective January 1, 2013. 2013 product revenue included a higher proportion of recently introduced instrument and accessory products which yield lower gross margin percentages, particularly Single-Site Instruments and the EndoWrist One Vessel Sealer. Margins on newly launched products will typically be lower than our mature products reflecting vendor pricing on low volumes, temporary tooling costs and other start-up costs. Over time, as volumes increase, and we refine the manufacturing processes and products, we expect to see improvement in the margins of these newer products. However, gross margins may ultimately differ for these newer products relative to our previous products based market conditions, volume, and complexity of the product. Product gross profit for the year ended December 31, 2013, and 2012 reflected share-based compensation expense of \$17.6 million and \$14.1 million, respectively.

Service gross profit during the year ended December 31, 2013, increased to \$269.8 million, or 67.9% of service revenue, compared with \$229.4 million, or 67.0% of service revenue during the year ended December 31, 2012. The

higher 2012 service gross profit was driven by higher service revenue as described above. The higher 2013 gross service profit percentage was primarily driven by lower service parts consumption rates. Service gross profit during the years ended December 31, 2013 and 2012, reflected share-based compensation expense of \$12.7 million and \$12.9 million, respectively.

Product gross profit during the year ended December 31, 2012, increased 22% to \$1,340.9 million, or 73.0% of product revenue, compared with \$1,096.6 million, or 74.1% of product revenue, during the year ended December 31, 2011. The higher product gross profit was driven by higher 2012 product revenue, as described above. The lower 2012 product gross profit margin primarily reflects the introduction of newly launched products possessing lower margins at their introduction point, particularly da Vinci Single-Site Instruments and the EndoWrist One Vessel Sealer. Margins on newly launched products will typically be lower than our mature products reflecting vendor pricing on low volumes, temporary tooling costs and other start-up costs. As

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volumes increase, and as we refine the manufacturing processes and products, we would expect to see improvement in the margins of these newer products. However, gross margins may ultimately differ for these newer products relative to our previous products based on the volume and complexity of the newer products. Product gross profit for the year ended December 31, 2012 and 2011, reflected share-based compensation expense of \$14.1 million and \$12.3 million, respectively.

Service gross profit during the year ended December 31, 2012, increased to \$229.4 million, or 67.0% of service revenue, compared with \$177.2 million, or 63.7% of service revenue during the year ended December 31, 2011. The higher 2012 service gross profit was driven by a larger installed base. The higher 2012 gross service profit margin was primarily driven by lower service parts consumption and costs associated with field upgrades. Service gross profit during the years ended December 31, 2012 and 2011, reflected share-based compensation expense of \$12.9 million and \$11.0 million, respectively.

Selling, General and Administrative Expenses

Selling, general and administrative expenses include costs for sales, marketing and administrative personnel, sales and marketing activities, tradeshow expenses, legal expenses, regulatory fees and general corporate expenses.

Selling, general and administrative expenses for the year ended December 31, 2013 increased 10% to \$574.0 million compared to \$522.2 million for the year ended December 31, 2012. The increase was primarily due to organizational growth to support our expanding business, particularly in the clinical field sales function, regulatory activity, and higher legal costs related to pending or threatened litigation, and higher non-cash share-based compensation expenses, partially offset by lower employee incentive costs. Share-based compensation expense charged to sales, general and administrative expenses during the years ended December 31, 2013 and 2012, were \$101.4 million and \$93.1 million, respectively.

Selling, general and administrative expenses for the year ended December 31, 2012, increased 19% to \$522.2 million compared to \$438.8 million for the year ended December 31, 2011. The increase in absolute dollars was due to organizational growth to support our expanding business, particularly in the clinical field sales function, higher commissions related to higher revenue levels, and higher non-cash share-based compensation expenses. Share-based compensation expense charged to sales, general and administrative expenses during the years ended December 31, 2012 and 2011 were \$93.1 million and \$84.3 million, respectively.

Research and Development Expenses

Research and development costs are expensed as incurred. Research and development expenses include costs associated with the design, development, testing and significant enhancement of our products. These enhancements represent significant improvements to our products.

Research and development expenses during the year ended December 31, 2013, decreased 1% to \$167.7 million compared to \$170.0 million during the year ended December 31, 2012. The decrease was due to lower 2013 incentive compensation, amortization of intangible assets, and prototype expenses, partly offset by higher share-based compensation. Share-based compensation expense charged to research and development expense during the years ended December 31, 2013 and 2012, were \$37.2 million and \$33.2 million, respectively. Amortization expense related to purchased intellectual property during the years ended December 31, 2013 and 2012, were \$10.8 million and \$13.8 million, respectively. We expect to continue to make substantial investments in research and development and anticipate that research and development expenses, including co-development arrangements with industry partners, is expected to increase in the future.

Research and development expenses during the year ended December 31, 2012, increased 21% to \$170.0 million compared to \$140.2 million during the year ended December 31, 2011. The increases in absolute dollars were due to the growth in our research and development organization and higher prototype costs directed at the development of new products including our vessel sealing and stapling products, as well as our da Vinci Single-Site instruments, and higher share-based compensation expenses. Share-based compensation expense charged to research and development expense during the years ended December 31, 2012 and 2011, were \$33.2 million and \$28.8 million, respectively.

Amortization expense related to purchased intellectual property during the years ended December 31, 2012 and 2011, were \$13.8 million and \$13.4 million, respectively. We expect to continue to make substantial investments in research and development and anticipate that research and development expenses, including co-development arrangements

with industry partners, will continue to increase in the future.

Interest and Other Income, Net

Interest and other income, net, was \$18.4 million during the year ended December 31, 2013, compared to \$15.8 million for the year ended December 31, 2012. Higher interest and other income, net for the year ended December 31, 2013 was driven by higher 2013 interest income earned in 2013.

Interest and other income, net, was \$15.8 million during the year ended December 31, 2012, compared to \$14.9 million for the year ended December 31, 2011. Higher interest and other income, net for the year ended December 31, 2012 was driven by higher 2012 interest income earned on higher cash and investment balances.

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Income Tax Expense

Our income tax expense was \$199.9 million, \$237.3 million and \$214.6 million during the years ended December 31, 2013, 2012 and 2011, respectively. The effective tax rate for 2013 was approximately 23.0% compared with 26.5% for 2012, and 30.2% for 2011. Our tax rates for all these periods differed from the U.S. federal statutory rate of 35% due primarily to income earned by certain of our overseas entities being taxed at rates lower than the federal statutory rate, partially offset by state income taxes net of federal benefit. We intend to indefinitely reinvest outside the U.S. all of our undistributed foreign earnings that were not previously subject to U.S. tax. In addition, our 2013 and 2012 tax provision reflected net tax benefits of \$26.7 million and \$38.0 million, respectively, associated with the reversal of unrecognized tax benefits and interests resulting from expiration of statutes of limitations in multiple jurisdictions. Our 2013 tax provision also included a net tax benefit of \$8.2 million related to 2012 federal research and development (“R&D”) credit which was retroactively reinstated during the first quarter of 2013. Our 2012 tax provision reflected \$8.5 million benefits related to certain previously unrecognized tax benefits and associated interest as a result of new IRS guidance issued in the first quarter of 2012.

A valuation allowance was recorded against the Company's California deferred tax assets because it is more likely than not these deferred tax assets will not be realized as a result of the computation of California taxes under the single sales factor. We will continue to monitor and reassess the need for further increases or decreases to the valuation allowance. As of December 31, 2013 and 2012, we had valuation allowances of \$7.2 million and \$6.0 million, respectively, primarily on California deferred tax assets.

We file federal, state and foreign income tax returns in many jurisdictions in the United States and abroad. Generally, years before 2010 are closed for most significant jurisdictions except for California, for which years before 2008 are considered closed. Certain of our unrecognized tax benefits could reverse based on the normal expiration of various statutes of limitations, which could affect our effective tax rate in the period in which they reverse.

We are subject to the examination of our income tax returns by the Internal Revenue Service and other tax authorities. The outcome of these audits cannot be predicted with certainty. Management regularly assesses the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. If any issues addressed in our tax audits are resolved in a manner not consistent with management's expectations, we could be required to adjust our provision for income taxes in the period such resolution occurs.

Liquidity and Capital Resources

Sources and Uses of Cash

Our principal source of liquidity is cash provided by operations and the exercise of stock options. Cash and cash equivalents plus short and long-term investments increased from \$2,171.8 million at December 31, 2011, to \$2,920.5 million at December 31, 2012, and decreased to \$2,753.9 million at December 31, 2013. Cash generation is one of our fundamental strengths and provides us with substantial financial flexibility in meeting our operating, investing and financing needs.

As of December 31, 2013, \$669.2 million of our cash, cash equivalents and investments were held by foreign subsidiaries. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S. We currently have no plans to repatriate any foreign earnings back to the U.S. as we believe our cash flows provided by our U.S. operations will meet our U.S. liquidity needs.

See “Item 7A. Quantitative and Qualitative Disclosures About Market Risk” for discussion on the impact of interest rate risk and market risk on our investment portfolio.

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Consolidated Cash Flow Data

	Years Ended December 31,		
	2013	2012	2011
	(in millions)		
Net cash provided by (used in)			
Operating activities	\$880.0	\$814.2	\$677.6
Investing activities	259.0	(845.7	) (479.0
Financing activities	(910.6	) 119.2	(12.4
Effect of exchange rates on cash and cash equivalents	—	0.2	(0.2
Net increase in cash and cash equivalents	\$228.4	\$87.9	\$186.0

Operating Activities

During the year ended December 31, 2013, cash flow from operations of \$880.0 million exceeded our net income of \$671.0 million for two primary reasons:

Our net income included substantial non-cash charges in the form of share-based compensation, amortization of 1. intangible assets, taxes, and depreciation. These non-cash charges totaled \$231.0 million during the year ended December 31, 2013.

2. Cash used in working capital during the year ended December 31, 2013 was approximately \$22.0 million.

Working capital is comprised primarily of accounts receivable, inventory, deferred revenue and other liabilities. Accounts receivable decreased by \$68.9 million, or 19%, in 2013 reflecting timing of our system sales. Inventory increased by \$58.1 million, or 48%, in 2013 due to expanded product offerings and safety stocks acquired for key components. Deferred revenue, which includes deferred service revenue that is being recognized as revenue over the service contract period, increased \$15.3 million, or 8%, in 2013 primarily due to the increase in the number of installed systems for which service contracts exist. Other liabilities including accounts payable, accrued compensation and employee benefits, and accrued liabilities decreased by \$35.1 million in 2013 primarily due to timing of vendor, tax and employee compensation payments during 2013.

During the year ended December 31, 2012, cash flow from operations of \$814.2 million exceeded our net income of \$656.6 million for two primary reasons:

Our net income included substantial non-cash charges in the form of share-based compensation, amortization of 1. intangible assets, taxes and depreciation. These non-cash charges totaled \$223.1 million during the year ended December 31, 2012.

2. Cash used in working capital during the year ended December 31, 2012 was approximately \$65.5 million.

Working capital is comprised primarily of accounts receivable, inventory, deferred revenue and other liabilities. Accounts receivable increased by \$68.9 million, or 24%, in 2012 reflecting timing of our system sales. Inventory increased by \$7.1 million, or 8%, in 2012 due to our business growth, expanded product offerings, and safety stocks acquired for key components. Deferred revenue, which includes deferred service contract revenue that is being amortized over the service contract period, increased \$30.5 million, or 20%, in 2012 primarily due to the increase in the number of installed systems for which service contracts exist. Other liabilities including accounts payable, accrued compensation and employee benefits, and accrued liabilities increased by \$17.1 million in 2012 primarily due to timing of vendor, tax and employee compensation payments during 2012.

During the year ended December 31, 2011, cash flow from operations of \$677.6 million exceeded our net income of \$495.1 million for two primary reasons:

Our net income included substantial non-cash charges in the form of share-based compensation, amortization of 1. intangible assets, taxes and depreciation. These non-cash charges totaled \$202.4 million during the year ended December 31, 2011.

2. Cash used in working capital during the year ended December 31, 2011 was approximately \$19.9 million.

Working capital is comprised primarily of accounts receivable, inventory, deferred revenue and other liabilities. Inventory increased by \$25.3 million or 29% in 2011 due to our business growth, expanded product offerings, and safety stocks acquired for key components. Deferred revenue, which includes deferred service contract revenue that is being amortized over the service contract period, increased \$28.1 million or 22% in 2011 primarily due to the increase

in the number of installed systems for which service contracts exist. Other liabilities including accounts payable, accrued compensation and employee benefits, and accrued liabilities increased \$37.8 million or 17% in 2011, primarily due to timing of vendor, tax and employee compensation payments during 2011.

Investing Activities

Net cash provided by investing activities during the year ended December 31, 2013 consisted primarily of proceeds from the sales and maturities of investments (net of purchases of investments) of \$363.6 million, less purchases of property and equipment

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and licensing of intellectual property of \$104.6 million. Net cash used in investing activities during the years ended December 31, 2012 and 2011, consisted primarily of purchases of investments (net of proceeds from sales and maturities of investments) of \$703.9 million and \$396.1 million, respectively, less purchases of property and equipment and licensing of intellectual property of \$114.2 million and \$82.9 million, respectively. We invest predominantly in high quality, fixed income securities. Our investment portfolio may at any time contain investments in U.S. Treasury and U.S. government agency securities, taxable and/or tax exempt municipal notes (some of which may have an auction reset feature), corporate notes and bonds, commercial paper, cash deposits and money market funds. We are not a capital-intensive business.

Financing Activities

Net cash used in financing activities in 2013 consisted primarily of \$1,109.2 million used for the repurchase of 2.6 million shares of our common stock through open market transactions, offset by proceeds from stock option exercises and employee stock purchases of \$160.6 million and excess tax benefits from share-based compensation of \$38.0 million. Net cash proceeds provided by financing activities in 2012 consisted primarily of stock option exercises and employee stock purchases of \$263.3 million, excess tax benefits from share-based compensation of \$94.2 million, offset by \$238.3 million used for the repurchase of 0.4 million shares of our common stock through open market transactions. Net cash used in financing activities in 2011 consisted primarily of \$331.8 million used for the repurchase of 1.0 million shares of our common stock through open market transactions, offset by proceeds from stock option exercises and employee stock purchases of \$260.6 million and excess tax benefits from share-based compensation of \$58.8 million.

Our cash requirements depend on numerous factors, including market acceptance of our products, the resources we devote to developing and supporting our products and other factors. We expect to continue to devote substantial resources to expand procedure adoption and acceptance of our products investments. In 2013, we made substantial investments in our commercial operations, product development activities, facilities and intellectual property. Based upon our business model, we anticipate that we will continue to be able to fund future growth through cash provided from operations. We believe that our current cash, cash equivalents and investment balances, together with income to be derived from the sale of our products, will be sufficient to meet our liquidity requirements for the foreseeable future.

Contractual Obligations and Commercial Commitments

The following table summarizes our contractual obligations as of December 31, 2013 (in millions):

	Payments due by period			
	Total	Less than 1 year	1 to 3 years	3 to 5 years
Operating leases	\$11.1	\$4.9	\$5.2	\$1.0
Purchase commitments and obligations	268.3	268.1	0.2	—
Total contractual obligations	\$279.4	\$273.0	\$5.4	\$1.0

Operating leases. We lease office spaces in the U.S., Switzerland, Mexico, Japan, China, and Korea. We also lease automobiles for certain sales and field service employees. Operating lease amounts include future minimum lease payments under all our non-cancelable operating leases with an initial term in excess of one year.

Purchase commitments and obligations. These amounts include an estimate of all open purchase orders and contractual obligations in the ordinary course of business, including commitments with contract manufacturers and suppliers, for which we have not received the goods or services and acquisition and licensing of intellectual property. A majority of these purchase obligations are due within a year. Although open purchase orders are considered enforceable and legally binding, the terms generally allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to the delivery of goods or performance of services. In addition to the above, we have committed to make potential future milestone payments to third parties as part of licensing, collaboration and development arrangements. Payments under these agreements generally become due and payable only upon achievement of certain developmental, regulatory and/or commercial milestones. Because the achievement of these milestones is neither probable nor reasonably estimable, such contingencies have not been recorded on our Consolidated Balance Sheets and have not been included in the table above.

Other commitments. We are unable to make a reasonably reliable estimate as to when payments may occur for our unrecognized tax benefits. Therefore, our liability for unrecognized tax benefits is not included in the table above.

Off-Balance Sheet Arrangements

As of December 31, 2013, we did not have any significant off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K promulgated under the Exchange Act.

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Critical Accounting Estimates

Our Consolidated Financial Statements are prepared in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”), which requires us to make judgments, estimates and assumptions. See “Note 2. Summary of Significant Accounting Policies,” in Notes to the Consolidated Financial Statements, which is included in “Item 8. Financial Statements and Supplementary Data,” which describes our significant accounting policies and methods used in the preparation of our Consolidated Financial Statements. The methods, estimates and judgments that we use in applying our accounting policies require us to make difficult and subjective judgments, often as a result of the need to make estimates regarding matters that are inherently uncertain. Our most critical accounting estimates include:

- the valuation and recognition of investments, which impacts our investment portfolio balance when we assess fair value, and interest and other income, net, when we record impairments;
- the valuation of revenue and allowance for sales returns and doubtful accounts, which impacts revenue;
- the estimation of transactions to hedge, which impacts revenue and other expense;
- the valuation of inventory, which impacts gross margins;
- the assessment of recoverability of intangibles and the estimated useful lives, which primarily impacts gross margin or operating expenses when we record asset impairments or accelerate their amortization;
- the valuation and recognition of share-based compensation, which impacts gross margin and operating expenses; and
- the recognition and measurement of current and deferred income taxes (including the measurement of uncertain tax positions), which impact our provision for taxes.

Investments Valuation

Fair Value

Our investment portfolio may at any time contain investments in U.S. Treasury and U.S. government agency securities, taxable and/or tax exempt municipal notes (some of which may have an auction reset feature), corporate notes and bonds, commercial paper, cash deposits and money market funds. In the current market environment, the assessment of the fair value of the investments can be difficult and subjective. U.S. GAAP establishes three levels of inputs that may be used to measure fair value. Each level of input has different levels of subjectivity and difficulty involved in determining fair value. Valuation of Level 1 and 2 instruments generally do not require significant management judgment and the estimation is not difficult. Level 3 instruments include unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. The determination of fair value for Level 3 instruments requires the most management judgment and subjectivity. All of the securities classified as Level 3 instruments are municipal bonds with an auction reset feature (“auction rate securities” or “ARS”) whose underlying assets are student loans which are substantially backed by the federal government. These ARS represent less than 1% of our total investment portfolio as of December 31, 2013. Since the auctions for these securities have continued to fail since February 2008, these investments are not currently trading and therefore do not have a readily determinable market value. Accordingly, the estimated fair value of the ARS no longer approximates par value. We have valued the ARS using a discounted cash flow model based on Level 3 assumptions, including estimates of, based on data available as of December 31, 2013, interest rates, timing and amount of cash flows, credit and liquidity premiums and expected holding periods of the ARS. Changes in associated market value have been recorded through other comprehensive income. If market conditions deteriorate further, we may be required to record additional unrealized losses in other comprehensive income or impairment charges in our income. We may not be able to liquidate these investments unless the issuer calls the security, a successful auction occurs, a buyer is found outside of the auction process, or the security matures.

Other-than-temporary impairment

After determining the fair value of our available-for-sales debt instruments, gains or losses on these securities are recorded to other comprehensive income, until either the security is sold or we determine that the decline in value is other-than-temporary. The primary differentiating factors we considered in classifying impairments as either temporary or other-than-temporary impairments are our intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value, the length of the time and the extent to which the market value of the investment has been less than cost, the financial condition and near-term prospects of the issuer. Given the current market conditions, these judgments could prove to be wrong, and companies with

relatively high credit ratings and solid financial conditions may not be able to fulfill their obligations. No significant impairment charges were recorded during the years ended December 31, 2013, 2012, and 2011. As of December 31, 2013 and 2012, our cumulative unrealized gains related to our investments classified as available-for-sale, net of tax, was approximately \$1.7 million and \$6.2 million, respectively.

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Allowance for sales returns and doubtful accounts. We record estimated reductions in revenue for potential returns of products by customers and other allowances. As a result, management must make estimates of potential future product returns and other allowances related to current period product revenue. In making such estimates, management analyzes historical returns, current economic trends and changes in customer demand and acceptance of our products. If management were to make different judgments or utilize different estimates, material differences in the amount of reported revenue could result.

Similarly, management makes estimates of the collectibility of accounts receivable, especially analyzing the aging and nature of accounts receivable and historical bad debts, customer concentrations, customer credit-worthiness, current economic trends, and changes in customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Credit evaluations are undertaken for all major sale transactions before shipment is authorized. On a quarterly basis, we evaluate aged items in the accounts receivable aging report and provide an allowance in an amount we deem adequate for doubtful accounts. If management were to make different judgments or utilize different estimates, material differences in the amount of our reported operating expenses could result.

Inventory valuation. Inventory is stated at the lower of cost or market, with cost determined on a first-in, first-out basis. The cost basis of the Company's inventory is reduced for any products that are considered excessive or obsolete based upon assumptions about future demand and market conditions. If actual future demand or market conditions are less favorable than those projected by management, additional inventory write-downs may be required, which could have a material adverse effect on the results of our operations.

Intangible Assets. Our intangible assets include identifiable intangibles and goodwill. Identifiable intangibles include developed technology, patents, and licenses. All of our identifiable intangibles have finite lives. Goodwill and intangible assets with indefinite lives are subject to an annual impairment review (or more frequent if impairment indicators arise) by applying a fair-value based test. There have been no impairments from the analysis required by U.S. GAAP.

Identifiable intangible assets with finite lives are subject to impairment testing and are reviewed for impairment when events or circumstances indicate that the carrying value of an asset is not recoverable and its carrying amount exceeds its fair value. We evaluate the recoverability of the carrying value of these identifiable intangibles based on estimated undiscounted cash flows to be generated from such assets. If the cash flow estimates or the significant operating assumptions upon which they are based change in the future, we may be required to record additional impairment charges.

We have intangible assets and goodwill. The valuation and classification of these assets and the assignment of useful lives for purposes of amortization involves judgments and the use of estimates. The evaluation of these intangibles and goodwill for impairment under established accounting guidelines is required on a recurring basis. Changes in business conditions could potentially require future adjustments to the assumptions made. When we determine that the useful lives of assets are shorter than we had originally estimated, we accelerate the rate of amortization over the assets' new, shorter useful lives. No impairment charge or accelerated amortization was recorded for the years ended December 31, 2013, 2012, and 2011. A considerable amount of judgment is required in assessing impairment, which includes financial forecasts. Should conditions be different from management's current estimates, material write-downs of long-lived assets may be required, which would adversely affect our operating results.

Revenue recognition. We frequently enter into revenue arrangements that contain multiple elements or deliverables such as system and services. Judgments related to how the arrangement consideration should be allocated to the multiple elements of the arrangement, including the determination of whether any undelivered elements are essential to the functionality of the delivered elements, and the timing of revenue recognition are critical in order to ensure compliance with U.S. GAAP. Changes to the elements in an arrangement and the ability to establish objective and reliable evidence of fair value for those elements could affect the timing of revenue recognition. Revenue recognition also depends on the timing of shipment, and is subject to customer acceptance. If shipments are not made on schedule, or if the products are not accepted by the customer in a timely manner, our reported revenues may differ materially from expectations.

For multiple element arrangements, we allocate revenue to all deliverables based on their relative selling prices. Because we have neither vendor-specific objective evidence ("VSOE") nor third-party evidence of selling price ("TPE")

for our systems, the allocation of revenue to the system element is based on management's best estimate of selling prices ("ESP"). The objective of ESP is to determine the price at which we would transact a sale had the product been sold on a stand-alone basis. We determine ESP for our systems by considering multiple factors, including but not limited to, features and functionality of the system, geographies, type of customer, and market conditions. We review ESP regularly and maintain internal controls over the establishment and updates of these estimates. Significant judgment is applied in determining ESP and any material changes in the judgments made could significantly affect the allocation of revenue to the different elements of our multiple element arrangements.

Hedge Accounting for Derivatives. We utilize foreign currency forward exchange contracts to hedge certain anticipated foreign currency sales transactions. When specific criteria required by relevant accounting standards have been met, changes in fair values of hedge contracts relating to anticipated transactions are recorded in other comprehensive income ("OCI") rather than

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net income until the underlying hedged transaction affects net income. By their very nature, our estimates of anticipated transactions may fluctuate over time and may ultimately vary from actual transactions. When we determine that the transactions are no longer probable within a certain time-frame, we are required to reclassify the cumulative changes in the fair values of the related hedge contracts from other comprehensive income to net income. Accounting for stock options. We account for share-based compensation in accordance with the fair value recognition provisions of U.S. GAAP. We use the Black-Scholes-Merton option-pricing model which requires the input of highly subjective assumptions. These assumptions include estimating the length of time employees will retain their vested stock options before exercising them, the estimated volatility of our common stock price over the expected term, and the number of options that will ultimately not complete their vesting requirements. The assumptions for expected volatility and expected term are the two assumptions that most significantly affect the grant date fair value of stock options. Changes in expected risk-free rate of return do not significantly impact the calculation of fair value, and determining this input is not highly subjective.

We use implied volatility based on freely traded options in the open market, as we believe implied volatility is more reflective of market conditions and a better indicator of expected volatility than historical volatility. In determining the appropriateness of relying on implied volatility, we considered the following:

- the sufficiency of the trading volume of freely traded options;
- the ability to reasonably match the terms, such as the date of the grant and the exercise price of the freely traded options to options granted; and
- the length of the term of the freely traded options used to derive implied volatility.

The expected term represents the weighted-average period that our stock options are expected to be outstanding. The expected term is based on the observed and expected time to exercise. We determine expected term based on historical exercise patterns and our expectation of the time it will take for employees to exercise options still outstanding.

U.S. GAAP requires us to develop an estimate of the number of share-based awards that will be forfeited due to employee turnover. Adjustments in the estimated forfeiture rates can have a significant effect on our reported share-based compensation, as we recognize the cumulative effect of the rate adjustments for all expense amortization in the period the estimated forfeiture rates were adjusted. We estimate and adjust forfeiture rates based on a periodic review of recent forfeiture activity and expected future employee turnover. If a revised forfeiture rate is higher than previously estimated forfeiture rate, we may make an adjustment that will result in a decrease to the expense recognized in the financial statements during the period when the rate was changed. Adjustments in the estimated forfeiture rates could also cause changes in the amount of expense that we recognize in future periods.

Changes in these subjective assumptions can materially affect the estimate of fair value of stock options and, consequently, the related amount of share-based compensation expense recognized on the Consolidated Statements of Income.

Accounting for income taxes. Significant management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against net deferred tax assets in accordance with U.S. GAAP. These estimates and judgments occur in the calculation of tax credits, benefits, and deductions, and in the calculation of certain tax assets and liabilities, which arise from differences in the timing of recognition of revenue and expense for tax and financial statement purposes, as well as the interest and penalties related to uncertain tax positions. Significant changes to these estimates may result in an increase or decrease to our tax provision in the current or subsequent period.

We must assess the likelihood that we will be able to recover our deferred tax assets. If recovery is less than a 50% likelihood, we must increase our provision for taxes by recording a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be recoverable. As of December 31, 2013, we believe it is more likely than not that our deferred tax assets ultimately will be recovered with the exception of our California deferred tax assets. We believe that due to the computation of California taxes under the single sale factor, it is more likely than not that our California deferred tax assets will not be realized. Should there be a change in our ability to recover our deferred tax assets, our tax provision would be affected in the period in which such change takes place.

The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. We recognize liabilities for uncertain tax positions based on a two-step process. The first step is to evaluate the tax

position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. If we determine that a tax position will more likely than not be sustained on audit, then the second step requires us to estimate and measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts, as we have to determine the probability of various possible outcomes. We re-evaluate these uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effective settlement of audit issues, and new audit activity. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision.

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RECENT ACCOUNTING PRONOUNCEMENTS

See “Note 2. Summary of Significant Accounting Policies” of the Notes to Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” for a full description of recent accounting pronouncements including the respective expected dates of adoption and effects on Consolidated Balance Sheets and Consolidated Statements of Income.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate and Market Risk

The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive from our investments without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash equivalents and short-term and long-term investments in a variety of high quality securities, including U.S. treasuries and government agencies, corporate debt, money market funds, commercial paper and taxable or tax exempt municipal bonds (some of which may have an auction reset feature). The securities are classified as available-for-sale and consequently are recorded at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income (loss). The weighted-average maturity of our investments excluding auction rate securities as of December 31, 2013 was approximately 1.3 years. If interest rates rise, the market value of our investments may decline, which could result in a realized loss if we are forced to sell an investment before its scheduled maturity. A hypothetical increase in interest rate by 25 basis points would have resulted in a decrease in the fair value of our net investment position of approximately \$7.7 million as of December 31, 2013. We do not utilize derivative financial instruments to manage our interest rate risks.

The uncertain financial markets have resulted in a tightening in the credit markets, a reduced level of liquidity in many financial markets, and extreme volatility in fixed income and credit markets. The credit ratings of the securities we have invested in could further deteriorate and may have an adverse impact on the carrying value of these investments. As of December 31, 2013, we held approximately \$7.4 million of municipal bonds with an auction reset feature whose underlying assets are student loans that are substantially backed by the federal government. These ARS represent less than 1% of our total investment portfolio. In February 2008, the auction market failed and the ARS therefore continue to be illiquid. We will not be able to access these funds until a future auction of these investments is successful or a buyer is found outside of the auction process. As a result, our ability to liquidate our investment and fully recover the carrying value of our investment in the near term may be limited. If the issuers are unable to service their current obligations, raise funds in the future and/or maintain their credit ratings, we may in the future be required to record an impairment charge on these investments.

Foreign Exchange Risk

The majority of our revenue, expense, and capital purchasing activities are transacted in U.S. dollars. However, because a portion of our operations consists of sales activities outside of the U.S., we have foreign exchange exposures to non-U.S. dollar revenues, operating expenses, accounts receivable, accounts payable and currency bank balances. Our primary exposure is with the Euro.

For the year ended December 31, 2013, sales denominated in foreign currencies were approximately 11% of total revenue. The objective of our hedging program is to mitigate the impact of changes in currency exchange rates on our net cash flow from foreign currency denominated sales. For the year ended December 31, 2013, our revenue would have decreased by approximately \$8.1 million if the U.S. dollar exchange rate would have strengthened by 10%. We also hedge the net recognized non-functional currency balance sheet exposures with foreign exchange forward contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates. A 10% strengthening of the U.S. dollar exchange rate against all currencies to which we have exposure, after taking into account hedges and offsetting positions as of December 31, 2013 would have resulted in a \$4.6 million decrease in the carrying amounts of those net assets. Actual gains and losses in the future may differ materially from the hypothetical gains and losses discussed above based on changes in the timing and amount of foreign currency exchange rate movements and our actual exposure and hedging transactions. Bank counterparties to foreign exchange forward contracts expose us to credit-related losses in the event of their nonperformance. To mitigate that risk, we only contract with counterparties that meet certain minimum requirements under our counterparty risk assessment process. We monitor ratings and potential downgrades on at least a quarterly basis. Based on our ongoing assessment

of counterparty risk, we will adjust our exposure to various counterparties.

Our international operations are subject to risks typical of international operations, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign exchange rate volatility.

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ITEM 8.	FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA	
	Financial Statements	
	Index To Consolidated Financial Statements	Page No.
	<u>Report of Independent Registered Public Accounting Firm</u>	<u>55</u>
	<u>Consolidated Balance Sheets at December 31, 2013 and 2012</u>	<u>56</u>
	<u>Consolidated Statements of Income for the years ended December 31, 2013, 2012, and 2011</u>	<u>57</u>
	<u>Consolidated Statements of Comprehensive Income for the years ended December 31, 2013, 2012, and 2011</u>	<u>58</u>
	<u>Consolidated Statements of Stockholders' Equity for the years ended December 31, 2013, 2012, and 2011</u>	<u>68</u>
	<u>Consolidated Statements of Cash Flows for the years ended December 31, 2013, 2012, and 2011</u>	<u>60</u>
	<u>Notes to the Consolidated Financial Statements</u>	<u>61</u>
	<u>Schedule II—Valuation and Qualifying Accounts</u>	<u>82</u>
	All other schedules have been omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or the Notes thereto.	

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of Intuitive Surgical, Inc.

We have audited the accompanying consolidated balance sheets of Intuitive Surgical, Inc. as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. Our audits also included the financial statement schedule listed in the index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Intuitive Surgical, Inc. at December 31, 2013 and 2012, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Intuitive Surgical, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated February 3, 2014 expressed an unqualified opinion thereon.

/S/ ERNST & YOUNG LLP

San Francisco, California

February 3, 2014

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INTUITIVE SURGICAL, INC.
 CONSOLIDATED BALANCE SHEETS
 (IN MILLIONS, EXCEPT PAR VALUE AMOUNTS)

	December 31, 2013	2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$782.1	\$553.7
Short-term investments	621.4	770.7
Accounts receivable, net of allowances of \$0.5 and \$3.0 at December 31, 2013 and 2012, respectively	301.4	370.3
Inventory	179.6	121.5
Prepays and other current assets	38.3	67.3
Deferred tax assets	9.6	9.3
Total current assets	1,932.4	1,892.8
Property, plant and equipment, net	309.9	241.8
Long-term investments	1,350.4	1,596.1
Long-term deferred tax asset	126.1	87.0
Intangible and other assets, net	94.1	103.4
Goodwill	137.4	138.1
Total assets	\$3,950.3	\$4,059.2
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$46.2	\$57.6
Accrued compensation and employee benefits	70.7	104.0
Deferred revenue	200.1	185.7
Other accrued liabilities	63.9	54.3
Total current liabilities	380.9	401.6
Other long-term liabilities	68.0	77.5
Total liabilities	448.9	479.1
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Preferred stock, 2.5 shares authorized, \$0.001 par value, issuable in series; no shares issued and outstanding as of December 31, 2013 and December 31, 2012, respectively	—	—
Common stock, 100.0 shares authorized, \$0.001 par value, 38.2 shares and 40.2 shares issued and outstanding as of December 31, 2013 and December 31, 2012, respectively	—	—
Additional paid-in capital	2,519.9	2,240.1
Retained earnings	979.4	1,333.4
Accumulated other comprehensive income	2.1	6.6
Total stockholders' equity	3,501.4	3,580.1
Total liabilities and stockholders' equity	\$3,950.3	\$4,059.2
See accompanying Notes to Consolidated Financial Statements.		

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INTUITIVE SURGICAL, INC.

CONSOLIDATED STATEMENTS OF INCOME

(IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

	Years Ended December 31,		
	2013	2012	2011
Revenue:			
Product	\$1,867.8	\$1,836.2	\$1,478.9
Service	397.3	342.6	278.4
Total revenue	2,265.1	2,178.8	1,757.3
Cost of revenue:			
Product	543.4	495.3	382.3
Service	127.5	113.2	101.2
Total cost of revenue	670.9	608.5	483.5
Gross profit	1,594.2	1,570.3	1,273.8
Operating expenses:			
Selling, general and administrative	574.0	522.2	438.8
Research and development	167.7	170.0	140.2
Total operating expenses	741.7	692.2	579.0
Income from operations	852.5	878.1	694.8
Interest and other income, net	18.4	15.8	14.9
Income before taxes	870.9	893.9	709.7
Income tax expense	199.9	237.3	214.6
Net income	\$671.0	\$656.6	\$495.1
Net income per share:			
Basic	\$17.12	\$16.50	\$12.63
Diluted	\$16.73	\$15.98	\$12.32
Shares used in computing net income per share:			
Basic	39.2	39.8	39.2
Diluted	40.1	41.1	40.2

See accompanying Notes to Consolidated Financial Statements.

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INTUITIVE SURGICAL, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(IN MILLIONS)

	Years Ended December 31,		
	2013	2012	2011
Net income	\$671.0	\$656.6	\$495.1
Other comprehensive income (loss):			
Change in foreign currency translation gains (losses)	—	0.6	(0.3)
Available-for-sale investments:			
Change in unrealized gains (losses), net of tax	(3.9)	5.0	1.4
Less: Reclassification adjustment for gains (losses) on investments recognized during the year	(0.6)	0.1	(1.6)
Net change, net of tax effect	(4.5)	5.1	(0.2)
Derivative instruments:			
Change in unrealized gains (losses)	(1.8)	(1.1)	0.5
Less: Reclassification adjustment for gains (losses) on derivative instruments recognized during the year, net of tax	1.8	1.1	(0.7)
Net change, net of tax effect	—	—	(0.2)
Other comprehensive income (loss)	(4.5)	5.7	(0.7)
Total comprehensive income	\$666.5	\$662.3	\$494.4
See accompanying Notes to Consolidated Financial Statements.			

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INTUITIVE SURGICAL, INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(IN MILLIONS)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total		
	Shares	Amount						
Balances at December 31, 2010	38.9	\$—	\$1,316.9	\$718.9	\$ 1.6	\$2,037.4		
Issuance of common stock upon exercise of options and under stock purchase plan	1.4		260.6			260.6		
Income tax benefit from stock option exercises			48.6			48.6		
Share-based compensation expense related to employee stock plans			136.4			136.4		
Repurchase and retirement of common stock	(1.0)	(19.7)	(312.1)	(331.8)
Net income				495.1		495.1		
Other comprehensive income (loss)					(0.7)	(0.7)
Balances at December 31, 2011	39.3	\$—	\$1,742.8	\$901.9	\$ 0.9	\$2,645.6		
Issuance of common stock upon exercise of options and under stock purchase plan	1.3		263.3			263.3		
Income tax benefit from stock option exercises			93.9			93.9		
Share-based compensation expense related to employee stock plans			153.3			153.3		
Repurchase and retirement of common stock	(0.4)	(13.2)	(225.1)	(238.3)
Net income				656.6		656.6		
Other comprehensive income (loss)					5.7	5.7		
Balances at December 31, 2012	40.2	\$—	\$2,240.1	\$1,333.4	\$ 6.6	\$3,580.1		
Issuance of common stock upon exercise of options and under stock purchase plan	0.6		160.6			160.6		
Income tax benefit from stock option exercises			34.5			34.5		
Share-based compensation expense related to employee stock plans			168.9			168.9		

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Repurchase and retirement of common stock	(2.6)	(84.2)	(1,025.0)	(1,109.2)
Net income			671.0	671.0
Other comprehensive income (loss)			(4.5)	(4.5)
Balances at December 31, 2013	38.2	\$—	\$2,519.9	\$979.4
			\$ 2.1	\$3,501.4

See accompanying Notes to Consolidated Financial Statements.

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INTUITIVE SURGICAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN MILLIONS)

	Years Ended December 31,		
	2013	2012	2011
Operating activities:			
Net income	\$671.0	\$656.6	\$495.1
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	46.0	34.7	28.7
Amortization of intangible assets	21.3	23.1	17.8
Accretion of discounts and amortization of premiums on investments, net	36.8	33.1	22.6
Deferred income taxes	(38.5)	) (20.8)	) 7.1
Income tax benefits from employee stock option plans	34.5	93.9	48.6
Excess tax benefit from share-based compensation	(38.0)	) (94.2)	) (58.8)
Share-based compensation expense	168.9	153.3	136.4
Changes in operating assets and liabilities, net of effects of acquisition:			
Accounts receivable	68.9	(68.9)	) (51.1)
Inventory	(70.0)	) (7.1)	) (25.3)
Prepays and other assets	(5.0)	) (37.1)	) (9.4)
Accounts payable	(8.9)	) 8.4	10.3
Accrued compensation and employee benefits	(33.3)	) 21.0	19.6
Deferred revenue	15.2	30.5	28.1
Other accrued liabilities	11.1	(12.3)	) 7.9
Net cash provided by operating activities	880.0	814.2	677.6
Investing activities:			
Purchase of investments	(1,443.7)	) (1,833.9)	) (1,532.2)
Proceeds from sales of investments	984.9	329.8	444.3
Proceeds from maturities of investments	822.4	800.2	691.8
Purchase of property, plant and equipment, intellectual property and business	(104.6)	) (141.8)	) (82.9)
Net cash provided by (used in) investing activities	259.0	(845.7)	) (479.0)
Financing activities:			
Proceeds from issuance of common stock, net	160.6	263.3	260.6
Excess tax benefit from share-based compensation	38.0	94.2	58.8
Repurchase and retirement of common stock	(1,109.2)	) (238.3)	) (331.8)
Net cash (used in) provided by financing activities	(910.6)	) 119.2	(12.4)
Effect of exchange rate changes on cash and cash equivalents	—	0.2	(0.2)
Net increase in cash and cash equivalents	228.4	87.9	186.0
Cash and cash equivalents, beginning of year	553.7	465.8	279.8
Cash and cash equivalents, end of year	\$782.1	\$553.7	\$465.8
Supplemental cash flow information:			
Income taxes paid	\$194.1	\$226.1	\$152.0
See accompanying Notes to Consolidated Financial Statements.			

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INTUITIVE SURGICAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. DESCRIPTION OF THE BUSINESS

Intuitive Surgical, Inc. designs, manufactures, and markets da Vinci® Surgical Systems and related instruments and accessories, which taken together, are advanced surgical systems that the Company considers an advanced generation of surgery. This advanced generation of surgery, which the Company calls da Vinci surgery, combines the benefits of minimally invasive surgery (“MIS”) for patients with the ease of use, precision and dexterity of open surgery. A da Vinci Surgical System consists of a surgeon’s console, a patient-side cart and a high performance vision system. The da Vinci Surgical System translates a surgeon’s natural hand movements, which are performed on instrument controls at a console, into corresponding micro-movements of instruments positioned inside the patient through small incisions, or ports. The da Vinci Surgical System is designed to provide its operating surgeons with intuitive control, range of motion, fine tissue manipulation capability and Three Dimensional (“3-D”), High-Definition (“HD”) vision while simultaneously allowing surgeons to work through the small ports enabled by MIS procedures.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) and include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying Notes to the Consolidated Financial Statements. The accounting estimates that require management’s most significant, difficult and subjective judgments include the valuation and recognition of investments, the valuation of the revenue and allowance for sales returns and doubtful accounts, the estimation of hedging transactions, the valuation of inventory, the assessment of recoverability of intangible assets and their estimated useful lives, the valuation and recognition of share-based compensation and the recognition and measurement of current and deferred income tax assets and liabilities. Actual results could differ materially from these estimates.

Concentrations of Credit Risk and Other Risks and Uncertainties

The carrying amounts for financial instruments consisting of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate fair value due to their short maturities. Marketable securities and derivative instruments are stated at their estimated fair values, based on quoted market prices for the same or similar instruments. The counterparties to the agreements relating to the Company’s investment securities and derivative instruments consist of various major corporations, financial institutions, municipalities and government agencies of high credit standing.

The Company’s accounts receivable are derived from net revenue to customers and distributors located throughout the world. The Company performs credit evaluations of its customers’ financial condition and, generally, requires no collateral from its customers. The Company provides reserves for potential credit losses but has not experienced significant losses to date. As of December 31, 2013 and 2012, 66% and 79%, respectively, of accounts receivable were from domestic customers. No single customer represented more than 10% of net accounts receivable as of December 31, 2013 and 2012.

During the years ended December 31, 2013, 2012, and 2011, domestic revenue accounted for 72%, 79%, and 78%, respectively, of total revenue, while international revenue accounted for 28%, 21%, and 22%, respectively, of total revenue for each of the years then ended. No single customer represented more than 10% of total revenue for the years ended December 31, 2013, 2012, and 2011.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity from date of purchase of 90 days or less to be cash equivalents.

Investments

Available-for-sale investments. The Company's investments consist of U.S. treasury and U.S. government agency securities, taxable and tax exempt municipal notes, some of which may have an auction reset feature ("auction rate securities" or "ARS"), corporate notes and bonds, commercial paper, cash deposits and money market funds. The Company has designated all investments as available-for-sale and therefore, such investments are reported at fair value, with unrealized gains and losses recorded in accumulated other comprehensive income. For securities sold prior to maturity, the cost of securities sold is based on the specific identification method. Realized gains and losses on the sale of investments are recorded in interest and other income, net.

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Investments with original maturities greater than approximately three months and remaining maturities less than one year are classified as short-term investments. Investments with remaining maturities greater than one year are classified as long-term investments.

Other-than-temporary impairment. All of the Company's investments are subject to a periodic impairment review. The Company recognizes an impairment charge when a decline in the fair value of its investments below the cost basis is judged to be other-than-temporary. Factors considered in determining whether a loss is temporary included the extent and length of time the investment's fair value has been lower than its cost basis, the financial condition and near-term prospects of the investee, extent of the loss related to credit of the issuer, the expected cash flows from the security, the Company's intent to sell the security, and whether or not the Company will be required to sell the security prior the expected recovery of the investment's amortized cost basis. During the years ended December 31, 2013, 2012, and 2011, the Company did not record any significant other-than-temporary impairment charges on its available-for-sale securities because the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell these securities before the recovery of their amortized cost basis.

Fair Value Measurements

The Company measures the fair value of money market funds, corporate equity securities and certain debt securities based on quoted prices in active markets for identical assets as Level 1 securities. Marketable securities, measured at fair value using Level 2 inputs, are primarily comprised of U.S. government agencies and FDIC guaranteed securities and corporate debt securities. We review trading activity and pricing for these investments as of the measurement date. When sufficient quoted pricing for identical securities is not available, we use market pricing and other observable market inputs for similar securities obtained from various third party data providers. These inputs either represent quoted prices for similar assets in active markets or have been derived from observable market data. This approach results in the Level 2 classification of these securities within the fair value hierarchy.

Where Level 1 and Level 2 inputs are not available, the Company used a discounted cash flow model based on data available, including interest rates, timing and amount of cash flows, credit and liquidity premiums and expected holding period for Level 3 securities. The only Level 3 securities consist of municipal bonds with an ARS whose underlying assets are student loans which are substantially backed by the federal government. Since the auctions for these securities have continued to fail since February 2008, these investments are not currently being actively traded and therefore do not have a readily determinable market value. The Company recognizes transfers into or out of Level 3 classification as of the actual date of the event or change in circumstances that caused the transfer.

Allowance for Sales Returns and Doubtful Accounts

The allowance for sales returns is based on the Company's estimates of potential future product returns and other allowances related to current period product revenue. The Company analyzes historical returns, current economic trends and changes in customer demand and acceptance of our products. The allowance for doubtful accounts is based on the Company's assessment of the collectability of customer accounts. The Company regularly reviews the allowance by considering factors such as historical experience, credit quality, the age of the accounts receivable balances, and current economic conditions that may affect a customer's ability to pay.

Inventory

Inventory is stated at the lower of cost or market on a first-in, first-out basis. Inventory costs include direct materials, direct labor, and normal manufacturing overhead. The cost basis of the Company's inventory is reduced for any products that are considered excessive or obsolete based upon assumptions about future demand and market conditions.

Property, Plant and Equipment

Property, plant and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets generally as follows:

	Useful Lives
Building	Up to 30 years
Building improvements	Up to 15 years
Leasehold improvements	Lesser of useful life or term of lease
Equipment and furniture	5 years

Computer equipment	3 years
Enterprise-wide software	5 years
Purchased software	Lesser of 3 years or life of license

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Depreciation expense for years ended December 31, 2013, 2012, and 2011 was \$46.0 million, \$34.7 million, and \$28.7 million, respectively.

Capitalized Software Costs for Internal Use

Internally developed software primarily includes enterprise-level business software that the Company customizes to meet its specific operational needs. The Company capitalized costs for enhancement of the enterprise resource planning software system and other internal use software of \$6.6 million and \$4.1 million during the years ended December 31, 2013 and 2012, respectively. Upon being placed in service, these costs are depreciated over an estimated useful life of up to 5 years.

Goodwill and Intangible Assets

Goodwill and intangible assets with indefinite useful lives are not amortized, but are tested for impairment at least annually during the fourth fiscal quarter, or as circumstances indicate their value may no longer be recoverable.

Goodwill represents the excess of the purchase price over the fair value of net tangible and identifiable intangible assets. The Company continues to operate in one segment, which is considered to be the sole reporting unit and therefore, goodwill was tested for impairment at the enterprise level. As of December 31, 2013, there has been no impairment of goodwill.

The Company does not have intangible assets with indefinite useful lives other than goodwill. The Company's intangible assets are comprised of purchased intellectual property. These intangible assets are carried at cost, net of accumulated amortization. Amortization is recorded on a straight-line basis over the intangible assets' useful lives, which range from approximately 1 to 7 years.

Impairment of Long-lived assets

The Company evaluates long-lived assets, which include amortizable intangible and tangible assets, for impairment whenever events or changes in circumstances indicate that the carrying value of long-lived assets may not be recoverable. The Company recognizes such impairment in the event the net book value of such assets exceeds the future undiscounted cash flows attributable to such assets. No material impairment losses were incurred in the periods presented.

Revenue Recognition

The Company's revenue consists of product revenue resulting from the sales of systems, instruments and accessories, and service revenue. The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, the price is fixed or determinable, and collectibility is reasonably assured. The Company generally recognizes revenue at the following points in time:

System sales. For systems sold directly to end customers, revenue is recognized when acceptance occurs, which is deemed to have occurred upon the customer acknowledging delivery or installation, depending on the terms of the arrangement. For systems sold through distributors, revenue is recognized when title and risk of loss has transferred, which generally occurs at the time of shipment. Distributors do not have price protection rights and the Company's system arrangements generally do not provide a rights of return. The da Vinci Surgical Systems are delivered with a software component. However, since the software and non-software elements function together to deliver the system's essential functionality, the Company's arrangements are excluded from being accounted for under software revenue recognition guidance.

Instruments and accessories. Revenue from sales of instruments and accessories is generally recognized at the time of shipment. The Company allows its customers in the normal course of business to return unused products for a limited period of time subsequent to initial purchase and records an allowance against revenue recognized based on historical experience.

Service. Service revenue is recognized ratably over the term of the service period. Revenue related to services performed on a time-and-materials basis is recognized when it is earned and billable.

The Company offers its customers the opportunity to trade in their older systems for credit towards the purchase of a newer generation system. The Company generally does not provide specified price trade-in rights or upgrade rights at the time of system purchase. Such trade-in or upgrade transactions are separately negotiated based on the circumstances at the time of the trade-in or upgrade, based on the then fair value of the system, and are generally not based on any pre-existing rights granted by the Company. Accordingly, such trade-ins and upgrades are not

considered as separate deliverables in the arrangement for a system sale.

As part of a trade-in transaction, the customer receives a new generation system in exchange for its older used system. The trade-in credit is negotiated at the time of the trade-in and is applied towards the purchase price of the new generation unit. Traded-in systems can be reconditioned and resold. The Company accounts for trade-ins consistent with the guidance in AICPA Technical Practice Aid 5100.01, Equipment Sales Net of Trade-Ins (“TPA 5100.01”). The Company applies the accounting guidance by crediting system revenue for the negotiated price of the new generation system, while the difference between (a) the trade-in

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allowance and (b) the net realizable value of the traded-in system less a normal profit margin is treated as a sales allowance. The value of the traded-in system is determined as the amount, after reconditioning costs are added, will allow a normal profit margin on the sale of the reconditioned unit to be generated. When there is no market for the traded-in units, no value is assigned. Traded-in units are reported as a component of inventory until reconditioned and resold, or otherwise disposed.

In addition, customers may also have the opportunity to upgrade their systems, for example, by adding a fourth arm to a three-arm system, adding a second surgeon console for use with the da Vinci Si Surgical System or adding new vision systems to the standard da Vinci and da Vinci S Surgical Systems. Such upgrades are performed by completing component level upgrades at the customer's site. Upgrade revenue is recognized when the component level upgrades are complete and all revenue recognition criteria are met.

For multiple-element arrangements revenue is allocated to each element based on their relative selling prices. Relative selling prices are based first on vendor specified objective evidence ("VSOE"), then on third-party evidence of selling price ("TPE") when VSOE does not exist, and then on management's best estimate of the selling price ("ESP") when VSOE and TPE do not exist.

Because the Company has neither VSOE nor TPE for its systems, the allocation of revenue is based on ESP for the systems sold. The objective of ESP is to determine the price at which the Company would transact a sale, had the product been sold on a stand-alone basis. The Company determines ESP for its systems by considering multiple factors, including, but not limited to, features and functionality of the system, geographies, type of customer, and market conditions. The Company regularly reviews ESP and maintains internal controls over the establishment and updates of these estimates.

Share-Based Compensation

The Company accounts for share-based employee compensation plans using the fair value recognition and measurement provisions under U.S. GAAP. The Company's share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as expense over the requisite service period.

Expected Term: The expected term represents the weighted-average period that the stock options are expected to be outstanding prior to being exercised. The Company determines expected term based on historical exercise patterns and its expectation of the time it will take for employees to exercise options still outstanding.

Expected Volatility: The Company uses market-based implied volatility for purposes of valuing options granted.

Market-based implied volatility is derived based on at least one-year traded options on the Company's common stock. The extent to which the Company relies on market-based volatility when valuing options, depend among other things, on the availability of traded options on the Company's stock and the term of such options. Due to sufficient volume of the traded options, the Company used 100% market-based implied volatility to value options granted, which the Company believes is more representative of future stock price trends than historical volatility.

Risk-Free Interest Rate: The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for the expected term of the option.

See "Note 8. Share-Based Compensation," for a detailed discussion of our share-based employee compensation plans and share-based compensation expense.

Computation of Net Income per Share

Basic net income per share is computed using the weighted-average number of shares outstanding during the period.

Diluted net income per share is computed using the weighted-average number of shares and dilutive potential shares outstanding during the period. Dilutive potential shares primarily consist of employee stock options.

U.S. GAAP requires that employee equity share options, non-vested shares and similar equity instruments granted by the Company be treated as potential common shares outstanding in computing diluted earnings per share. Diluted shares outstanding include the dilutive effect of in-the-money options, which is calculated based on the average share price for each fiscal period using the treasury stock method. Under the treasury stock method, the amount the employee must pay for exercising stock options, the amount of compensation cost for future service that the Company has not yet recognized, and the amount of tax benefits that would be recorded in additional-paid-in-capital ("APIC") when the award becomes deductible are all assumed to be used to repurchase shares.

Research and Development Expenses

Research and development expenses include amortization of purchased intellectual property, costs associated with co-development R&D licensing arrangements, costs of prototypes, salaries, benefits and other headcount related costs, contract and other outside service fees, and facilities and overhead costs.

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Foreign Currency and Other Hedging Instruments

For subsidiaries whose local currency is their functional currency, their assets and liabilities are translated into U.S. dollars at exchange rates at the balance sheet date and revenues and expenses are translated using average exchange rates in effect during the quarter. Gains and losses from foreign currency translation are included in accumulated other comprehensive income within stockholders' equity in the Consolidated Balance Sheets. For all non-functional currency account balances, the re-measurement of such balances to the functional currency will result in either a foreign exchange gain or loss, which is recorded to interest and other income, net in the same accounting period that the re-measurement occurred.

The Company uses derivatives to partially offset its business exposure to foreign currency exchange risk. The Company enters into foreign currency forward contracts with one to seven month terms. The Company typically hedges portions of its forecasted foreign currency exposure associated with revenue. The Company may also enter into foreign currency forward contracts to offset the foreign currency exchange gains and losses generated by re-measurement of certain assets and liabilities denominated in non-functional currencies. The hedging program is not designated for trading or speculative purposes.

The Company's accounting policies for these instruments are based on whether the instruments are designated as hedge or non-hedge instruments. The Company records all derivatives on the Consolidated Balance Sheets at fair value. The effective portions of cash flow hedges are recorded in other comprehensive income (loss) ("OCI") until the hedged item is recognized in earnings. Derivative instruments designated as cash flow hedges are de-designated as hedges when it is probable the forecasted hedged transaction will not occur in the initially identified time period or within a subsequent two month time period. Deferred gains and losses in OCI associated with such derivative instruments are reclassified immediately into earnings through interest and other income, net. Any subsequent changes in fair value of such derivative instruments also are reflected in current earnings.

Derivatives that are not designated as hedging instruments and the ineffective portions of cash flow hedges are adjusted to fair value through earnings in interest and other income, net.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts that are expected more likely than not to be realized in the future.

The Company recognizes tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

Segments

The Company operates in one segment. Management uses one measurement of profitability and does not segregate its business for internal reporting. As of December 31, 2013 and 2012, over 94% and 97% of all long-lived assets were maintained in the United States. For the years ended December 31, 2013, 2012, and 2011, 72%, 79%, and 78%, respectively, of net revenue were generated in the United States.

Recent Accounting Pronouncements

In June 2013, the Financial Accounting Standards Board determined that an unrecognized tax benefit should be presented as a reduction of a deferred tax asset for a net operating loss ("NOL") carryforward or other tax credit carryforward when settlement in this manner is available under applicable tax law. This guidance is effective for the Company's interim and annual periods beginning January 1, 2014. The Company does not believe the adoption of this guidance will have a material impact on its consolidated financial statements.

Effective January 1, 2013, the Company adopted the accounting guidance which requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. The

Company elected to present the information in the notes to the Company's consolidated financial statements.

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NOTE 3. FINANCIAL INSTRUMENTS

Cash, Cash Equivalents and Investments

The following tables summarize the Company's cash and available-for-sale securities' adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category recorded as cash and cash equivalents or short-term or long-term investments as of December 31, 2013 and 2012 (in millions):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-term Investments	Long-term Investments
December 31, 2013							
Cash	\$247.8	\$—	\$—	\$247.8	\$247.8	\$—	\$—
Level 1:							
Money market funds	516.2	—	—	516.2	516.2	—	—
U.S. Treasuries & corporate equity securities	65.4	—	(0.3)	65.1	—	25.5	39.6
Subtotal	581.6	—	(0.3)	581.3	516.2	25.5	39.6
Level 2:							
Commercial paper	100.2	—	—	100.2	18.1	82.1	—
Corporate securities	844.7	2.9	(1.9)	845.7	—	227.7	618.0
U.S. government agencies	352.2	0.7	(0.7)	352.2	—	84.7	267.5
Non-U.S. government securities	67.7	0.2	(0.1)	67.8	—	41.2	26.6
Municipal securities	550.1	1.5	(0.1)	551.5	—	160.2	391.3
Subtotal	1,914.9	5.3	(2.8)	1,917.4	18.1	595.9	1,303.4
Level 3:							
Auction rate securities	8.0	—	(0.6)	7.4	—	—	7.4
Subtotal	8.0	—	(0.6)	7.4	—	—	7.4
Total assets measured at fair value	\$2,752.3	\$5.3	\$(3.7)	\$2,753.9	\$782.1	\$621.4	\$1,350.4
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-term Investments	Long-term Investments
December 31, 2012							
Cash	\$89.7	\$—	\$—	\$89.7	\$89.7	\$—	\$—
Level 1:							
Money market funds	388.1	—	—	388.1	388.1	—	—
U.S. Treasuries & corporate equity securities	179.2	0.2	—	179.4	—	155.4	24.0
Subtotal	567.3	0.2	—	567.5	388.1	155.4	24.0
Level 2:							
Commercial paper	157.4	—	—	157.4	75.9	81.5	—
Corporate securities	952.1	5.8	(0.4)	957.5	—	274.6	682.9
U.S. government agencies	636.9	2.6	—	639.5	—	133.6	505.9
Non-U.S. government securities	90.8	0.5	—	91.3	—	21.8	69.5
Municipal securities	409.3	1.1	(0.2)	410.2	—	103.8	306.4
Subtotal	2,246.5	10.0	(0.6)	2,255.9	75.9	615.3	1,564.7
Level 3:							
Auction rate securities	8.0	—	(0.6)	7.4	—	—	7.4
Subtotal	8.0	—	(0.6)	7.4	—	—	7.4

Total assets measured at fair value	\$2,911.5	\$10.2	\$(1.2)	\$2,920.5	\$553.7	\$770.7	\$1,596.1
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The following table summarizes the contractual maturities of the Company's cash equivalents and available-for-sale investments, excluding corporate equity securities, at December 31, 2013 (in millions):

	Amortized Cost	Fair Value
Mature in less than one year	\$1,154.6	\$1,155.7
Mature in one to five years	1,341.9	1,343.0
Mature in after five years	8.0	7.4
Total	\$2,504.5	\$2,506.1

Realized gains, net of tax, recognized on the sale of investments during the year ended December 31, 2013 was \$0.6 million. Realized losses, net of tax, recognized on the sale of investments during the year ended December 31, 2012 was \$0.1 million. Realized gains, net of tax, recognized on the sale of investments during the year ended December 31, 2011 was \$1.6 million.

As of December 31, 2013 and 2012, unrealized gains on investments, net of tax, of \$1.7 million and \$6.2 million, respectively, were included in accumulated other comprehensive income in the accompanying Consolidated Balance Sheets.

The following tables present the breakdown of the available-for-sale investments with unrealized losses at December 31, 2013 and 2012 (in millions):

	Unrealized losses less than 12 months		Unrealized losses 12 months or greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2013						
Corporate securities	\$245.3	\$(1.9)	\$9.5	\$—	\$254.8	\$(1.9)
U.S. government and agency securities	142.8	(1.0)	—	—	142.8	(1.0)
Municipal securities	37.6	(0.1)	—	—	37.6	(0.1)
Non-U.S. government securities	18.7	(0.1)	—	—	18.7	(0.1)
Auction rate securities	—	—	7.4	(0.6)	7.4	(0.6)
	\$444.4	\$(3.1)	\$16.9	\$(0.6)	\$461.3	\$(3.7)
December 31, 2012						
Corporate securities	\$148.5	\$(0.2)	\$8.4	\$(0.2)	\$156.9	\$(0.4)
Municipal securities	127.0	(0.2)	—	—	127.0	(0.2)
Commercial paper	27.1	—	—	—	27.1	—
Non-U.S. government securities	3.8	—	—	—	3.8	—
U.S. government agencies	15.3	—	—	—	15.3	—
Auction rate securities	—	—	7.4	(0.6)	7.4	(0.6)
	\$321.7	\$(0.4)	\$15.8	\$(0.8)	\$337.5	\$(1.2)

The unrealized losses on the available-for-sale investments are related to ARS and corporate securities. The Company determined these unrealized losses to be temporary and recorded no other-than-temporary impairments. Factors considered in determining whether a loss is temporary included the length of time and extent to which the investments fair value has been less than the cost basis; the financial condition and near-term prospects of the investee; extent of the loss related to credit of the issuer; the expected cash flows from the security; the Company's intent to sell the security and whether or not the Company will be required to sell the security before the recovery of its amortized cost.

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The following table provides reconciliation for all assets measured at fair value using significant unobservable Level 3 inputs for the years ended December 31, 2013 and 2012 (in millions):

	Fair Value Measurements at Reporting Date Using Significant Unobservable Inputs (Level 3) Auction rate securities
Balance at January 1, 2011	\$ 18.6
Sales	(2.6)
Total gains or (losses):	
Included in other comprehensive income (loss)	0.4
Included in earnings	—
Balance at December 31, 2011	\$ 16.4
Sales	(12.0)
Total gains or (losses):	
Included in other comprehensive income (loss)	3.0
Included in earnings	—
Balance at December 31, 2012	\$ 7.4
Sales	—
Total gains or (losses):	
Included in other comprehensive income (loss)	—
Included in earnings	—
Balance at December 31, 2013	\$ 7.4

There have been no transfers between Level 1 and Level 2 measurements during the year ended December 31, 2013, and there were no changes in the Company's valuation technique. Level 3 assets consist of municipal bonds with ARS whose underlying assets are student loans which are substantially backed by the federal government. Since the auctions for these securities have continued to fail since February 2008, these investments are not currently trading and therefore do not have a readily determinable market value. The Company has valued the ARS using a discounted cash flow model based on Level 3 assumptions, including estimates of, based on data available as of December 31, 2013, interest rates, timing and amount of cash flows, credit and liquidity premiums and expected holding periods of the ARS.

Foreign currency derivative

The objective of the Company's hedging program is to mitigate the impact of changes in currency exchange rates on net cash flow from foreign currency denominated sales and intercompany balances and other monetary assets or liabilities denominated in currencies other than the U.S. dollar. The Company had \$3.8 million and \$2.7 million of derivative liabilities recorded as other accrued liabilities in the Consolidated Balance Sheets at December 31, 2013 and 2012. The derivative assets and liabilities are measured using Level 2 fair value inputs.

Cash Flow Hedges

The Company enters into currency forward contracts as cash flow hedges to hedge certain forecasted revenue transactions denominated in currencies other than the U.S. dollar, primarily the European Euro ("Euro or €"), the British Pound ("GBP or £") and the Korean Won ("KRW").

As of December 31, 2013, the Company had notional amounts of €59.0 million and KRW4.4 billion of outstanding currency forward contracts entered into to hedge Euro and KRW denominated sales, compared to €20.0 million and KRW4.4 billion at December 31, 2012. The net gains (losses) reclassified to revenue related to the hedged revenue transactions for the years ended December 31, 2013, 2012, and 2011 were not significant. Other impacts of derivative instruments designated as cash flow hedges were not significant for the years ended December 31, 2013, 2012, and 2011.

Other Derivatives Not Designated as Hedging Instruments

Other derivatives not designated as hedging instruments consist primarily of forward contracts that the Company uses to hedge intercompany balances and other monetary assets or liabilities denominated in currencies other than the U.S. dollar, primarily the Euro, GBP, the Swiss Franc (“CHF”), Japanese Yen (“JPY”) and the KRW.

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Derivative instruments used to hedge against balance sheet foreign currency exposures at the end of each period were as follows (in millions):

	Years Ended December 31,		
	2013	2012	2011
Recognized gains (losses) in interest and other income, net	\$ (3.4	) \$ (0.3	) \$ (1.2
Foreign exchange gains (losses) related to re-measurement	\$ 3.1	\$ 0.7	\$ 0.3

The notional amounts for derivative instruments provide one measure of the transaction volume. Total gross notional amounts (in local currency) for derivatives (recorded at fair value) outstanding at the end of each period were as follows (in millions):

	Years Ended December 31,		
	2013	2012	2011
European Euro	64.0	37.6	35.0
Korean Won	23,000.0	4,600.0	—
British Pound	7.7	5.4	1.8
Swiss Franc	—	(1.0	) (1.7
Japanese Yen	60.0	—	—

NOTE 4. BALANCE SHEET DETAILS

The following table provides details of the inventory balance sheet item (in millions):

	December 31,	
	2013	2012
Inventory:		
Raw materials	\$ 67.2	\$ 41.2
Work-in-process	12.6	4.4
Finished goods	99.8	75.9
Total inventory	\$ 179.6	\$ 121.5

The following table provides details of the property, plant and equipment, net balance sheet item (in millions):

	December 31,	
	2013	2012
Property, plant and equipment, net:		
Land	\$ 84.7	\$ 83.6
Building and building/leasehold improvements	151.9	99.1
Machinery and equipment	137.2	105.0
Computer and office equipment	27.1	19.2
Capitalized software	66.9	53.9
Construction-in-process	16.4	15.4
	484.2	376.2
Less: Accumulated depreciation	(174.3) (134.4
Total property, plant and equipment, net	\$ 309.9	\$ 241.8

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The following table provides details of the other accrued liabilities—short term balance sheet item (in millions):

	December 31,	
	2013	2012
Other accrued liabilities—short term:		
Other accrued liabilities	\$52.8	\$44.6
Taxes payable	5.1	5.8
Accrued professional fees	6.0	3.9
Total other accrued liabilities—short-term	\$63.9	\$54.3

The following table provides details of the other long-term liabilities balance sheet item (in millions):

	December 31,	
	2013	2012
Other long-term liabilities:		
Income taxes—long term	\$64.5	\$76.7
Other long-term liabilities	3.5	0.8
Total other long-term liabilities	\$68.0	\$77.5

NOTE 5. GOODWILL AND INTANGIBLE ASSETS**Goodwill**

The Company's gross carrying amount of goodwill was \$137.4 million and \$138.1 million as of December 31, 2013 and 2012, respectively. The Company acquired its Korean distributor on January 11, 2012. The total purchase consideration of the acquisition was not material, and the acquisition has not had a material impact on the results of our operations.

Intangibles

The gross carrying amount of total intangible assets, primarily representing purchased intellectual property, was \$179.7 million and \$177.7 million as of December 31, 2013 and 2012, respectively.

Additions made to intangibles assets, including intellectual property and asset purchase, during the years ended December 31, 2013 and 2012 were \$2.0 million and \$41.6 million, respectively. The weighted average useful life was six years for each of the years ended December 31, 2013 and 2012. Amortization expense related to intangible assets was \$21.3 million, \$23.1 million, and \$17.8 million for the years ended December 31, 2013, 2012, and 2011, respectively. Accumulated amortization of intangible assets was \$115.4 million and \$94.1 million as of December 31, 2013 and 2012, respectively.

The estimated future amortization expense of intangible assets as of December 31, 2013 is as follows (in millions):

Fiscal Year	Amount
2014	\$18.0
2015	17.7
2016	14.7
2017	8.8
2018	5.1
2019 and thereafter	—
Total	\$64.3

NOTE 6. COMMITMENTS AND CONTINGENCIES**OPERATING LEASES**

The Company leases office space in China, Japan, Korea, Mexico, Switzerland and United States. The Company leases automobiles for certain sales and field service employees. These leases have varying terms, predominantly no longer than three years.

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Future minimum lease commitments under the Company's operating leases as of December 31, 2013, are as follows (in millions):

Years	Amount
2014	\$4.9
2015	3.4
2016	1.8
2017	0.7
2018	0.3
2019 and thereafter	—
	\$11.1

Other commitments include an estimated amount of approximately \$268.3 million of all open cancellable purchase orders and contractual obligations that occur in the ordinary course of business, including commitments with suppliers, for which we have not received the goods or services.

CONTINGENCIES

The Company is involved in a variety of claims, lawsuits, investigations and proceedings relating to securities laws, product liability, patent infringement, contract disputes and other matters relating to various claims that arise in the normal course of our business. Certain of these lawsuits and claims are described in further detail below. We do not know whether we will prevail in these matters nor can we assure that any remedy could be reached on commercially reasonable terms, if at all. It is not possible to predict the outcome of the pending or threatened litigation matters currently disclosed. We have therefore determined that an estimate of possible loss or range of loss cannot be determined as of December 31, 2013. Nevertheless, it is possible that future legal costs (including settlements, judgments, legal fees and other related defense costs) could have a material adverse effect on our business, financial condition, and results of operations or cash flows.

In accordance with U.S. generally accepted accounting principles, the Company records a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case.

Purported Shareholder Class Action Lawsuit filed August 6, 2010

On August 6, 2010, a purported class action lawsuit entitled *Perlmutter v. Intuitive Surgical et al.*, No. CV10-3451, was filed against seven of the Company's current and former officers and directors in the United States District Court for the Northern District of California. The lawsuit seeks unspecified damages on behalf of a putative class of persons who purchased or otherwise acquired the Company's common stock between February 1, 2008 and January 7, 2009. The complaint alleges that the defendants violated federal securities laws by making allegedly false and misleading statements and omitting certain material facts in the Company's filings with the Securities and Exchange Commission. On February 15, 2011, the Police Retirement System of St. Louis was appointed Lead Plaintiff in the case pursuant to the Private Securities Litigation Reform Act of 1995. An amended complaint was filed on April 15, 2011, making allegations substantially similar to the allegations described above. On May 23, 2011 the Company filed a motion to dismiss the amended complaint. On August 10, 2011 that motion was granted and the action was dismissed; the plaintiffs were given 30 days to file an amended complaint. On September 12, 2011, plaintiffs filed their amended complaint. The allegations contained therein are substantially similar to the allegations in the prior complaint. The Company filed a motion to dismiss the amended complaint. A hearing occurred on February 16, 2012, and on May 22, 2012 the Company's motion was granted. The complaint was dismissed with prejudice, and a final judgment was entered in the Company's favor on June 1, 2012. On June 20, 2012, plaintiffs filed a notice of appeal with the United States Court of Appeals for the Ninth Circuit. The appeal is styled *Police Retirement System of St. Louis v. Intuitive Surgical, Inc. et al.*, No. 12-16430. Plaintiffs filed their opening brief on September 28, 2012. The Company filed an answering brief on November 13, 2012, and plaintiffs filed a reply brief on December 17, 2012. No oral argument date has been set, and the appeal remains pending. Based on currently available information, the Company does not believe the resolution of this matter will have a material adverse effect on its business, financial position or future results of operations.

Purported Derivative Actions

On August 19, 2010, an alleged stockholder caused a purported stockholder's derivative lawsuit entitled Himmel v. Smith et al., No. 1-10-CV-180416, to be filed in the Superior Court of California for the County of Santa Clara naming the Company as a nominal defendant, and naming 14 of the Company's current and former officers and directors as defendants. The lawsuit seeks to recover, for the Company's benefit, unspecified damages purportedly sustained by the Company in connection with allegedly misleading statements and/or omissions made in connection with the Company's financial reporting for the period between

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February 1, 2008 and January 7, 2009. It also seeks a series of changes to the Company's corporate governance policies and an award of attorneys' fees. On September 15, 2010, another purported stockholder filed a substantially identical lawsuit entitled Applebaum v. Guthart et al., No. 1-10-CV-182645, in the same court against 15 of the Company's current and former officers and directors. On October 5, 2010 the court ordered that the two cases be consolidated for all purposes. By agreement with the plaintiffs, all activity in the case has been stayed pending the results of the appeal in the purported shareholder class action lawsuit discussed above. Based on currently available information, the Company does not believe the resolution of this matter will have a material adverse effect on its business, financial position or future results of operations.

Purported Shareholder Class Action Lawsuits filed April 26, 2013 and May 24, 2013

On April 26, 2013, a purported class action lawsuit entitled Abrams v. Intuitive Surgical, et al., No. 5-13-cv-1920, was filed against several of the Company's current and former officers and directors in the United States District Court for the Northern District of California. A substantially identical complaint, entitled Adel v. Intuitive Surgical, et al., No. 5:13-cv-02365, was filed in the same court against the same defendants on May 24, 2013. The Adel case was voluntarily dismissed without prejudice on August 20, 2013.

On October 15, 2013 the plaintiffs in the Abrams matter filed an amended complaint. The case has since been re-titled In re Intuitive Surgical Securities Litigation. The plaintiffs seek unspecified damages on behalf of a putative class of persons who purchased or otherwise acquired our common stock between February 6, 2012 and July 18, 2013. The amended complaint alleges that the defendants violated federal securities laws by making allegedly false and misleading statements and omitting certain material facts in the Company's filings with the Securities and Exchange Commission. On November 18, 2013 the Court appointed Employees' Retirement System of the State of Hawaii as lead plaintiff and appointed lead counsel. The Company filed a motion to dismiss the amended complaint on December 16, 2013. The Company anticipates a hearing on the motion in May 2014. Based on currently available information, the Company does not believe the resolution of this matter will have a material adverse effect on its business, financial position or future results of operations.

Product Liability Litigation

The Company is currently named as a defendant in about 76 individual product liability lawsuits filed in various state and federal courts by plaintiffs who allege that they underwent surgical procedures that utilized the da Vinci Surgical System and sustained a variety of personal injuries and, in some cases, death as a result of such surgery. In addition, the Company has been named as a defendant in a purported class action filed in Louisiana state court, and removed to federal court, seeking damages on behalf of all patients who were allegedly injured by the da Vinci Surgical System at a single hospital in Louisiana. The cases raise a variety of allegations including, to varying degrees, that the plaintiffs' injuries resulted from purported defects in the da Vinci Surgical System and/or failure on the Company's part to provide adequate training resources to the healthcare professionals who performed plaintiffs' surgeries. The cases further allege that the Company failed to adequately disclose and/or misrepresented the potential risks and/or benefits of the da Vinci Surgical System. Plaintiffs also assert a variety of causes of action, including for example, strict liability based on purported design defects, negligence, fraud, breach of express and implied warranties, unjust enrichment, and loss of consortium. Plaintiffs seek recovery for alleged personal injuries and, in many cases, punitive damages. Except for a few cases, including the Taylor case described below, these cases generally are in the early stages of pretrial activity.

Plaintiffs' attorneys continue to engage in well-funded national advertising campaigns soliciting clients who have undergone da Vinci surgery and claim to have suffered an injury. The plaintiffs' attorneys are now alleging that Intuitive Surgical is liable for those injuries under products liability theories. The Company continues to receive claims as a result of these advertising efforts; however, the Company has not received detailed information regarding all claims. In an effort to provide an orderly process for evaluating claims before they result in costly litigation, the Company has entered into tolling agreements with certain plaintiffs' counsel acting on behalf of such claimants. The tolling agreements provide that the statute of limitations for each individual will be tolled for a certain period in exchange for the individual's agreement that, if he or she ultimately files a lawsuit, it will be filed in certain agreed upon venues. A substantial number of claims have been added to the tolling agreements, which provide the parties and their legal counsel with additional time to evaluate the claims, and to explore whether the claims have merit and

whether they can be resolved through mediation without litigation. As of result of these discussions, plaintiffs' counsel have voluntarily removed a sizable number of claims from the tolling agreements and notified the Company that they no longer intend to pursue these claims. Nonetheless, the Company does not currently know how many individuals will ultimately file lawsuits or how many additional individuals will decide not to pursue their claims, nor is the Company able at this time to reasonably estimate the financial impact of their claims or predict the final disposition of such claims. Based on currently available information, the Company believes that it has meritorious defenses and although the Company continues to explore means of resolving individual claims or aggregate groups of claims without litigation, it intends to assert such defenses vigorously in the lawsuits that are currently pending and any future lawsuits. The Company is not at present able to determine whether the resolution of these matters will have a material adverse effect on its business, financial position or future results of operations.

In February 2011, the Company was named as a defendant in a product liability action that had originally been filed in Washington State Superior Court for Kitsap County against the healthcare providers and hospital involved in the plaintiff's

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decedent's surgery (Josette Taylor, as Personal Representative of the Estate of Fred E. Taylor, deceased; and on behalf of the Estate of Fred E. Taylor v. Intuitive Surgical, Inc., No. 09-2-03136-5). In Taylor, plaintiff asserted wrongful death and product liability claims against the Company, generally alleging that the decedent died four years after surgery as a result of injuries purportedly suffered during the surgery, which was conducted with the use of the da Vinci Surgical System. The plaintiff in Taylor asserted that such injuries were caused, in whole or in part, by the Company's purported failure to properly train, warn, and instruct the surgeon. The lawsuit sought unspecified damages for past medical expenses, pain and suffering, loss of consortium as well as punitive damages. A trial commenced in the action on April 15, 2013. On May 23, 2013, the jury returned a defense verdict, finding that the Company was not negligent. Judgment was entered in favor of Intuitive Surgical, Inc. on June 7, 2013. Plaintiff has filed a notice of appeal.

False Claims Act Litigation

In October 2013, the Company was served in a case entitled *Rose v. Intuitive Surgical, Inc.*, No. 12-cv-1812, in the Middle District of Florida. Relator Bryan Rose, a former employee of Intuitive Surgical, brought the action on behalf of the United States of America, alleging violations of the False Claims Act, 31 U.S.C. § 3729 et seq., and the analogous false-claims statutes of twenty-one states and of the District of Columbia. Broadly, he alleges that he has first-hand knowledge of a fraudulent scheme, involving kickbacks paid in exchange for referrals and surgical procedures, and first-hand knowledge of off-label usage of Intuitive Surgical's products. The complaint was filed under seal on November 27, 2012, and was provided to the Department of Justice and the twenty-one states and the District of Columbia. The United States Government declined to intervene on October 8, 2013. The twenty-one states and the District of Columbia declined to intervene on November 21, 2013. Based on currently available information, the Company believes that it has meritorious defenses in this action and intends to assert them vigorously. Based on currently available information, the Company does not believe the resolution of this matter will have a material adverse effect on its business, financial position or future results of operations.

Insurance Litigation

In October 2013, the Company was named as a defendant in an insurance action entitled *Illinois Union Insurance Co. v. Intuitive Surgical, Inc.*, No. 3:13-cv-04863-JST, filed in the Northern District of California. Plaintiff Illinois Union Insurance Co. seeks to rescind the Life Sciences Products-Completed Operations Liability Policy issued by Plaintiff to Intuitive Surgical, which provides coverage for products liability claims first made against Intuitive Surgical during the policy period March 1, 2013 to March 1, 2014. In December 2013, the Company was named as a defendant in another insurance action entitled *Navigators Specialty Insurance Co. v. Intuitive Surgical, Inc.*, No. 5:13-cv-05801-HRL, filed in the Northern District of California. Plaintiff Navigators Insurance Co. alleges that the Follow Form Excess Liability Insurance Policy issued by Plaintiff to Intuitive Surgical for products liability claims first made against Intuitive Surgical during the policy period March 1, 2013 to March 1, 2014 should be rescinded. Both Plaintiffs generally allege that Intuitive Surgical did not disclose the existence of tolling agreements and the number of claimants incorporated within those agreements, and that those agreements were material to Plaintiffs' underwriting processes. The Company intends to vigorously defend these actions. Based on currently available information, the Company does not believe the resolution of this matter will have a material adverse effect on its business, financial position or future results of operations.

The Company is also a party to various other legal actions that arose in the ordinary course of its business. The Company does not believe that any of these other legal actions will have a material adverse impact on its business, financial position or results of operations.

NOTE 7. STOCKHOLDERS' EQUITY**STOCK REPURCHASE PROGRAM**

In February 2011 and October 2011, the Board authorized the repurchase of an additional \$400 million and \$500 million, respectively, under the share repurchase program originally established in March 2009. On July 25, 2013 and March 20, 2013, the Board authorized additional stock repurchases of \$779 million and \$1.0 billion, respectively. As of December 31, 2013, the remaining amount of share repurchases authorized by the Board was approximately \$1.0 billion.

On July 29, 2013, in connection with the stock repurchase authorization, the Company entered into an accelerated share repurchase program (the “ASR Program”) with Goldman, Sachs & Co. (“Goldman”) to repurchase \$500 million of the Company’s common stock. Under the ASR Program, the Company paid an initial purchase price of \$500 million to Goldman and received an initial delivery of approximately 1.2 million shares of its common stock. On September 11, 2013, Goldman exercised its early termination option under the ASR Program and the pricing period was closed. The settlement price was \$385.16 per share. Based on this settlement price, the final number of shares repurchased by the Company and delivered by Goldman under the ASR Program was 1.3 million shares. The Company received the additional 0.1 million shares from Goldman on September 16, 2013 to settle the difference between the initial share delivery and the total number of shares repurchased.

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In addition to the ASR Program, the Company repurchased an additional 0.5 million shares of the Company's common stock during the year ended December 31, 2013. All of these shares were repurchased in the open market. All common stock repurchased has been retired as of December 31, 2013.

The following table provides the stock repurchase activities during the years ended December 31, 2013, 2012, and 2011 (in millions, except per share amounts):

	Years Ended December 31,		
	2013	2012	2011
Shares repurchased	2.6	0.4	1.0
Average price per share	\$429.09	\$503.05	\$344.72
Value of shares repurchased	\$1,109.2	\$238.3	\$331.8

The Company uses the par value method of accounting for its stock repurchases. As a result of the share repurchases during the years ended December 31, 2013, 2012, and 2011, the Company reduced common stock and additional paid-in capital by an aggregate of \$84.2 million, \$13.2 million, and \$19.7 million, respectively, and charged \$1,025.0 million, \$225.1 million, \$312.1 million, respectively, to retained earnings.

ACCUMULATED OTHER COMPREHENSIVE INCOME

The components of accumulated other comprehensive income, net of tax, for the years ended December 31, 2013 and 2012 are as follows (in millions):

	Year Ended December 31, 2013			
	Gains (Losses) on Hedge Instruments	Unrealized Gains (Losses) on Available-for-Sale Securities	Foreign Currency Translation Gains (Losses)	Total
Beginning balance	\$—	\$6.2	\$0.4	\$6.6
Other comprehensive income before reclassifications	(1.8)	(3.9)	—	(5.7)
Reclassified from accumulated other comprehensive income	1.8	(0.6)	—	1.2
Net current-period other comprehensive income	—	(4.5)	—	(4.5)
Ending balance	\$—	\$1.7	\$0.4	\$2.1

	Year Ended December 31, 2012			
	Gains (Losses) on Hedge Instruments	Unrealized Gains (Losses) on Available-for-Sale Securities	Foreign Currency Translation Gains (Losses)	Total
Beginning balance	\$—	\$1.1	\$(0.2)	\$0.9
Other comprehensive income before reclassifications	(1.1)	5.0	0.6	4.5
Reclassified from accumulated other comprehensive income	1.1	0.1	—	1.2
Net current-period other comprehensive income	—	5.1	0.6	5.7
Ending balance	\$—	\$6.2	\$0.4	\$6.6

NOTE 8. SHARE-BASED COMPENSATION
STOCK OPTION PLANS
2010 Incentive Award Plan

In April 2010, the Company's stockholders approved the 2010 Incentive Award Plan ("2010 Plan"). Under this plan, the Company issues nonqualified stock options ("NSOs") to employees and certain consultants. The 2010 Plan generally permits NSOs to be granted at no less than the fair market value of the common stock on the date of grant, with terms of 10 years from the date of grant. The 2010 Plan expires in 2020. On April 25, 2013, the Shareholders approved an amended and restated 2010 Incentive Award Plan ("2010 Plan") to provide for an increase in the number of shares of common stock reserved for issuance from 3,650,000 to 4,850,000. As of December 31, 2013, approximately 1.6 million shares were reserved for future issuance under the 2010 Plan.

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2009 Employment Commencement Incentive Plan

In October 2009, the Board of Directors adopted the 2009 Employment Commencement Incentive Plan (“New Hire Plan”). The New Hire Plan provides for the shares to be used exclusively for the grant of NSOs to new employees (“New Hire Options”), who were not previously an employee or non-employee director of the Company. Options are granted at an exercise price not less than the fair market value of the stock on the date of grant and have a term not to exceed 10 years.

As of December 31, 2013, approximately 200,000 shares were reserved for future issuance under the New Hire Plan. In January 2013, the Board amended and restated the 2009 Employment Commencement Incentive Plan (“2009 Plan”) to provide for an increase in the number of shares of common stock authorized for issuance pursuant to awards granted under the 2009 Plan from 730,000 to 855,000. In May 2013, the Board amended and restated the 2009 Plan to provide for an additional increase in the number of shares of common stock authorized for issuance pursuant to awards granted under the 2009 Plan from 855,000 to 1,155,000.

2000 Equity Incentive Plan

In March 2000, the Board of Directors adopted the 2000 Equity Incentive Plan (“2000 Plan”), which took effect upon the closing of the Company’s initial public offering. Under this plan, certain employees, consultants and non-employee directors may be granted Incentive Stock Options (“ISOs”) and Nonstatutory Stock Options (“NSOs”) to purchase shares of the Company’s common stock. The 2000 Plan permitted ISOs to be granted at an exercise price not less than the fair value on the date of the grant and NSOs at an exercise price not less than 85% of the fair value on the date of grant. Options granted under the 2000 Plan generally expire 10 years from the date of grant and become exercisable upon grant subject to repurchase rights in favor of the Company until vested. The 2000 Plan expired in March 2010. However, options granted prior to the plan’s expiration continue to vest or remain outstanding until their original expiration date.

Employee Option Vesting

Prior to 2012, stock options were granted to employees at their start date (“New Hire Options”) and on February 15 of each year or the next business day if the date is not a business day (“Annual Grant”). The Annual Grant and New Hire Options generally vest 12.5% upon completion of 6 months service and 1/48 per month thereafter. Beginning in 2013, the Company split the annual grant into a grant on February 15 (or the next business day if the date is not a business day) and a separate grant on August 15 (or the next business day if the date is not a business day). The February 15 grants vest 12.5% upon completion of 6 months service and 1/48 per month thereafter. The August 15 stock option awards vest 7/48 at the end of one month and 1/48 per month thereafter through a 3.5 year vesting period. Option vesting terms are determined by the Board of Directors and, in the future, may vary from past practices.

2000 Non-Employee Directors’ Stock Option Plan

In March 2000, the Board of Directors adopted the 2000 Non-Employee Directors’ Stock Option Plan (the “Directors’ Plan”). In October 2009, the automatic evergreen increase provisions were eliminated so that no further automatic increases will be made to the number of shares reserved for issuance under the Directors’ Plan. In addition, the common stock authorized for issuance under the Directors’ Plan was reduced to 150,000. Options are granted at an exercise price not less than the fair market value of the stock on the date of grant and have a term not to exceed 10 years. Initial grants are vested over a three-year period with 33.3% of the shares vesting after 1 year from the date of grant and 1/36 of the shares vesting monthly thereafter. Annual grants are vested one year from the date of the grant. As of December 31, 2013, approximately 64,000 shares were reserved for future issuance under the Directors’ Plan.

2000 Employee Stock Purchase Plan

In March 2000, the Board of Directors adopted the 2000 Employee Stock Purchase Plan (ESPP). Employees are generally eligible to participate in the ESPP if they are customarily employed by the Company for more than 20 hours per week and more than 5 months in a calendar year and are not 5% stockholders of the Company. Under the ESPP, eligible employees may select a rate of payroll deduction up to 15% of their eligible compensation subject to certain maximum purchase limitations. The duration for each offering period is twenty-four months long and is divided into four shorter purchase periods approximately six months in length. Offerings are concurrent. The purchase price of the shares under the offering is the lesser of 85% of the fair market value of the shares on the offering date or 85% of the fair market value of the shares on the purchase date. A two-year look-back feature in the ESPP causes the offering

period to reset if the fair value of the Company's common stock on the first or last day of the purchase period is less than that on the original offering date. ESPP purchases by employees are settled with newly-issued common stock from the ESPP's previously authorized and available pool of shares.

The Company issued 0.1 million, 0.1 million and 0.1 million shares under the ESPP, representing approximately \$28.8 million, \$27.8 million, and \$18.5 million in employee contributions for the years ended December 31, 2013, 2012, and 2011, respectively. As of December 31, 2013, there were approximately 0.4 million shares reserved for grant under the ESPP.

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STOCK OPTION PLAN INFORMATION

Option activity during fiscal 2013 under all the stock plans was as follows (in millions, except per share amounts):

	Shares Available for Grant	Number Outstanding	Weighted Average Exercise Price Per Share
Balance at December 31, 2012 (with 2.5 options exercisable at a weighted-average exercise price of \$268.31 per share and with 4.8 options vested and expected to vest at a weighted-average exercise price of \$340.83 per share)	1.6	4.8	\$ 340.83
Options authorized	1.6	—	\$ —
Options granted	(1.5	) 1.5	\$ 471.33
Options exercised	—	(0.5	) \$ 250.17
Options forfeited/expired	0.2	(0.2	) \$ 456.64
Balance at December 31, 2013	1.9	5.6	\$ 380.71

The aggregate intrinsic value of options exercised under our stock option plans determined as of the date of option exercise was \$130.2 million, \$375.7 million, and \$262.8 million during the years ended December 31, 2013, 2012, and 2011 respectively. Cash received from option exercises and employee stock purchase plans for the years ended December 31, 2013, 2012, and 2011 was \$160.6 million, \$263.3 million, and \$260.6 million, respectively.

The following table summarizes significant ranges of outstanding and exercisable options as of December 31, 2013 (number of shares in millions):

Range of Exercise Prices	Options Outstanding			Aggregate Intrinsic Value (1)	Options Exercisable			
	Number of Shares	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price Per Share		Number of Shares	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price Per Share	
\$18.50-\$303.27	1.2	4.23	\$ 184.37	1.2		\$ 182.68		
\$308.96-\$341.19	1.4	6.55	\$ 336.63	1.1		\$ 335.80		
\$343.83-\$504.43	1.2	8.92	\$ 400.49	0.3		\$ 392.02		
\$505.23-\$518.29	1.1	8.26	\$ 511.45	0.5		\$ 511.37		
\$529.51-\$579.24	0.7	8.89	\$ 565.89	0.2		\$ 565.61		
TOTAL	5.6	7.17	\$ 380.71	\$ 311.2	3.3	6.16	\$ 324.60	\$ 293.3

The aggregate intrinsic value represents the total pre-tax intrinsic value, based on the Company's closing stock price (1) of \$384.08 as of December 31, 2013, which would have been received by the option holders had all in-the-money option holders exercised their options as of that date.

As of December 31, 2013, a total of 5.4 million shares vested and expected to vest had a weighted average remaining contractual life of 7.1 years, an aggregate intrinsic value of \$310.8 million, and the shares had a weighted average exercise price of \$378.80.

SHARE-BASED COMPENSATION EXPENSE:

The following table summarizes share-based compensation expense (in millions):

	Years Ended December 31,		
	2013	2012	2011
Cost of sales—products	\$17.6	\$14.1	\$12.3
Cost of sales—services	12.7	12.9	11.0
Total cost of sales	30.3	27.0	23.3
Selling, general and administrative	101.4	93.1	84.3
Research and development	37.2	33.2	28.8
Share-based compensation expense before income taxes	168.9	153.3	136.4

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Income tax effect	58.5	47.5	42.9
Share-based compensation expense after income taxes	\$110.4	\$105.8	\$93.5

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The Black-Scholes option pricing model is used to estimate the fair value of stock options granted under the Company's share-based compensation plans and rights to acquire stock granted under the Company's employee stock purchase plan. The weighted average estimated fair values of the stock options and rights to acquire stock granted under the Company's employee purchase plan as well as the weighted average assumptions used in calculating these values during the years ended December 31, 2013, 2012, and 2011, were based on estimates at the date of grant as follows:

	Years Ended December 31,			
	2013	2012	2011	
STOCK OPTION PLANS				
Average risk free interest rate	1.2	% 0.8	% 2.2	%
Average expected term (years)	4.5	4.3	4.8	
Average volatility	30	% 33	% 35	%
Weighted average fair value at grant date	\$126.50	\$146.26	\$116.03	
Total share-based compensation expense (in millions)	\$157.4	\$139.9	\$128.3	
EMPLOYEE STOCK PURCHASE PLAN				
Average risk free interest rate	0.2	% 0.2	% 0.3	%
Average expected term (years)	1.3	1.3	1.3	
Average volatility	34	% 32	% 33	%
Weighted average fair value at grant date	\$153.33	\$138.61	\$99.94	
Total share-based compensation expense (in millions)	\$11.5	\$13.4	\$8.1	

As share-based compensation expense recognized in the Consolidated Statements of Income during the years ended December 31, 2013, 2012, and 2011 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. Stock compensation accounting requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimated.

As of December 31, 2013, there was \$290.5 million and \$19.5 million, of total unrecognized compensation expense related to non-vested stock options and employee stock purchases, respectively. The unrecognized compensation expenses are expected to be recognized over a weighted average period of 2.5 years for non-vested stock options and 1.6 years for employee stock purchases.

Excess tax benefits are realized tax deductions for exercised options in excess of the deferred tax asset attributable to stock compensation costs for such options. Excess tax benefits of \$38.0 million, \$94.2 million, and \$58.8 million for the years ended December 31, 2013, 2012, and 2011, respectively, have been classified as a financing cash inflow. The total income tax benefit recognized in the consolidated statements of income for share-based compensation costs was \$58.5 million, \$47.5 million, and \$42.9 million for the years ended December 31, 2013, 2012, and 2011, respectively.

NOTE 9. INCOME TAXES

Income before provision for income taxes for the years ended December 31, 2013, 2012, and 2011 consisted of the following (in millions):

	Years Ended December 31,		
	2013	2012	2011
U.S	\$612.5	\$718.5	\$540.3
Foreign	258.4	175.4	169.4
Total income before provision for income taxes	\$870.9	\$893.9	\$709.7

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The provision for income taxes for the years ended December 31, 2013, 2012, and 2011 consisted of the following (in millions):

	Years Ended December 31,			
	2013	2012	2011	
Current				
Federal	\$216.8	\$239.9	\$195.7	
State	17.4	17.0	8.1	
Foreign	4.3	3.4	3.7	
	\$238.5	\$260.3	\$207.5	
Deferred				
Federal	\$(36.2	) \$(20.6	) \$6.8
State	(1.9	) (1.2	) 0.4
Foreign	(0.5) (1.2) (0.1)
	\$(38.6	) \$(23.0	) \$7.1
Total income tax expense	\$199.9	\$237.3	\$214.6	

Income tax expense differs from amounts computed by applying the statutory rate of 35% for the years ended December 31, 2013, 2012, and 2011 as a result of the following (in millions):

	Years Ended December 31,			
	2013	2012	2011	
Federal tax at statutory rate	\$304.8	\$312.9	\$248.3	
Increase (reduction) in tax resulting from:				
State taxes, net of federal benefits	15.5	15.8	8.5	
Foreign rate differential	(73.6) (42.8) (47.7)
Research and development credit	(12.2) —	(6.6)
Share-based compensation not benefited	1.9	5.9	5.1	
Domestic production activities deduction	(9.2	) (8.2) —	
Releases due to statute expirations and other	(26.7	) (46.5) —	
Other	(0.6	) 0.2	7.0
	\$199.9	\$237.3	\$214.6	

Deferred income taxes reflect tax carry forwards and the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets are as follows (in millions):

	December 31,		
	2013	2012	
Deferred tax assets:			
Share-based compensation expense	\$123.4	\$85.3	
Expenses deducted in later years for tax purposes	30.3	25.9	
Research and other credits	5.8	5.3	
Other	1.2	1.2	
Gross deferred tax assets	\$160.7	\$117.7	
Valuation allowance	(7.2) (6.0)
Deferred tax assets	\$153.5	\$111.7	
Deferred tax liabilities:			
Fixed assets	\$(16.1) \$(12.3)
Identified intangible assets related to acquisitions	(1.9) (2.2)
Other	(2.1) (3.8)
Deferred tax liabilities	\$(20.1) \$(18.3)
Net deferred tax assets	\$133.4	\$93.4	

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The Company has not provided U.S. income taxes and foreign withholding taxes on the undistributed earnings of its foreign subsidiaries as of December 31, 2013 because the Company intends to indefinitely reinvest such earnings outside the U.S. If these foreign earnings were to be repatriated in the future, the related U.S. tax liability may be reduced by any foreign income taxes previously paid on these earnings. As of December 31, 2013, the cumulative amount of earnings upon which U.S. income taxes have not been provided is approximately \$707.9 million.

Determination of the amount of unrecognized deferred tax liability related to these earnings is not practicable at this time. The Company has a tax holiday in effect for its business operations in Switzerland which will continue until the end of year 2017 to the extent certain terms and conditions continue to be met. This tax holiday provides for a lower rate of taxation in Switzerland based on various thresholds of investment and employment in such jurisdiction. The Company has been in compliance with the terms of the holiday.

As of December 31, 2013 and 2012, the Company had valuation allowances of \$7.2 million and \$6.0 million, respectively, primarily related to California deferred tax assets generated by California R&D credit forwards which have no expiration period. The Company recorded a valuation allowance against its California deferred tax assets as it is more likely than not these deferred tax assets will not be realized as a result of the computation of California taxes under the single sales factor. We will continue to monitor and reassess the need for further increases or decreases to the valuation allowance.

The Company recorded a net decrease of its gross unrecognized tax benefits of approximately \$14.0 million during the year ended December 31, 2013. The net decrease was primarily related to the reversal of gross unrecognized tax benefits of \$35.3 million in connection with the expiration of certain statutes of limitations in multiple jurisdictions in the second half of 2013 and certain audit settlements, partially offset by increases during the year 2013 related to other uncertain tax positions. The Company had gross unrecognized tax benefits of approximately \$74.0 million, \$88.0 million, and \$98.1 million as of December 31, 2013, 2012, and 2011, respectively, of which \$74.0 million, \$83.8 million, and \$93.8 million, if recognized would result in a reduction of the Company's effective tax rate during the years ended December 31, 2013, 2012, and 2011, respectively. The Company included interest expense and penalties accrued on unrecognized tax benefits as a component of its income tax expense. As of December 31, 2013, 2012, and 2011, gross interest and penalties related to unrecognized tax benefits accrued was approximately \$3.4 million, \$3.2 million, and \$7.9 million, respectively, and a net increase of \$0.2 million was included in our 2013 income tax expense as a result of the current year increases offset by the decreases associated with the above-mentioned decreases in unrecognized tax benefits. The Company classified a majority of its net unrecognized tax benefits and related interest in "Other accrued liabilities" on the Consolidated Balance Sheets.

A reconciliation of the beginning and ending amounts of gross unrecognized income tax benefits for the years ended December 31, 2013, 2012, and 2011 are as follows (in millions):

	Years Ended December 31,		
	2013	2012	2011
Beginning balance	\$88.0	\$98.1	\$78.9
Increases related to tax positions taken during the current year	22.8	17.5	18.1
Increases related to tax positions taken during a prior year	—	12.9	1.1
Decreases related to tax positions taken during a prior year	(1.5	) (8.3) —
Decreases related to settlements with tax authorities	(6.0) —	—
Decreases related to expiration of statute of limitations	(29.3	) (32.2) —
Ending balance	\$74.0	\$88.0	\$98.1

The Company files federal, state and foreign income tax returns in many jurisdictions in the United States and abroad. Generally, years before 2010 are closed for most significant jurisdictions except for California, for which years before 2008 were considered closed. Certain of the Company's unrecognized tax benefits could reverse based on the normal expiration of various statutes of limitations, which could affect the Company's effective tax rate in the period in which they reverse.

The Company is subject to the examination of its income tax returns by the Internal Revenue Service and other tax authorities. The outcome of these audits cannot be predicted with certainty. Management regularly assesses the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of the Company's

provision for income taxes. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs.

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NOTE 10. NET INCOME PER SHARE

The following table presents the computation of basic and diluted net income per share (in millions, except per share amounts):

	Years Ended December 31,		
	2013	2012	2011
Net income	\$671.0	\$656.6	\$495.1
Basic:			
Weighted-average shares outstanding	39.2	39.8	39.2
Basic net income per share	\$17.12	\$16.50	\$12.63
Diluted:			
Weighted-average shares outstanding used in basic calculation	39.2	39.8	39.2
Add: Dilutive potential shares	0.9	1.3	1.0
Weighted-average shares used in computing diluted net income per share	40.1	41.1	40.2
Diluted net income per share	\$16.73	\$15.98	\$12.32

Employee stock options to purchase approximately 2.3 million, 0.9 million, and 2.1 million shares for the years ended December 31, 2013, 2012, and 2011, respectively, were outstanding, but were not included in the computation of diluted net income per share because the effect of including such shares would have been antidilutive in the periods presented.

NOTE 11. EMPLOYEE BENEFIT PLANS

The Company sponsors various retirement plans for its eligible U.S. and non-U.S. employees. For employees in the U.S., the Company maintains the Intuitive Surgical, Inc. 401(k) Plan (the "Plan"). As allowed under Section 401(k) of the Internal Revenue Code, the Plan provides tax-deferred salary contributions for eligible U.S. employees. The Plan allows employees to contribute up to 75% of their annual compensation to the Plan on a pre-tax and after-tax basis. Employee contributions are limited to a maximum annual amount as set periodically by the Internal Revenue Code. Employer matching contributions are made solely at the Company's discretion. No employer matching contributions were made to the Plan during the years ended December 31, 2013, 2012, and 2011.

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SELECTED QUARTERLY DATA

(UNAUDITED, IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

	2013			
	Q1	Q2	Q3	Q4
Revenue	\$611.4	\$578.5	\$499.0	\$576.2
Gross profit	\$434.3	\$405.2	\$356.7	\$398.0
Net income ⁽¹⁾	\$188.9	\$159.1	\$156.8	\$166.2
Net income per common share				
Basic	\$4.69	\$3.99	\$4.06	\$4.36
Diluted	\$4.56	\$3.90	\$3.99	\$4.28

(1) Includes one-time discrete tax benefits as follows:

Expiration of the statutes of limitations in multiple jurisdictions	\$—	\$—	\$26.2	\$0.5
Reinstatement of the 2012 federal R&D tax credit	\$7.5	\$—	\$—	\$0.7

	2012			
	Q1	Q2	Q3	Q4
Revenue	\$495.2	\$536.5	\$537.8	\$609.3
Gross profit	\$355.9	\$386.4	\$390.1	\$437.9
Net income ⁽¹⁾	\$143.5	\$154.9	\$183.3	\$174.9
Net income per common share				
Basic	\$3.63	\$3.88	\$4.59	\$4.37
Diluted	\$3.50	\$3.75	\$4.46	\$4.25

(1) Includes one-time discrete tax benefits as follows:

Expiration of the statutes of limitations in multiple jurisdictions	\$—	\$—	\$38.0	\$—
Benefit from new IRS guidance relating to the Section 199 Domestic Production Deduction	\$8.5	\$—	\$—	\$—

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SCHEDULE II

INTUITIVE SURGICAL, INC.

VALUATION AND QUALIFYING ACCOUNTS

(IN MILLIONS)

	Balance at Beginning of Year	Additions	Deductions ⁽¹⁾	Balance at End of Year
Allowance for doubtful accounts and sales returns				
Year ended December 31, 2013	\$8.0	\$14.1	\$(16.3)	) \$5.8
Year ended December 31, 2012	\$5.6	\$15.0	\$(12.6)	) \$8.0
Year ended December 31, 2011	\$4.8	\$12.3	\$(11.5)) \$5.6

(1) Primarily represents amounts returned.

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ITEM CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND
9. FINANCIAL DISCLOSURES

None.

ITEM 9A. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow for timely decisions regarding required disclosure.

As required by SEC Rule 13a-15(b), we carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K. Based on the foregoing, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

Inherent Limitations Over Internal Controls

Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP. Our internal control over financial reporting includes those policies and procedures that:

- (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Management, including our principal executive officer and principal financial officer, does not expect that our internal controls will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of internal controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Also, any evaluation of the effectiveness of controls in future periods are subject to the risk that those internal controls may become inadequate because of changes in business conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control—1992 Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the 1992 framework in Internal Control—Integrated Framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2013.

The effectiveness of our internal control over financial reporting as of December 31, 2013 has been audited by an independent registered public accounting firm, as stated in their report, which is included herein.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial statements.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of Intuitive Surgical, Inc.

We have audited Intuitive Surgical, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (the COSO criteria). Intuitive Surgical, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Intuitive Surgical, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Intuitive Surgical, Inc. as of December 31, 2013 and 2012 and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2013, and the financial statement schedule listed in the index at Item 15(a) and our report dated February 3, 2014, expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Francisco, California

February 3, 2014

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ITEM 9B. OTHER INFORMATION

None.

PART III

Certain information required by Part III is omitted from this Report on Form 10-K and is incorporated herein by reference to our definitive Proxy Statement for our next Annual Meeting of Stockholders (the "Proxy Statement"), which we intend to file pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, within 120 days after December 31, 2013.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item concerning our directors and corporate governance is incorporated by reference to the information set forth in the section titled "Directors and Corporate Governance" in our Proxy Statement. Information required by this item concerning our executive officers is incorporated by reference to the information set forth in the section entitled "Executive Officers of the Company" in our Proxy Statement. Information regarding our Section 16 reporting compliance is incorporated by reference to the information set forth in the section entitled "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters" in our Proxy Statement.

ITEM 11. EXECUTIVE
COMPENSATION

The information required by this item regarding executive compensation is incorporated by reference to the information set forth in the sections titled "Executive Compensation" and "Compensation for Directors" in our Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND
RELATED STOCKHOLDER MATTERS

The information required by this item regarding security ownership of certain beneficial owners and management is incorporated by reference to the information set forth in the section titled "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters" in our Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this item regarding certain relationships and related transactions and director independence is incorporated by reference to the information set forth in the sections titled "Certain Relationships and Related Transactions" and "Directors and Corporate Governance" in our Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item regarding principal accountant fees and services is incorporated by reference to the information set forth in the section titled "Principal Accountant Fees and Services" in our Proxy Statement.

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULE

(a) The following documents are filed as part of this Annual Report on Form 10-K

1) Financial Statements—See Index to Consolidated Financial Statements at Item 8 of this Report on Form 10-K.

2) The following financial statement schedule of Intuitive Surgical, Inc. is filed as part of this Report and should be read in conjunction with the financial statements of Intuitive Surgical:

Schedule II: Valuation and Qualifying Accounts.

All other schedules have been omitted because they are not applicable, not required under the instructions, or the information requested is set forth in the consolidated financial statements or related notes thereto.

3) Exhibits

The exhibits filed as part of this report are listed under “Exhibits” at subsection (b) of this Item 15.

(b) Exhibits

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EXHIBIT INDEX

- 3.1(1) Amended and Restated Certificate of Incorporation of the Company.
- 3.2(1) Certificate of Amendment to Amended and Restated Certificate of Incorporation of the Company.
- 3.3(2) Certificate of Amendment to Amended and Restated Certificate of Incorporation of the Company.
- 3.4(3) Amended and Restated Bylaws of the Company.
- 4.1(4) Specimen Stock Certificate.
- 10.1(4) Form of Indemnity Agreement.
- 10.2(4) 2000 Equity Incentive Plan.
- 10.3(4) 2000 Non-Employee Directors' Stock Option Plan.
- 10.4(4) 2000 Employee Stock Purchase Plan.
- 10.5(5) 2009 Employment Commencement Incentive Plan, as amended and restated.
- 10.6(6) 2010 Incentive Award Plan, as amended and restated.
- 10.7(7) Severance Plan.
- 10.8(8) Third Amendment effective as of July 1, 2010, to Employment Agreement between the Company and Lonnie M. Smith, dated February 28, 1997.
- 10.9(9) Form of Intuitive Surgical, Inc. 2000 Equity Incentive Plan Stock Option Agreement (Incentive and Nonstatutory Stock Options).
- 21.1(5) Intuitive Surgical, Inc. subsidiaries.
- 23.1(5) Consent of Independent Registered Public Accounting Firm.
- 31.1(5) Certification of Principal Executive Officer.
- 31.2(5) Certification of Principal Financial Officer.
- 32.1(5) Certification of Chief Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101(5) The following materials from Intuitive Surgical, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2013, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statement of Stockholders' Equity, (iv) Consolidated Statements of Cash Flows, and (v) Notes to Consolidated Financial Statements, tagged at Level I through IV.

(1)

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- Incorporated by reference to exhibits filed with the Company's 2008 Annual Report on Form 10-K filed February 6, 2009 (File No. 000-30713).
- (2) Incorporated by reference to Exhibit A filed with the Company's Definitive Proxy Statement on Schedule 14A filed March 1, 2012 (File No. 000-30713).
- (3) Incorporated by reference to Exhibit 3.1 filed with the Company's Current Report on Form 8-K filed April 24, 2012 (File No. 000-30713).
- (4) Incorporated by reference to exhibits filed with the Company's Registration Statement on Form S-1 filed March 22, 2000 (File No. 333-33016).
- (5) Filed herewith.
- (6) Incorporated by reference to Exhibit 4.1 filed with the Company's Registration Statement on Form S-8 filed June 17, 2013 (File No. 333-189399).
- (7) Incorporated by reference to Exhibit 10.1 filed with the Company's Current Report on Form 8-K filed December 2, 2008 (File No. 000-30713).
- (8) Incorporated by reference to Exhibit 10.1 filed with the Company's Current Report on Form 8-K filed July 26, 2010 (File No. 000-30713).
- (9) Incorporated by reference to Exhibit 10.2 filed with the Company's Quarterly Report on Form 10-Q filed July 23, 2009 (File No. 000-30713).

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SIGNATURES

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

INTUITIVE SURGICAL, INC.

(Registrant)

By: /S/ GARY S. GUTHART
Gary S. Guthart, Ph.D.
President and Chief Executive Officer

Date: February 3, 2014

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

Signature	Title	Date
/S/ GARY S. GUTHART Gary S. Guthart, Ph.D.	President, Chief Executive Officer and Director (Principal Executive Officer)	February 3, 2014
/S/ MARSHALL L. MOHR Marshall L. Mohr	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	February 3, 2014
/S/ JAMIE E. SAMATH Jamie E. Samath	Vice President, Corporate Controller, and Principal Accounting Officer	February 3, 2014
/S/ LONNIE M. SMITH Lonnie M. Smith	Chairman of the Board of Directors	February 3, 2014
/S/ CRAIG H. BARRATT Craig H. Barratt, Ph.D.	Director	February 3, 2014
/S/ AMAL M. JOHNSON Amal M. Johnson	Director	February 3, 2014
/S/ ERIC H. HALVORSON Eric H. Halvorson	Director	February 3, 2014
/S/ ALAN J. LEVY Alan J. Levy, Ph.D.	Director	February 3, 2014
/S/ FLOYD D. LOOP Floyd D. Loop, M.D.	Director	February 3, 2014
/S/ MARK J. RUBASH Mark J. Rubash	Director	February 3, 2014
/S/ GEORGE STALK JR. George Stalk Jr.	Director	February 3, 2014