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AOL TIME WARNER INC
Form 10KT405
March 27, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTIONS 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

(MARK ONE)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM JULY 1, 2000 TO DECEMBER 31, 2000

COMMISSION FILE NUMBER 001-15062

AOL TIME WARNER INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

13-4099534
(I.R.S. EMPLOYER
IDENTIFICATION NO.)

75 ROCKEFELLER PLAZA, NEW YORK, N.Y.
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

10019
(ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (212) 484-8000

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS

NAME OF EACH EXCHANGE
ON WHICH REGISTERED

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Common Stock, \$.01 par value

New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:
None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

As of the close of business on February 28, 2001, there were 4,248,098,682 shares of registrant's Common Stock and 171,185,826 shares of registrant's Series LMCN-V Common Stock outstanding. The aggregate market value of the registrant's voting securities held by non-affiliates of the registrant (based upon the closing price of such shares on the New York Stock Exchange Composite Tape on February 28, 2001) was approximately \$179.56 billion.

DOCUMENTS INCORPORATED BY REFERENCE:

DESCRIPTION OF DOCUMENT -----	PART OF THE FORM 10-K -----
Portions of the Definitive Proxy Statement to be used in connection with the registrant's 2001 Annual Meeting of Stockholders.	Part III (Item 10 through Item 13)

AOL Time Warner Inc.
Corporate Organization Chart

Included in the Form 10-K for AOL Time Warner Inc. ("AOL Time Warner") is a chart illustrating AOL Time Warner's corporate organization, providing the following information:

AOL Time Warner Inc. owns 100% of each of America Online, Inc. ("America Online") and Time Warner Inc. ("Time Warner").

America Online owns 100% of the America Online business.

Time Warner Inc. owns 100% of Turner Broadcasting System, Inc. (Networks and Filmed Entertainment - New Line) and 100% of Time Warner Companies, Inc.

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Time Warner Companies, Inc. owns 100% of the Publishing division, TWI Cable and the AOL Time Warner General and Limited Partners.(1)

Time Warner Entertainment Company, L.P. ("TWE") is 25.51%-owned by the AT&T Limited Partner(2) and 74.49%-owned by the AOL Time Warner General and Limited Partners.(3)

TWE owns 100% of Time Warner Cable, Networks - HBO and The WB, and Filmed Entertainment-Warner Bros., and 64.8% of the TWE - A/N Partnership (Cable). The TWE - A/N Partnership is also 1.9%-owned by TWI Cable and 33-1/3% - owned by Advance/Newhouse.(4)

- (1) Time Warner Companies, Inc. directly or indirectly owns 100% of the capital stock of each of the AOL Time Warner General and Limited Partners.
- (2) Interest held by AT&T Corp.'s subsidiary, MediaOne TWE Holdings, Inc.
- (3) Pro rata priority capital and residual equity interests. In addition, the AOL Time Warner General Partners own 100% of the priority capital interests that are junior to the pro rata priority capital interests. See Note 6 to Time Warner Inc.'s consolidated statements included in AOL Time Warner's Current Report on Form 8-K/A dated January 11, 2001 (filed February 9, 2001).
- (4) Direct or indirect common equity interests. In addition, TWI Cable indirectly owns preferred partnership interests.

PART I

ITEM 1. BUSINESS

AOL Time Warner Inc. (the 'Company' or 'AOL Time Warner') is the world's first fully integrated, Internet-powered media and communications company. The Company was formed in connection with the merger of America Online, Inc. ('America Online') and Time Warner Inc. ('Time Warner') which was consummated on January 11, 2001 (the 'Merger' or the 'AOL-Time Warner merger'). As a result of the Merger, America Online and Time Warner each became wholly owned subsidiaries of AOL Time Warner. Accordingly, the following discussion will be of the businesses of AOL Time Warner, which comprise the combined businesses previously conducted by America Online and Time Warner. However, because the Merger was not consummated on or before December 31, 2000, in accordance with the applicable Federal securities regulations, the accompanying consolidated financial statements and management's discussion and analysis of results of operations and financial condition set forth on pages F-1 through F-52 reflect only the financial results of America Online, as predecessor to the Company.

The Company classifies its business interests into the following fundamental areas:

- o America Online, consisting principally of interactive services, Web brands, Internet technologies and electronic commerce;

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- o Cable, consisting principally of interests in cable television systems;
- o Filmed Entertainment, consisting principally of interests in filmed entertainment and television production;
- o Networks, consisting principally of interests in cable television and broadcast television networks;
- o Music, consisting principally of interests in recorded music and music publishing; and
- o Publishing, consisting principally of interests in magazine publishing, book publishing and direct marketing.

The Company has undertaken a number of business initiatives to advance cross-divisional activities, including cross-promotions of the Company's various businesses, cross-divisional advertising opportunities, and shared infrastructures. During 2000, each of the divisions entered into arrangements with America Online either for promotion of that division on the AOL service or of the AOL service on the division's property or to provide content on an AOL service, Web site or property. The Company expects to continue and expand such arrangements.

For convenience, the terms the 'Registrant,' 'Company' and 'AOL Time Warner' are used in this report to refer to both the parent company and collectively to the parent company and the subsidiaries through which its various businesses are conducted, unless the context otherwise requires.

TWE

Time Warner Entertainment Company, L.P. ('TWE') is a Delaware limited partnership that was formed in 1992 to own and operate substantially all of the business of Warner Bros., Home Box Office and the cable television businesses owned and operated by Time Warner prior to such date. Currently, the Company, through its wholly owned subsidiaries, owns general and limited partnership interests in 74.49% of the pro rata priority capital ('Series A Capital') and residual equity capital ('Residual Capital') of TWE and 100% of the junior priority capital. The remaining 25.51% limited partnership interests in the Series A Capital and Residual Capital of TWE are held by MediaOne TWE Holdings, Inc., a subsidiary of AT&T Corp. ('AT&T').

The Company and AT&T have been engaged in discussions regarding AT&T's interest in TWE. In addition, AT&T has delivered to the Company and TWE notice of its exercise of certain rights under the TWE partnership agreement that could result in a public sale or the purchase by TWE of some or all of AT&T's interest in TWE. See 'Description of Certain Provisions of the TWE Partnership Agreement -- Registration Rights' at page I-30 herein.

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CAUTION CONCERNING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K includes certain 'forward-looking statements' within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on management's current expectations and are naturally subject to uncertainty and changes in circumstances. Actual results may vary materially from the expectations contained herein due to changes in economic, business, competitive, technological and/or regulatory factors. More detailed information about those factors is set forth on pages F-16 through F-18

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herein. AOL Time Warner is under no obligation to (and expressly disclaims any such obligation to) update or alter its forward-looking statements whether as a result of new information, future events or otherwise.

AMERICA ONLINE

America Online, a wholly owned subsidiary of the Company based in Dulles, Virginia, is the world's leader in interactive services, Web brands, Internet technologies, and electronic commerce services. America Online's operations include: two worldwide Internet services, the AOL service and the CompuServe service; 'AOL Anywhere' services; Netscape; AOL local brands such as Digital City, AOL Moviefone, and MapQuest; AOL messaging services such as ICQ and AOL Instant Messenger; and AOL music properties such as Spinner.com, Winamp and SHOUTcast. Utilizing its 'AOL Anywhere' strategy, key services, features and content of the AOL service are available through multiple platforms and devices. Through iPlanet E-Commerce Solutions, its strategic alliance with Sun Microsystems, Inc., America Online also develops and offers easy-to-deploy, end-to-end electronic commerce and enterprise solutions for companies operating in and doing business on the Internet.

THE AOL SERVICE

The flagship AOL service, a subscription-based service with more than 26 million members at December 31, 2000, provides members with a global, interactive community offering a wide variety of content, features and tools. The range of content, features, and tools offered on the AOL service includes the following:

- o Online Community -- The AOL service promotes interactive community through electronic mail services, message boards, the Buddy List feature (for instant messaging) and public and private 'chat rooms.' 'You've Got Pictures' allows members to receive their developed photos online, share the photos with others via e-mail, organize and store photos online and order reprints and gifts.
- o Content -- Content on the AOL service is organized in a variety of ways for easy access by members, including channels, favorite places, toolbar icons and customization tools. Channels such as the following offer informational content and commerce and community opportunities: News, Sports, Travel, International, Personal Finance, Computer Center, Research & Learn, Autos, Entertainment, Games, House & Home, Shopping, Health, Careers & Work, Music, Parenting, Women, Teens, Kids Only and Local Guide. Content on the AOL service comes from diverse sources, including CBS News, Hachette Filipacchi Magazines, Time Inc. Magazines, Bloomberg and Business Week.
- o Customization and Control Features -- Members can customize their experience on the AOL service through features and tools such as an interactive calendar, 'My Places,' which allows customization of the Welcome Screen, a reminder service, Mail Controls, which allow members to limit who may send them e-mail and to block certain types of e-mail, and Favorite Places, which allows members to mark particular Web sites or AOL areas. Parental Controls help parents form their children's online experience and include tools that limit access to particular AOL areas, Web sites or to certain features.
- o Search Capability -- AOL Search enables AOL members to search the Internet and AOL's exclusive content without leaving the AOL service.
- o AOL Plus -- The AOL Plus feature provides additional multimedia online content to members connecting to the AOL service through high-speed broadband technologies, including DSL, cable, satellite and wireless technologies. The expanded content includes streaming audio, full-motion

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video, games and online catalogue shopping features.

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AOL ANYWHERE

Under its 'AOL Anywhere' strategy, America Online has taken steps to make the services, features and content of the AOL service and other properties available through multiple connections and devices in addition to personal computers, such as televisions, wireless telephones, hand-held and pocket devices, and specialized Internet appliances. America Online launched a number of key initiatives under AOL Anywhere in 2000, including the AOLTV service, AOLbyPhone, a voice portal that allows members to access e-mail via the telephone, and versions of its AOL service that are accessible on mobile platforms, such as mobile phones, pagers and handheld computer devices. In April 2000, America Online and Gateway announced the development of a family of specialized Internet appliances featuring the 'Instant AOL' service, a customized version of the standard AOL service. A countertop appliance was launched in the fall of 2000 and additional devices will include a wireless Web pad and a desktop appliance.

The AOL Anywhere Web site (<http://www.aol.com>) offers AOL members and other Internet users content, features and tools from the AOL service, including AOL Mail, AOL Search, the AOL Instant Messenger service, My News, a personalized news service, and My Calendar, a personalized calendar service.

America Online launched the AOLTV service, an interactive television service for mass-market consumers, in the summer of 2000 in three initial markets -- Phoenix, Sacramento and Baltimore. With the AOLTV service, consumers can watch television using their existing signal and choose from a range of additional interactive features, such as e-mail, instant messaging, and chat, utilizing a set-top box and a wireless keyboard or universal remote control. The AOLTV service offers additional content provided by partners that complements the television programming and a program guide that organizes the television channels into different categories and allows users to select channels by clicking on words and graphics.

The AOL mobile services deliver a variety of the AOL service's features and content to users of wireless devices, such as mobile phones, pagers and other handheld devices. The content and services include wireless access to e-mail, news, weather, sports and stock quotes, as well as content from America Online's other properties, such as Digital City, MapQuest.com and Moviefone. In the fall of 2000, America Online introduced the AOL Mobile Communicator service, which offers wireless access to e-mail and instant messaging using pager-sized two-way wireless devices. America Online also provides text entry solutions for wireless devices through its subsidiary, Tegic Communications, Inc. Tegic's leading product, the T9 Text Input software, enables individuals to send e-mail, short messaging services and instant messages, as well as perform other text-based functions and access the Internet, using the standard telephone keypad to enter words or sentences.

THE COMPUSERVE SERVICE

The CompuServe service, with approximately 3 million members at December 31, 2000, targets the value-oriented portion of the U.S. market and the professional business-oriented market outside of the U.S. It is available in over 500 cities worldwide, including in the U.S., Canada and Europe. CompuServe offers three

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services -- CompuServe 2000, CompuServe 2000 Premier, which has been available with CompuServe's consumer electronic rebate program, and CompuServe Classic. Version 6.0 of CompuServe 2000, launched in January 2001, offers improvements such as enhanced e-mail applications, a built-in media player, the CompuServe Shopping Assistant, expanded personalization options, a more streamlined look and feel, and other enhancements. CompuServe has created a Custom Solutions group to develop and operate co-branded and custom versions of the CompuServe 2000 software. This group operates the Gateway.net Internet Service Provider. The Custom Solutions group also offers private label Internet solutions for strategic partners.

NETSCAPE

NETSCAPE.COM

Netscape (<http://www.netscape.com>) offers a variety of products and services, including news and information, opportunities to purchase goods and services, Internet site directories, software, software downloads, and product and technical support information. More than 36 million users have registered with

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Netscape as of December 31, 2000. In the fall of 2000, Netscape launched Netscape Netbusiness (<http://netbusiness.netscape.com/>), an Internet site targeted to owners of small businesses that offers easy-to-use and fully customizable information resources, productivity and communications tools. Netscape's services include search and navigation services, such as SmartBrowsing; programming channels; communications and community services such as e-mail and message board services; personalization services, and opportunities for electronic commerce. CNN Interactive is now a premier news provider for Netscape. Netscape includes a co-branded version of the AOL Instant Messenger service and local content provided by Digital City. A Netscape-branded toolbar is included on the Company's Time, People, Money and Warner Bros. Web sites to enable visitors to the sites to access Netscape features such as instant messaging, e-mail and online searches.

NETSCAPE BROWSERS

The next-generation Netscape 6 browser software was released in November 2000. Powered by Netscape's Gecko technology, which features a faster and more powerful browser engine technology, Netscape 6 allows individual developers to tailor the browser software to their own use, and it is designed to operate across multiple platforms, so that it can be deployed on a range of Internet devices. Gecko can run on multiple computing systems, including LINUX, Mac OS and Windows. The Netscape 6 browser software offers a number of new features, such as a customizable integrated search engine, and also integrates e-mail and instant messaging within the browser environment.

Netscape also offers Netscape Communicator, a suite of open HTML-based client software that integrates browsing, e-mail, Web-based word processing and group scheduling that enables users to communicate, share and access information. The latest version, Communicator 4.75, was released in August 2000 and features SmartBrowsing, as well as streaming audio and visual capabilities. With SmartBrowsing, consumers can search the Web and connect to Web sites covering a variety of topics by entering common words or topics (Netscape Internet Keywords) into the browser location bar.

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AOL MUSIC: SPINNER.COM, WINAMP AND SHOUTCAST

Spinner.com is a free music service that offers over 150 music channels. Spinner's content library includes over 420,000 songs. The Spinner music player displays artist and song information as the songs are played, and provides links that enable real-time listener feedback and instant ordering of the music being played. Winamp is a branded MP3 player for Windows, and SHOUTcast is an MP3 streaming audio service. Winamp surpassed 55 million registered installations as of December 31, 2000. The SHOUTcast streaming audio service enables individuals to broadcast their own audio stream over the Internet.

INTERACTIVE PROPERTIES

The AOL Interactive Properties group leads the local services and instant messaging initiatives for America Online.

AOL LOCAL: DIGITAL CITY, MOVIEFONE AND MAPQUEST

America Online has a number of branded local services that operate across multiple services and/or platforms, such as Digital City, Moviefone, and MapQuest. Digital City, Inc., is the leading local online city guide offering local products and services in over 200 U.S. markets. Digital City provides original and third-party news, sports, weather, and local directories that offer information and reviews on events, restaurants, health care, housing and job listings. Digital City provides local interactive content and services for all of America Online's interactive services and properties, including the AOL service, the AOL Anywhere services and devices, the CompuServe service, Netscape, and on the Web (digitalcity.com).

Moviefone is the largest movie guide and ticketing service in the United States in terms of the number of users and tickets sold remotely. Through its interactive telephone service (777-FILM), its online service (Moviefone.com), and its wireless services, Moviefone provides millions of moviegoers each week with a free

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directory of movies, showtimes and theater locations, and also provides the ability to purchase tickets via any device and platform.

MapQuest, acquired by America Online in June 2000, is a leader in online destination solutions. Through licensing agreements with more than 1,750 business partners, MapQuest helps businesses integrate maps and driving directions into their Internet, intranet and call center applications for improved marketing and customer service functions. MapQuest also provides customized maps, destination information and driving directions to consumers through its Web site (MapQuest.com) and its wireless partners.

AOL MESSAGING: AOL INSTANT MESSENGER AND ICQ

AOL Instant Messenger is a Web-based communications service that enables Internet users to know when other users of the service are online and to send and receive instant messages in real time. The service offers other limited features. AOL Instant Messenger had over 84 million registered users as of December 31, 2000. AOL Instant Messenger is free and available for downloading on the AOL Anywhere Web site and on America Online's other brands and services, on a co-branded basis, including the CompuServe service and Netscape. America Online has also developed co-branded versions of the AOL Instant Messenger

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service for numerous other companies.

ICQ Ltd., is an Internet-based real-time communications service that utilizes the ICQ ('I seek you') instant communications and chat technology with a constant desktop presence. ICQ also has a Web site (ICQ.com) that offers community and content products and services. At December 31, 2000, ICQ had over 88 million registered users, approximately two-thirds of whom were outside the U.S.

AOL INTERNATIONAL

AOL International oversees the AOL and CompuServe services and operations outside the United States, as well as the Netscape Online service, which operates in the United Kingdom. As of December 31, 2000, the AOL and CompuServe services had nearly 6 million members outside the United States. One component of AOL International's strategy is to provide consumers with local services in key international markets featuring local language, content, marketing and community. Central to the strategy has been the formation of strategic alliances with strong local and regional partners and the provision of access for all members of international services. The AOL, CompuServe and/or Netscape branded services are offered through joint ventures or distribution arrangements in Argentina, Australia, Austria, Brazil, Canada, France, Germany, Hong Kong, Japan, Mexico, the Netherlands, Sweden, Switzerland and the United Kingdom. Globally, members are able to access these services in over 100 countries. In addition, U.S. and global subscribers to AOL services can access selected content and communities offered on the other global AOL services.

During the past year, America Online has launched services in several new foreign markets and has taken steps to develop or enhance services in existing markets:

- o EUROPE: AOL Europe, S.A., a joint venture between America Online and Bertelsmann AG, provides the AOL service and the CompuServe service in several European countries, Netscape Online in the United Kingdom and CompuServe Office in Germany. In March 2000, America Online and Bertelsmann announced plans to restructure the AOL Europe joint venture pursuant to a put and call arrangement to provide for the terms of the eventual exit of Bertelsmann from the joint venture and to undertake a new strategic alliance providing for expanded distribution of Bertelsmann's media content and electronic commerce properties over America Online's interactive brands worldwide. For further information on the restructuring, see note 6 to Notes to Financial Statements. In the fall of 2000, AOL Europe entered into a joint venture with Banco Santander Central Hispano, S.A., and Prodigios Interactivos, S.A., to launch the AOL-Avant branded service in Spain.
- o AUSTRALIA: In March 2000, America Online formed a new joint venture with AAPT Limited, Australia's third largest telecommunications company, to operate the AOL Australia service. This followed Bertelsmann's transfer of its 50% interest in AOL Australia to America Online in connection with the entry into the put and call arrangements between America Online and Bertelsmann.

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- o LATIN AMERICA: AOL Latin America, a joint venture originally formed with the Cisneros Group of Companies, has launched services in three Latin American countries: Argentina (August 2000), Brazil (November 1999) and Mexico (July 2000). In August 2000, America Online Latin America, Inc.

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completed an initial public offering of common stock and, concurrently, Banco Itau, a regional bank in Latin America with online banking operations, became a minority shareholder.

- o AOL JAPAN: During 2000, America Online, Mitsui and Nikkei expanded and restructured their joint venture in Japan, with the addition of NTT DoCoMo, Japan's largest mobile communications company, to the joint venture.

NETSCAPE ENTERPRISE SOLUTIONS

IPLANET E-COMMERCE SOLUTIONS

The Netscape Enterprise Group operates primarily through a strategic alliance formed in November 1998 between America Online and Sun Microsystems, Inc. which is now referred to as the iPlanet E-Commerce Solutions, a Sun-Netscape Alliance. The alliance develops, markets, sells and supports on a collaborative basis an Internet software platform that enables enterprises to put their businesses online, deploy new services and scale to growing demand. The infrastructure product portfolio includes: messaging (e-mail) and calendar, collaboration, Web, application, directory and certificate (security) servers. The electronic commerce applications include commerce exchange, procurement, selling and billing applications.

TECHNOLOGIES

AOL NET

America Online employs a multiple vendor strategy in designing, structuring and operating the network services utilized in its interactive online services. AOLnet, a transfer control protocol/Internet protocol (TCP/IP) network of third-party network service providers, including Sprint Communications Company, Genuity Inc., WorldCom, Inc. and Level 3 Communications, is used for the AOL service and certain versions of the CompuServe service in North America, including CompuServe 2000. America Online anticipates continuing to build AOLnet in order to increase its network capacity, provide members of its online services with higher speed access and reduce data network costs on a per-hour basis. The AOL service grew as of December 31, 2000 to achieve peaks of over 2.0 million simultaneous users and the exchange of approximately 180 million e-mail messages a day.

America Online enters into multiple-year data communications agreements to support AOLnet. In connection with those agreements, America Online may commit to purchase certain minimum data communications services or to pay a fixed cost for the network services. The expansion of AOLnet requires a substantial investment in telecommunications equipment. In addition to purchasing telecommunications equipment, America Online also enters into operating leases for the use of this equipment.

SERVICE PLATFORMS

America Online supports a variety of software platforms and conduits for access to the interactive services and Web-based properties. Today, the vast majority of members and users of interactive services access such services through personal computers. Operating systems on which the AOL and CompuServe services are available include primarily the Windows (3.1, 95 and 98) and Macintosh operating systems. America Online has also taken steps to adopt new technology and developments in the delivery of interactive services. America Online has upgraded AOLnet to support the v.90 standard for high-speed access at 56 kps, and is also investing in the development of alternative technologies to deliver its interactive online services, including cable modems, Digital Subscriber Line (DSL) access, satellite and wireless technologies (as discussed under 'AOL Anywhere'). America Online plans to continue to offer its members

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higher-speed options when they become easy-to-use and commercially viable for the mass market. America Online has formed strategic alliances with

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Verizon Communications and SBC Communications to use new DSL technology to make available a high-speed upgrade connection to subscribers. The initial roll out began in the summer of 1999.

America Online formed a strategic alliance with Hughes Electronic Corporation, a subsidiary of General Motors Corporation, in June 1999 to develop and market integrated digital entertainment and Internet services. The alliance provides for the delivery of AOL Plus to members via Hughes' DirectPC satellite Internet network, as well as delivery over Hughes' next generation satellite system for two-way, broadband connectivity. In connection with the alliance, America Online made a \$1.5 billion investment in Hughes in the form of a General Motors preference stock, which carries a 6 1/4% coupon rate and has a mandatory conversion into General Motors Class H common stock (GMH) in 2002.

ADVERTISING AND COMMERCE

America Online offers its advertising and commerce partners a variety of customized programs, which may include premier placement or select sponsorship of particular online areas or Web pages for designated time periods. As merchants recognize the value in reaching the large, growing and active subscriber base to the AOL and CompuServe services and users of the Web-based properties, America Online has been able to earn additional revenues by offering selected merchants preferred rights to market particular goods or services within one or more of the online services and properties. In those transactions, America Online provides its commerce partners certain marketing and promotional opportunities and in return receives cash payments, the opportunity for revenue sharing, cross-promotions and competitive pricing and online conveniences for subscribers. Certain of the transactions also include an equity component from the partner, such as a warrant to purchase stock or a direct equity interest in the partner. These investments are accounted for in accordance with Company accounting policies. See note 2 to Notes to Financial Statements. In addition, these investments can also represent an additional potential source of income or loss to the Company upon their disposition.

An important component of America Online's strategy is to continue increasing revenues from advertising and commerce sources and from the direct sale of merchandise, as well as from additional sources such as transaction and licensing fees. It continues to establish a wide variety of relationships with advertising and commerce partners to grow and diversify its non-subscription-based revenues and to provide subscribers on the interactive services with access to a broad selection of competitively priced, easy-to-order products and services. America Online has also expanded the scope, range and types of businesses involved in advertising and commerce relationships; many of its advertising and commerce contracts are with mainstream industry leaders such as Coca-Cola, Kodak, Sears and Citigroup. America Online frequently has entered into advertising arrangements that encompass multiple brands within the AOL family of brands. AOL Time Warner intends to continue this practice and to increase the number of advertising arrangements that include two or more of the Company's lines of businesses by drawing upon and making full use of its brands and assets.

MARKETING

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America Online utilizes a common marketing infrastructure for its multiple brands of interactive services and Web properties. To support its goals of attracting and retaining members or users, as applicable, and developing and differentiating the family of brands, America Online markets its products, services and brands through a broad array of programs and strategies, including broadcast television and radio advertising campaigns, direct mail, magazine inserts (including magazines published by the Company's publishing business) and advertisements, co-marketing, retail distribution, bundling agreements, Web advertising and alternate media. America Online also markets through extensive online and offline cross-promotion and co-branding with a wide variety of partners. Additionally, through multi-year bundling agreements, the interactive online services and products are installed on a range of computers made by personal computer manufacturers and are available to consumers by clicking on an icon during the computer's initial setup process.

America Online utilizes targeted or limited promotions and marketing programs and pricing plans designed to appeal to particular groups of potential users of its interactive online services and to distinguish and develop its different brands. For example, in connection with the positioning of the CompuServe service in the United

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States as a value-oriented brand, CompuServe uses a series of consumer electronic rebate programs with retailers. Under these promotions, consumers signing up for two-year memberships to the CompuServe 2000 Premier service at \$21.95 per month will receive a rebate of \$200 in connection with the purchase of designated merchandise.

COMPETITION

America Online competes for subscription revenues and members' usage with a large number of companies providing Internet access, including online services such as the Microsoft Network and AT&T Worldnet, local and national Internet service providers, cable Internet access providers, and telephone companies and other companies that provide Internet access among other services. It also competes more broadly for subscription revenues and members' usage with cable, information, entertainment and media companies. America Online competes for advertising and commerce revenues with a wide range of companies, including those that focus on the Internet, such as online services, Internet access companies, Web-based portals, and individual Web sites providing content, commerce, community and similar features, and media companies, such as those with newspaper or magazine publications, radio stations and broadcast stations or networks. America Online's Netscape Enterprise group also competes with a wide range of companies in the development and sale of electronic commerce infrastructure and applications.

America Online faces competition in developing technologies and risks from potential new developments in distribution technologies and equipment in Internet access. In particular, America Online faces competition from developments in the following types of Internet access distribution technologies or equipment and must keep pace with the developments:

- o broadband distribution technologies used in cable Internet access services;
- o advanced personal computer-based access services offered through digital subscriber line technologies offered by local telecommunications companies;

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- o other advanced digital services offered by satellite and wireless companies;
- o television-based interactive services;
- o personal digital assistants or handheld computers;
- o enhanced mobile phones;
- o other equipment offering functional equivalents to the AOL Anywhere services.

CABLE

The Company's Cable business consists principally of interests in cable television systems. Of the approximately 12.8 million subscribers served by the Company at December 31, 2000, approximately 1.8 million are in systems owned by TWI Cable Inc. ('TWI Cable'), a wholly owned subsidiary of the Company, and approximately 11 million are in systems owned or managed by TWE. TWE's cable systems include approximately 6.7 million subscribers in a joint venture between TWE and Advance/Newhouse known as TWE-A/N; 1.1 million of these TWE-A/N subscribers are part of the Texas Cable Partners 50-50 joint venture with AT&T. TWE-A/N is owned 33.3% by Advance/Newhouse, 64.8% by TWE and 1.9% by TWI Cable. Time Warner Cable, a division of TWE, generally manages all such systems and receives a fee for management of the systems owned by TWI Cable and TWE-A/N.

SYSTEMS OPERATIONS

Time Warner Cable is one of the largest operators of cable television systems in the United States with more than 90% of its customers served by clustered cable systems with 100,000 subscribers or more. As of December 31, 2000, Time Warner Cable had 35 distinct geographic system groupings serving more than 100,000 subscribers. This clustering strategy has enabled, among other things, significant cost and marketing

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efficiencies, more effective pursuit of local and regional cable advertisers, the development of local news channels, and the roll-out of advanced services over a geographically concentrated customer base.

Over the past several years, Time Warner Cable has pursued a strategy of upgrading its existing cable systems generally to 750 MHz capability, based on a hybrid fiber optic/coaxial cable architecture. By year-end 2000, Time Warner Cable had completed the upgrade of approximately 92% of its cable plant. Upgraded systems can deliver increased channel capacity and provide two-way transmission capability with improved network management systems. Upgrading also permits Time Warner Cable to roll out new advanced services, including digital and high-definition television ('HDTV') programming, high-speed Internet service, video-on-demand, telephony and other services. See 'New Cable Services' below.

FRANCHISES

Cable systems are constructed and operated under non-exclusive franchises granted by state or local governmental authorities. Franchises typically contain many conditions, such as time limitations on commencement or completion of

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construction; conditions of service, including number of channels; provision of free services to schools and other public institutions; and the maintenance of insurance and indemnity bonds. Cable franchises are subject to various federal, state and local regulations. See 'Regulation and Legislation' below.

PROGRAMMING

Programming is generally made available to customers by tiers, which are packages of different programming services provided for prescribed monthly fees. The available analog channel capacity of Time Warner Cable's systems has been expanding as system upgrades are completed. As Time Warner Cable rolls out digital services in its systems, the number of channels of video programming a customer may elect to receive are further increased such that over 150 video channels are available.

Video programming available to customers includes local and distant broadcast television stations, cable programming services like CNN, A&E and ESPN, and premium cable services like HBO, Showtime and Starz! The terms and conditions of carriage of programming services are generally established through affiliation agreements between the programmers and Time Warner Cable. Many programming services impose a monthly license fee per subscriber upon the cable operator. Programming costs generally have been increasing sharply in recent years and depending on the terms of a specific agreement, the cost of providing any cable programming service may continue to rise. Time Warner Cable sometimes has the right to cancel contracts and generally has the right not to renew them. In addition, Time Warner Cable may not always be able to renew contracts when it wishes to do so. It is unknown whether the loss of any one popular supplier would have a material adverse effect on Time Warner Cable's operations.

SERVICE CHARGES AND ADVERTISING

Subscribers to the Company's cable systems are charged monthly subscription fees based on the level of service selected, which fees in some cases include equipment charges. Subscription revenues account for most of Time Warner Cable's revenues. A one-time installation fee is generally charged for connecting subscribers to the cable television system. Although regulation of certain cable programming rates ended on March 31, 1999, rates for 'basic' programming and for equipment and installation continue to be regulated pursuant to federal law. See 'Regulation and Legislation' below.

Subscribers may purchase premium programming services and, in certain systems, other per-channel services, for an additional monthly fee for each such service, with discounts generally available for the purchase of more than one service. Subscribers may discontinue purchasing services at any time. Pay-per-view programming offers movies and special events, such as boxing, for a separate charge.

Time Warner Cable also generates revenue by selling advertising time to national, regional and local businesses. Cable television operators receive an allocation of advertising time availabilities on certain cable

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programming services into which commercials can be inserted at the local system level. The clustering of Time Warner Cable's systems expands the share of viewers that Time Warner Cable reaches within a local DMA (Designated Market Area), which helps local ad sales personnel to compete more effectively with broadcast and other media. In addition, in many localities, contiguous cable

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system operators have formed advertising interconnects to deliver locally inserted commercials across wider geographic areas, replicating the reach of the broadcast stations as much as possible. Eighteen of Time Warner Cable's 39 field divisions participate in a local cable advertising interconnect.

LOCAL NEWS CHANNELS

Time Warner Cable operates, alone or in partnerships, 24-hour local news channels in New York City (NY1 News), Tampa Bay (Bay News 9), Orlando (Central Florida News 13), Rochester, NY (R/News), and Austin (News 8 Austin). Preparations are underway to launch news channels in Houston, San Antonio, Charlotte, Raleigh, Syracuse and Albany. These channels have developed into successful vehicles for local advertising.

NEW CABLE SERVICES

DIGITAL CABLE SERVICES

Digital Tier Service

During 2000, Time Warner Cable continued its aggressive roll-out of digital cable service in its cable systems. As of December 31, 2000, Time Warner Cable had more than 1.7 million digital service subscribers. As of March 1, 2001, 38 of Time Warner Cable's 39 field divisions are offering digital cable and the one remaining division is expected to commence offering digital service in 2001. A digital format allows a signal to be compressed so that it occupies less bandwidth, which substantially increases the number of channels that can be provided over a system. The digital set-top boxes delivered to subscribing customers will offer a digital programming tier with the potential for more than 100 networks, 40 CD-quality music services, more pay-per-view options, more channels of multiplexed premium services, a digital interactive program guide, and other features such as parental control options.

HDTV

Pursuant to FCC order, television broadcast stations have been granted additional over-the-air spectrum to provide, under a prescribed roll-out schedule, high definition and digital television signals to the public. Time Warner Cable's upgraded hybrid fiber optic/coaxial cable architecture should provide a technologically superior means of distributing HDTV signals. To date, Time Warner Cable has agreed to carry the high definition television signals and other digital signals that will be broadcast by television stations owned and operated by the ABC, CBS, NBC and Fox networks, and also by nearly all public television stations, in Time Warner Cable's operating areas. Time Warner Cable is seeking similar arrangements with other broadcasters. Time Warner Cable is also carrying the HDTV versions of HBO and Showtime in certain areas.

Video-on-Demand

By adding digital servers and software to its digital television service platform, Time Warner Cable will be able to offer network-based video-on-demand services, including 'virtual' VCR features such as pause, rewind and fast forward. Time Warner Cable began testing of video-on-demand equipment in 1999 in its-Austin, Texas; Tampa Bay, Florida; and Hawaii systems, and provided a movies-on-demand service on a trial basis to customers in those systems during 2000. Additional testing is continuing in 2001. Time Warner Cable is negotiating with a number of studios to obtain video-on-demand distribution rights for movies to support commercial launches. Depending on the results of the foregoing, video-on-demand services are expected to be launched in a number of additional locations in 2001.

INTERNET SERVICES

Road Runner

To date, Time Warner Cable has offered the Road Runner high-speed Internet service as its sole cable modem service providing high-speed Internet services to customers. Customers connect their personal computers to Time Warner Cable's two-way hybrid fiber optic/coaxial cable system which, together with the Road Runner backbone network, enables customers to access the Internet and Road Runner's content at speeds much greater than traditional telephone modems.

The Road Runner service, as of March 1, 2001, has been launched by Time Warner Cable in 36 of its 39 field divisions. In January 2001, Time Warner Cable's Road Runner customer base exceeded 1,000,000 customers, a significant milestone for the service. Time Warner Cable intends to continue aggressively rolling out the Road Runner service throughout its divisions during 2001.

Starting in 1998, Road Runner was provided by a joint venture (the 'RR JV') of TWE, TWE-A/N, TWI Cable, MediaOne, and subsidiaries of Microsoft Corp. ('Microsoft') and Compaq Computer Corp. ('Compaq'). The agreements between the RR JV and Time Warner Cable restricted Time Warner Cable's ability to distribute the services of other Internet service providers ('ISPs') over Time Warner Cable's cable systems. In connection with AT&T's acquisition of MediaOne, the Department of Justice ordered the divestiture of MediaOne's interest in the RR JV. As a result, in December 2000, AT&T and Time Warner announced that the Road Runner service would be restructured and that the RR JV will terminate. This restructuring, under which TWE, TWE-A/N and TWI Cable will obtain sole ownership and control of certain RR JV assets, is expected to be completed during the second quarter of 2001. Microsoft's and Compaq's interests in the RR JV were acquired by the RR JV in February 2001.

Multiple ISP Services

In connection with the announcement of the AOL-Time Warner merger, Time Warner and America Online entered into a Memorandum of Understanding in February 2000. Time Warner committed that it would enter into agreements with multiple ISPs to offer its customers a choice of ISP services, including services not owned by AOL Time Warner. During 2000, Time Warner Cable began the technical and operational work necessary to develop a cable platform capable of providing the services of multiple ISPs and, during the summer, began working with a number of ISPs and vendors on a trial of its multiple ISP service platform in Columbus, Ohio.

Time Warner Cable's first definitive agreement with an unaffiliated ISP, EarthLink, was entered into in November 2000 and Time Warner Cable expects to commence launching the EarthLink service in its divisions in the second half of 2001. Discussions with other ISPs regarding distribution terms have also commenced. America Online and Time Warner Cable have also entered into a definitive agreement to provide the AOL service over Time Warner Cable's broadband cable system, and Time Warner Cable expects to commence launching the AOL service in the same timeframe as the launch of the EarthLink service. Time Warner Cable's provision of the AOL service and its obligation to make multiple ISP service available to its customers are subject to compliance with the terms of the FTC Consent Decree and the FCC Order entered in connection with the regulatory clearance of the AOL-Time Warner merger. (See 'Regulation and Legislation' below, for a description of these terms).

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TELEPHONY

Time Warner Telecom Inc. ('Time Warner Telecom') is a leading fiber facilities-based integrated communications provider that offers a wide range of business telephony services in selected metropolitan areas across the United States. Time Warner Telecom was formed in 1998 through a restructuring of the business telephony operations of Time Warner Cable. As of January 31, 2001, the Company's aggregate equity interest in Time Warner Telecom was approximately 44% and the Company's aggregate voting interest in Time Warner Telecom, consisting of high-voting common stock, was approximately 66%.

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COMPETITION

Cable television systems face strong competition for viewers and subscriptions from a wide variety of news, information and entertainment providers. These include multichannel video providers like DTH, MMDS, SMATV systems (which are described immediately below) and telephone companies, other sources of video programs (such as broadcast television and videocassettes), and additional sources for news, entertainment and information, including the Internet. Cable television systems also face strong competition from all media for advertising dollars.

DTH (Direct-to-home). DTH services offer pre-packaged programming services that can be received by relatively small and inexpensive receiving dishes. In many metropolitan areas, DTH services now also include local broadcast signals.

MMDS/Wireless Cable (Multichannel microwave distribution services). Wireless cable operators, including digital wireless operators, use microwave technology to distribute video programming.

SMATV (Satellite-master antenna television). Additional competition comes from private cable television systems servicing condominiums, apartment complexes and certain other multiple unit residential developments, often on an exclusive basis, with local broadcast signals and many of the same satellite-delivered program services offered by franchised cable television systems.

Overbuilds. Under the 1992 Cable Act, franchising authorities are prohibited from unreasonably refusing to award additional franchises. There are an increasing number of overlapping cable systems operating in Time Warner Cable franchise areas, including municipally-owned systems.

Telephone Companies. Under the 1996 Telecommunications Act, telephone companies are now free to enter the retail video distribution business within their local exchange service areas, including through DTH, MMDS and SMATV, as traditional franchised cable system operators, or as operators of 'open video systems' subject to certain local authorizations and local fees.

Additional Competition. In addition to multichannel video providers, cable television systems compete with all other sources of news, information and entertainment including over-the-air television broadcast reception, live events, movie theaters, home video products, and the Internet.

'On-Line' Competition. Time Warner Cable's systems face competition in its cable modem services from a variety of companies that service customers with various other forms of 'on-line' services, including DSL high-speed Internet

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access services and dial-up services over ordinary telephone lines. Monthly prices of these ISPs are often comparable to cable offerings. Other developing new technologies, such as Internet access via satellite or wireless connections, compete with cable and cable modem services as well.

FILMED ENTERTAINMENT

The Company's Filmed Entertainment businesses produce and distribute theatrical motion pictures, television shows, animation and other programming, distribute home video product, license rights to the Company's programs and characters and operate motion picture theaters. All of the foregoing businesses are principally conducted by Warner Bros., which is a division of TWE. The filmed entertainment business also includes New Line Cinema Corporation ('New Line Cinema'), as well as the Turner classic film and animation libraries, all of which are wholly owned through Turner Broadcasting System, Inc. ("TBS").

WARNER BROS. FEATURE FILMS

Warner Bros. Pictures produces feature films both wholly on its own and under co-financing arrangements with others, and also distributes completed films produced and financed by others. The terms of Warner Bros. Pictures' agreements with independent producers and other entities are separately negotiated and vary depending upon the production, the amount and type of financing by Warner Bros., the media and territories covered, the distribution term and other factors.

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Warner Bros. Pictures' strategy focuses on building movie franchises, which will continue with the planned expansion of The Matrix into a series of films and the introduction in 2001 of the first of a planned series of Harry Potter motion pictures. Warner Bros. Pictures also is pursuing a strategy to release films with a diversified mix of genres, talent and budgets. In response to the rising cost of producing theatrical films, Warner Bros. Pictures has entered into a number of joint venture agreements with other companies to co-finance films, decreasing its financial risk while in most cases retaining substantially all worldwide distribution rights. During 2000, Warner Bros. Pictures released a total of 22 motion pictures for theatrical exhibition (including the re-release of The Exorcist), of which 7 were wholly financed by Warner Bros. Pictures and 15 were produced by or with others. 2000 releases from Warner Bros. Pictures (both wholly financed and co-produced) included A Perfect Storm, Miss Congeniality and Space Cowboys. A total of 33 motion pictures are currently slated to be released during 2001 (including the re-release of Superman), of which 5 are wholly financed by Warner Bros. Pictures, and 28 are produced by or with others.

Warner Bros. Pictures' joint venture arrangements include: (i) Bel-Air Entertainment, a joint venture with Canal+ to co-finance the production, overhead and development costs of motion pictures; (ii) a joint venture with Village Roadshow Pictures to co-finance the production of motion pictures; (iii) an exclusive worldwide distribution arrangement with Alcon Entertainment; and (iv) an arrangement with Gaylord Entertainment ('Gaylord') to co-finance the production of motion pictures with medium to high budgets, and with Gaylord's wholly-owned subsidiary, Pandora Investments SARL, to co-finance the production of lower budget pictures.

Warner Bros. Pictures has distribution servicing agreements with Morgan Creek Productions Inc. ('Morgan Creek') through June 2003 pursuant to which,

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among other things, Warner Bros. provides domestic distribution services for all Morgan Creek pictures and certain foreign distribution services for selected pictures. Warner Bros. Pictures has entered into a distribution arrangement with Franchise Entertainment LLC ('Franchise') under which it will obtain domestic distribution rights in certain motion pictures produced by Franchise.

Warner Bros. Pictures has begun to collaborate with AOL to promote its feature films to AOL subscribers in advance of a film's opening in theaters. The marketing campaign for *The Perfect Storm*, which was featured on the AOL welcome screen, generated many advance viewings of the trailer and made it easy for AOL subscribers to order tickets for the movie through Moviefone.

NEW LINE AND OTHER FILMED ENTERTAINMENT

Theatrical films are also produced and distributed by New Line Cinema, which is a wholly owned subsidiary of TBS. New Line is a leading independent producer and distributor of theatrical motion pictures with two film divisions, New Line Productions and Fine Line Features. New Line Cinema's 2000 releases included *Frequency*, *Final Destination*, *Thirteen Days* and *The Cell*. A total of 18 motion pictures are currently slated for theatrical release by New Line Cinema during 2001, including the first installment of *The Lord of the Rings* trilogy.

Castle Rock Television, also owned by TBS, produced the highly rated Emmy Award-winning series *Seinfeld*, which is distributed by a third party for a fee. Distributed throughout the world, *Seinfeld* was successfully sold to broadcast television stations in 1998 for a second syndication cycle commencing in 2001 as well as to TBS Superstation for basic cable exhibition commencing in 2002.

HOME VIDEO

Warner Home Video ('WHV') distributes for home video use pre-recorded videocassettes and DVDs containing the filmed entertainment product produced or distributed by the Company's Warner Bros. Pictures, WarnerVision Entertainment, New Line Cinema and Home Box Office divisions. WHV also distributes other companies' product for which it has acquired the rights.

WHV sells and/or licenses its product in the United States and in major international territories to retailers and/or wholesalers through its own sales force, with warehousing and fulfillment handled by divisions of Warner Music Group and third parties. In some international countries, WHV's product is distributed through licensees.

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Videocassette product is manufactured under contract with independent duplicators. DVD product is replicated by Warner Music Group companies and third parties.

In North America, WHV released nine titles on videocassette for home rental in 2000 whose sales and licensed units exceeding one million units each, including: *The Green Mile*, *The Whole Nine Yards*, and *Three Kings*. Additionally, WHV released eleven titles on videocassette in the North American sell-through market that generated sales of more than one million units each, including *The Perfect Storm*, *How the Grinch Stole Christmas* (animated) and *Pokemon -- The Movie*.

During 2000, DVDs further increased their presence in the North American and international markets. Since inception of the format, WHV has released over 850

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titles on DVD, led by The Matrix with worldwide sales in excess of seven million units.

TELEVISION

Warner Bros. is one of the world's leading suppliers of television programming, distributing programming in more than 175 countries and in more than 40 languages. Warner Bros. both develops and produces new television series, made-for-television movies, mini-series, reality-based entertainment shows and animation programs and also distributes television programming for exhibition on all media. The distribution library owned or managed by Warner Bros. currently has approximately 6,500 feature films, 32,000 television titles, and 13,500 animated titles (including 1,500 classic animated shorts).

Warner Bros.' television programming is primarily produced by Warner Bros. Television ('WBTV'), which produces primetime dramatic and comedy programming for the major networks, and Telepictures Productions ('Telepictures'), which specializes in reality-based and talk/variety series for the syndication markets. Returning network primetime series from WBTV include, among others, ER, Friends, The Drew Carey Show, Whose Line Is It Anyway? and the Emmy-award winning series, The West Wing. Telepictures has successfully launched, among others, The Rosie O'Donnell Show.

Warner Bros. Animation is responsible for the creation, development and production of contemporary television and feature film animation, as well as for the creative use and production of classic animated characters from Warner Bros.', TBS's and DC Comics' libraries, including Looney Tunes and the Hanna-Barbera libraries.

Warner Bros. Television has begun to collaborate with AOL to promote its television shows to AOL subscribers. For example, The Drew Carey Show Web site appearing on Warner Bros. Online featured a 'Name Mimi's Baby' contest, allowing fans to submit potential baby names for one of the lead characters on the show. AOL's promotion of the contest on its welcome screen both helped to make the contest successful and to draw additional traffic for the show's promotional Web site.

BACKLOG

Backlog represents the future revenue not yet recorded from cash contracts for the licensing of theatrical and television programming for pay cable, network, basic cable and syndicated television exhibition. Backlog for all of AOL Time Warner's filmed entertainment companies amounted to \$3.523 billion at December 31, 2000, compared to \$3.595 billion at December 31, 1999 (including amounts relating to the intercompany licensing of film product to the Company's cable television networks of \$1.269 billion and \$1.176 billion as of December 31, 2000 and December 31, 1999, respectively). The backlog excludes advertising barter contracts.

CONSUMER PRODUCTS AND STUDIO STORES

Warner Bros. Consumer Products licenses rights in both domestic and international markets to the names, photographs, logos and other representations of characters and copyrighted material from the films and television series produced or distributed by Warner Bros., including the superhero characters of DC Comics, Hanna-Barbera characters, Turner classic films and the literary phenomenon Harry Potter.

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In January 2001, the Company announced that it intends to sell or close its domestic Warner Bros. Studio Store operations. International operations, consisting of 53 stores operated by franchisees and licensees in 13 countries and territories as of December 31, 2000, will continue, although it is anticipated that the number of franchised international stores will decrease substantially in 2001.

OTHER ENTERTAINMENT ASSETS

TWE and a wholly owned subsidiary of the Company each own a 50% interest in DC Comics. DC Comics publishes more than 50 regularly issued comics magazines, among the most popular of which are Superman, Batman, Wonder Woman and The Sandman. DC Comics also derives revenues from motion pictures, television, product licensing and books. The Company wholly owns E.C. Publications, Inc., the publisher of MAD magazine.

COMPETITION

The production and distribution of theatrical motion pictures, television and animation product and videocassettes/videodiscs/DVDs are highly competitive businesses, as each vies with the other, as well as with other forms of entertainment and leisure time activities, including video games, the Internet and other computer-related activities for viewers' attention. Furthermore, there is increased competition in the television industry evidenced by the increasing number and variety of broadcast networks and basic cable and pay television services now available. There is active competition among all production companies in these industries for the services of producers, directors, writers, actors and others and for the acquisition of literary properties. With respect to the distribution of television product, there is significant competition from independent distributors as well as major studios. Revenues for filmed entertainment product depend in part upon general economic conditions, but the competitive position of a producer or distributor is still greatly affected by the quality of, and public response to, the entertainment product it makes available to the marketplace. Warner Bros. competes in its character merchandising and other licensing and retail activities with other licensors and retailers of character, brand and celebrity names. Many of the major film and television producers, including the Company's filmed entertainment divisions, have been accelerating their production schedules in preparation for possible strikes by actors and writers in connection with the re-negotiation of the Screen Actors Guild and Writers Guild of America collective bargaining agreements which expire on June 30 and May 1 of 2001, respectively. If such strikes occur and continue for a sustained period, businesses related to the production, distribution and exploitation of filmed entertainment products, including the Company's filmed entertainment businesses, may be adversely affected.

NETWORKS

The Company's Networks business consists principally of domestic and international basic cable networks, pay television programming services, a broadcast television network, and sports franchises. The basic cable networks (collectively, the 'Turner Networks') owned by Turner Broadcasting System, Inc. ('TBS'), a wholly owned subsidiary, constitute the principal component of the Company's basic cable networks. TBS also operates several large advertiser-supported online sites, including the CNN family of Internet destinations. Pay television programming consists of the multichannel HBO and Cinemax pay television programming services (collectively, the 'Home Box Office Services'), operated by the Home Box Office division of TWE ('Home Box Office'). The WB Television Network ('The WB'), a broadcast television network, is operated as a limited partnership in which WB Communications (a division of TWE) holds a

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majority interest in the network and is the network's managing general partner.

The Turner Networks and the Home Box Office Services (collectively, the 'Cable Networks') distribute their programming via cable and other distribution technologies, including satellite distribution. The Cable Networks generally enter into separate multi-year agreements, known as affiliation agreements, with distributors that have agreed to carry them.

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The Turner Networks (other than Turner Classic Movies, which is commercial-free) generate their revenue principally from the sale of advertising time and from receipt of monthly per subscriber fees paid by cable system operators, DTH distribution companies, hotels and other customers (known as affiliates) that have contracted to receive and distribute such networks. The Home Box Office Services and Turner Classic Movies, being commercial-free, generate their revenue from the monthly fees paid by affiliates, which are generally charged on a per subscriber basis.

Advertising revenue on the basic cable networks and The WB is comprised of consumer advertising, which is sold primarily on a national basis (The WB sells time exclusively on a national basis, with local affiliates of The WB selling local advertising). Advertising contracts generally have terms of one year or less. Advertising revenue is generated from a wide variety of categories, including financial and business services, food and beverages, automotive, entertainment and office supplies and equipment. Advertising revenue is a function of the size and demographics of the audience delivered, the 'CPM,' which is the cost per thousand viewers delivered, and the number of units of time sold. Units sold and CPM's are influenced by the quantitative and qualitative characteristics of the audience of each network as well as overall advertiser demand in the marketplace.

TURNER NETWORKS

DOMESTIC NETWORKS

TBS's entertainment networks include two general entertainment networks, TBS Superstation, with approximately 80.9 million subscribers in the U.S., as of December 31, 2000, and TNT, with approximately 79.7 million subscribers in the U.S., as of December 31, 2000; as well as Cartoon Network, with approximately 68.3 million subscribers in the U.S., as of December 31, 2000; and Turner Classic Movies, a 24-hour, commercial-free network which presents classic films from TBS's MGM, RKO and pre-1950 Warner Bros. film libraries, which had approximately 45.9 million subscribers in the U.S., as of December 31, 2000. Programming for these entertainment networks is derived, in part, from the Company's film, made-for-television and animation libraries as to which TBS or other divisions of the Company own the copyrights, licensed programming, including sports, and original productions. In October 1999, TBS launched Turner South, a regional entertainment network featuring movies and sitcoms from the Turner library and original programming targeted to viewers in the Southeast, as well as regional news and sports. On April 1, 2000, TBS launched Boomerang, a digital network featuring classic cartoons.

TBS has acquired programming rights from the National Basketball Association (the 'NBA') to televise a certain number of regular season and playoff games on TBS Superstation and TNT through the 2001-02 season for which it has agreed to pay fees, plus a share of the advertising revenues generated in excess of specified amounts. TBS Superstation also televises a certain number of baseball

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games of the Atlanta Braves, a major league baseball club owned by a subsidiary of TBS, for which rights fee payments are made to Major League Baseball's central fund for distribution to all Major League Baseball clubs. Through a joint venture with NBC, TBS has also acquired rights to televise certain NASCAR Winston Cup and Busch Series races from 2001-2006.

TBS's CNN network is a 24-hour per day cable television news service which had more than 80 million subscribers in the U.S. as of December 31, 2000. Together with CNN International ('CNNI'), CNN reached more than 250 million locations in 212 countries and territories as of December 31, 2000. CNN operates 39 news bureaus, of which 10 are located in the United States and 29 are located around the world. In addition to Headline News, which provides updated half-hour newscasts throughout each day, CNN has expanded its brand franchise to include CNNfn (soon to be renamed and refocused as CNN Money), featuring business and consumer news; and CNNSI, a venture with Sports Illustrated, an AOL Time Warner publication, featuring sports news and features. TBS has also expanded into a number of special market networks.

During 2000, TBS collaborated with several other subsidiaries of the Company to provide advertisers with marketing opportunities across the Company's numerous platforms, thereby reaching AOL Time Warner's significant subscriber base.

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INTERNATIONAL NETWORKS

CNNI is distributed to multiple distribution platforms for delivery to cable systems, broadcasters, hotels and other viewers around the world on a network of 16 regional satellites. CNN en Espanol, a Spanish language all-news network in Latin America, as of December 31, 2000, had 10.5 million subscribers. TBS also distributes region-specific versions of TNT and Cartoon Network, on either a single channel or combined channel basis, and Turner Classic Movies in approximately 120 countries around the world.

In a number of regions, TBS has launched international versions of its channels through joint ventures with local partners. These include CNN+, a Spanish language 24-hour news network launched for distribution in Spain and Andorra; CNN Turk, a Turkish language 24-hour news network; and Cartoon Network Japan. TBS also owns an interest in n-tv, a German language news network currently reaching nearly 40 million homes in Germany and contiguous countries in Europe, primarily via cable systems and satellite.

INTERNET SITES

In addition to its cable networks, TBS operates various advertiser-supported Internet sites. CartoonNetwork.com is a popular advertiser-supported site for children ages two to eleven. CNN News Group operates multiple sites, such as CNN.com and allpolitics.com primarily through CNN Interactive. The CNN News Group also produces two other major news sites: CNNfn.com, a unit of CNN Financial News; and CNNSI.com, a sports site developed jointly with Sports Illustrated.

HOME BOX OFFICE

HBO, operated by the Home Box Office division of TWE, is the nation's most widely distributed pay television service, which together with its sister service, Cinemax, had approximately 36.9 million subscriptions, as of

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December 31, 2000. Both HBO and Cinemax are made available in a multichannel format. Together with various joint ventures, Home Box Office also distributes HBO-branded services in Latin America, Asia and Eastern Europe.

A majority of the programming on HBO and Cinemax consists of recently released, uncut and uncensored theatrical motion pictures. Home Box Office's practice has been to negotiate licensing agreements of varying duration for such programming with major motion picture studios, and independent producers and distributors. These agreements typically grant pay television exhibition rights to recently released and certain older films owned by the particular studio, producer or distributor in exchange for a negotiated fee, which may be a function of, among other things, the films' box office performances.

HBO also defines itself by the exhibition of award-winning pay television original movies and mini-series, sporting events such as boxing matches, sports documentaries and sports news programs, as well as dramatic and comedy specials and series, such as The Sopranos, and Sex and the City, concerts, family programming and documentaries.

HBO has begun a number of cross-company initiatives with AOL including promotions of HBO shows like The Sopranos and Sex and the City and AOL's offering of online sign up for HBO subscriptions through the HBO Express service.

Home Box Office produces Everybody Loves Raymond, now in its fifth season on CBS. Divisions of Home Box Office also produce programming for HBO and for other networks. HBO Sports, a division of Home Box Office, operates TVKO Pay-Per-View from HBO, an entity that distributes pay-per-view prize fights and other pay-per-view programming.

THE WB TELEVISION NETWORK

The WB now airs 13 hours of prime time series programming six nights per week. The network's line-up includes veteran drama series 7th Heaven, Dawson's Creek, Buffy the Vampire Slayer, Felicity, Roswell, Angel and Charmed, as well as the new critically acclaimed series Gilmore Girls. Kids' WB!, airs 19 hours of

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programming per week with strip programming airing weekday mornings and afternoons, along with a weekend line-up of original programming that includes the Pokemon series.

As of March 1, 2001, 83 primary and four secondary affiliates provide coverage for The WB in the top 100 markets. Additional coverage of approximately 6.6 million homes in 101 markets is provided by The WB 100+ Station Group, a venture between The WB and local broadcasters under which WB programming is disseminated over the facilities of local cable operators in markets 101-212.

Tribune Broadcasting owns a 22.25% interest in The WB. Key employees of The WB hold an 11% interest in the network and the balance is owned by a division of TWE.

OTHER NETWORK INTERESTS

The Company, through the Home Box Office division of TWE, holds a 50% interest in Comedy Central, an advertiser-supported basic cable television

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service, which provides comedy programming. Comedy Central was available in approximately 68 million homes at December 31, 2000.

The Company, through TWE, also holds a 50% interest in Court TV, which was available in approximately 53 million homes at December 31, 2000. Court TV is an advertiser-supported basic cable television service whose programming includes coverage of live and taped courtroom trials during the day and an expanded schedule focused on crime and criminal justice genre television series in prime time.

Through wholly owned subsidiaries, TBS owns the Atlanta Braves of Major League Baseball, the Atlanta Hawks of the National Basketball Association, and the Atlanta Thrashers of the National Hockey League. Each sports team is subject to the team rules and regulations of the league to which it belongs. The teams derive income from gate receipts, advertising and related sales, suite sales, local sponsorships and local media, and share pro rata in proceeds from national media contracts and licensing activities of the relevant league, as well as expansion fees.

COMPETITION

Each of the Networks competes with other television programming services for distribution on the limited number of channels available on cable and other television systems. All of the Networks compete for viewers' attention and audience share with all other forms of programming provided to viewers, including broadcast networks, local over-the-air television stations, other pay and basic cable television services, home video, pay-per-view services, online activities and other forms of news, information and entertainment. In addition, the Networks face competition for programming product with those same commercial television networks, independent stations, and pay and basic cable television services, some of which have exclusive contracts with motion picture studios and independent motion picture distributors. The Turner Networks, The WB and TBS's Internet sites compete for advertising with numerous direct competitors and other media.

The Cable Networks' production divisions compete with other producers and distributors of programs for air time on broadcast networks, independent commercial television stations, and pay and basic cable television networks.

MUSIC

The Company's worldwide recorded music and music publishing businesses are conducted under the umbrella name, Warner Music Group ('WMG'). In fall 2000, the Company announced that it had terminated its previously-announced agreement to combine WMG's global music operations with that of Britain's EMI Group plc.

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RECORDED MUSIC

In the United States, the Company's recorded music business is principally conducted through WMG's Warner Bros. Records Inc., Atlantic Recording Corporation, Elektra Entertainment Group Inc. and London-Sire Records Inc. and their affiliated labels, as well as through the WEA Inc. companies. WMG's recorded music activities are also conducted in over 70 countries outside the United States through various subsidiaries, affiliates and non-affiliated licensees.

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The WEA Inc. companies include WEA Manufacturing Inc., which manufactures compact discs (CDs), audio and videocassettes, CD-ROMs and DVDs for WMG's record labels, Warner Home Video and outside companies; Ivy Hill Corporation, which produces printed material and packaging for WMG's recorded music products as well as for a wide variety of other consumer products; and Warner-Elektra-Atlantic Corporation ('WEA Corp.'), which markets and distributes WMG's recorded music products to retailers and wholesale distributors. WMG also owns a majority interest in Alternative Distribution Alliance ('ADA'), an independent distribution company specializing in alternative rock, metal, hip hop and dance music with a focus on new artists.

DOMESTIC

WMG's major record labels in the United States -- Warner Bros., Atlantic, Elektra and London-Sire -- each with a distinct identity, discover and sign musical artists. The labels scout and sign talent in many different musical genres, including pop, rock, jazz, country, hip hop, rap, reggae, latin, folk, blues, gospel and Christian music. Among the artists that resulted in significant U.S. sales for WMG during 2000 were: Yolanda Adams, Barenaked Ladies, Green Day, Don Henley, Faith Hill, Kid Rock, Linkin Park, Madonna, matchbox twenty, Tim McGraw, Red Hot Chili Peppers and Third Eye Blind.

WMG is a vertically integrated music company. After an artist has entered into a contract with a WMG label, a master recording of the artist's music is produced and provided to WMG's manufacturing operation, WEA Manufacturing, which replicates the music primarily on CDs and audio cassettes. WEA Manufacturing is also the largest manufacturer of DVDs in the world. Ivy Hill prints material that is included with CDs, DVDs and audio cassettes and creates packaging for them. WEA Corp. and ADA, WMG's distribution arms, market and sell product and deliver it, either directly or through sub-distributors and wholesalers, to thousands of record stores, mass merchants and other retailers throughout the country. CDs and audio cassettes are also increasingly being sold directly to consumers through Internet retailers such as amazon.com and CDnow.

In January 2000, WMG entered into a consent order with the Federal Trade Commission with respect to the FTC's investigation of the Company's practices related to minimum advertised prices. Among other things, WMG has agreed that for seven years it will not make the receipt of any funds for cooperative advertising of its recorded music product contingent upon the price or price level at which such product is advertised or promoted.

In addition to newly released records, each of WMG's labels markets and sells albums from its extensive catalogs of prior releases, in which the labels generally continue to own the copyright in perpetuity. Rhino Records specializes in compilations and reissues of previously released music.

WMG also has entered into joint venture arrangements pursuant to which WMG companies manufacture, distribute and market (in most cases, domestically and internationally) recordings owned by joint ventures such as Maverick, 143 and Strictly Rhythm. Through a 50/50 joint venture, WMG and Sony Music Entertainment Inc. operate The Columbia House Company, a direct marketer of CDs, audio and videocassettes in North America.

WMG has actively pursued new media opportunities in the physical and digital arenas. It has been a driving force in establishing the DVD Audio format, launched in fall 2000, which improves on the CD by providing higher fidelity and six-channel surround sound. WMG has also made its recordings available for commercial digital downloading and by licensing its repertoire to Webcasters, such as Launch, MTV and ARTISTdirect, and digital 'locker' services, such as Musicbank and MP3.com. WMG's record labels' online sites collectively experience the second-largest traffic volume among all the major music companies.

During 2000, WMG and AOL initiated several successful cross-promotional endeavors. In September, Warner Bros. Records and Spinner teamed up for the launch of Madonna's latest album, Music. The promotion included a world premier global listening party followed by Madonna's first-ever live AOL chat with more than 120,000 fans. The album debuted the following week at No. 1 on the Billboard top-selling album chart. Earlier in the year, a matchbox twenty promotion with AOL, Spinner.com and Winamp.com helped drive matchbox twenty's mad season album to No. 1 on Billboard's Internet sales chart in its first week and to a No. 3 debut on the SoundScan Top 200. The CD version of this album contained AOL's registration software as well as software related to AOL-owned Spinner and Winamp Web sites.

INTERNATIONAL

The Warner Music International ('WMI') division of WMG operates through various subsidiaries and affiliates and their non-affiliated licensees in over 70 countries around the world. WMI engages in the same activities as WMG's domestic labels, discovering and signing artists and manufacturing, packaging, distributing and marketing their recorded music. The artists signed to WMI and its affiliates number more than a thousand. Significant album sales for WMI in 2000 were generated by the following artists: All Saints, Cher, Eric Clapton, Enya, Yuki Koyanagi, Luis Miguel, Laura Pausini, Alejandro Sanz and Helene Segara.

In most cases, WMI also markets and distributes the records of those artists for whom WMG's domestic record labels have international rights. In certain countries, WMI licenses to unaffiliated third-party record labels the right to distribute its records. WMI operates a plant in Germany that manufactures CDs and DVDs for its affiliated companies, as well as for outside companies and, as part of a joint venture, operates a plant in Australia that also manufactures CDs.

MUSIC PUBLISHING

WMG's music publishing companies, Warner/Chappell, own or control the rights to more than one million musical compositions, including numerous pop music hits, American standards, folk songs and motion picture and theatrical compositions. The catalogue includes works from a diverse range of artists and composers including Madonna, Eric Clapton, Jewel, George and Ira Gershwin, Radiohead and Cole Porter. Warner/Chappell also administers the music of several television and motion picture companies, including Lucasfilm, Ltd. and Hallmark Entertainment.

Warner/Chappell also owns Warner Bros. Publications, one of the world's largest publishers of printed music, which includes CPP/Belwin, acquired in 1995. Warner Bros. Publications markets publications throughout the world containing the works of such artists as Shania Twain, The Grateful Dead and Led Zeppelin and containing works from the Chrysalis, Zomba and Universal music publishing catalogs.

The principal source of revenues to Warner/Chappell is license fees paid for the use of its musical compositions on radio, television, in motion pictures and in other public performances; royalties for the use of its compositions on CDs, audio cassettes, music videos and in television commercials; and sales of published sheet music and song books.

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COMPETITION

The revenues of a company in the recording industry depend upon public acceptance of the company's recording artists and their music. Although WMG is one of the largest recorded music companies in the world, its competitive position is dependent on its continuing ability to attract and develop talent that can achieve a high degree of public acceptance. The competition among record companies for such talent is intense, as is the competition among companies to sell the recordings created by these artists. The recorded music business continues to be adversely affected by counterfeiting of both audio cassettes and CDs, piracy and parallel imports and also by Web sites and technologies that allow consumers to download quality sound reproductions from the Internet without authorization from the Company. In response, the recorded music industry has engaged in a coordinated effort to develop secure technologies for digital music delivery. Competition in the music publishing business is also intense. Although WMG's music publishing business is one of the largest on a worldwide basis,

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it competes with every other music publishing company in acquiring musical compositions and in having them recorded and performed. In addition, the vast majority of WMG's music publishing revenues are subject to rate regulation either by government entities or by collecting societies throughout the world.

PUBLISHING

The Company's Publishing business is conducted primarily by Time Inc., a wholly owned subsidiary of the Company, either directly or through its subsidiaries. Time Inc. is one of the world's leading magazine and book publishers and is one of the largest direct mail marketers.

MAGAZINES

GENERAL

As of March 1, 2001, Time Inc. published 64 magazines, including Time, People, Sports Illustrated, Fortune, Money, Entertainment Weekly and In Style. These magazines generally appeal to the broad consumer market.

New business activity during 2000 included the acquisition of Times Mirror Magazines, which as of March 1, 2001 published 23 magazine titles, including Golf, Ski, Skiing, Popular Science, Field and Stream and Yachting, and the launch of four new magazines, including Real Simple, a lifestyle magazine, and eCompany Now, a business magazine and Web site reporting on the Internet economy. During 2000, Time Inc. also entered into a joint venture with Essence Communications, Inc. to publish Essence Magazine and engage in other media activities. The joint venture will expand Time Inc.'s reach with African-American women and the African-American community at large.

Time Inc. also continues to expand its core magazine businesses through the development of product extensions. These are generally managed by the individual magazines and involve new magazines, specialized editions aimed at particular audiences, and publication of editorial content through different media, such as the Internet, books and television.

DESCRIPTION OF MAGAZINES

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Each magazine published by Time Inc. has an editorial staff under the general supervision of a managing editor and a business staff under the management of a president or publisher. Magazine production and distribution activities are generally centralized. Fulfillment activities for Time Inc.'s magazines are generally administered from a centralized facility in Tampa, Florida.

Time Inc.'s major magazines and their areas of editorial focus are summarized below:

Time is a weekly newsmagazine that summarizes the news and interprets the week's events, both national and international, across a spectrum of topics. Time also has five weekly English-language editions that circulate outside the United States. Time for Kids is a current events newsmagazine for children, ages 5-12.

People is a weekly magazine that reports on celebrities and other notable personalities. People has expanded its franchise in recent years to include People en Espanol, a Spanish-language edition aimed primarily at Hispanic readers in the United States, and Teen People, aimed at teenage readers. Who Weekly is an Australian version of People.

Sports Illustrated is a weekly magazine that covers a variety of competitive sports. New venues and magazine extensions have also been developed, including CNN/NI, a sports news cable television network and Web site that is operated as a joint venture between Sports Illustrated and CNN, Sports Illustrated for Women covering women's sports, and Sports Illustrated for Kids, which is intended primarily for pre-teenagers.

Time Inc. has other magazines also directed at readers' interests in celebrities and entertainers. In Style is a monthly magazine that focuses on fashion, beauty and celebrity lifestyles. In Style Australia was launched in 2000.

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Entertainment Weekly is a weekly magazine that includes reviews and reports on television, movies, video, music, books and multimedia.

Fortune is a bi-weekly magazine that reports on worldwide economic and business developments and compiles the annual Fortune 500 list of the largest U.S. corporations. Money is a monthly magazine that reports primarily on personal finance. Other business and financial magazines include FSB: Fortune Small Business, a business magazine covering small business, eCompany Now, a business magazine covering the Internet economy, and Mutual Funds, a personal finance magazine covering investing and financial planning.

Through Southern Progress Corporation and other subsidiaries, Time Inc. publishes several regional magazines including Southern Living; Sunset, The Magazine of Western Living; and several specialty publishing titles, including Cooking Light, Health, This Old House and Parenting.

Time Inc. also has management responsibility for most of the American Express Publishing Corporation's operations, including its core lifestyle magazines Travel & Leisure, Food & Wine and Departures.

ADVERTISING

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Advertising carried in Time Inc. magazines is predominantly consumer advertising, including computers and technology, domestic and foreign automobile manufacturers, financial, media and entertainment, toiletries and cosmetics, food, retail and department stores and pharmaceuticals. In 2000, Time Inc. magazines (including the Times Mirror magazines) accounted for nearly 25% of the total advertising revenue in consumer magazines, as measured by the Publishers Information Bureau (PIB). People, Time, Sports Illustrated and Fortune were ranked 1, 2, 3 and 5, respectively, by PIB, and Time Inc. had 8 of the 30 leading magazines in terms of advertising dollars.

CIRCULATION

Circulation drives the advertising rate base, which is the guaranteed minimum paid circulation level on which advertising rates are determined. Time Inc.'s magazines are primarily sold by subscription and delivered to subscribers through the mail. Subscriptions are sold by direct mail and online solicitation, subscription sales agencies, television and telephone solicitation and insert cards in Time Inc. magazines and other publications. During 2000, Time Inc. launched a successful cross-promotional campaign on AOL offering subscriptions to various Time Inc. magazines, generating more than 100,000 gross subscriptions per month. In return, among other things, Time Inc. enclosed AOL registration discs in certain of its magazines sent to subscribers.

Single copies of magazines are sold through retail news dealers and other outlets such as newsstands, supermarkets, and convenience and drug stores, which are supplied by wholesalers or directly through a Time Inc. subsidiary. Time Distribution Services Inc. is responsible for the national distribution and marketing of single copies of Time Inc. magazines and other publications. Warner Publisher Services Inc. is a major distributor of magazines and paperback books sold through wholesalers in the United States and Canada.

PAPER AND PRINTING

Lightweight-coated paper constitutes a significant component of physical costs in the production of magazines. During 2000, Time Inc. purchased its paper supplies principally from four independent manufacturers. Time Inc. has been able to obtain an adequate supply of paper to fulfill its needs in the past, but periodic shortages may occur in the event of strikes or other unexpected disruptions in the paper industry.

Printing and binding for Time Inc. magazines are performed primarily by major domestic and international independent printing concerns in approximately 20 locations. Magazine printing contracts are either fixed-term or open-ended at fixed prices with, in some cases, adjustments based on certain criteria.

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DIRECT MARKETING

Through subsidiaries, Time Inc. conducts world-wide direct mail marketing businesses. Time Life Inc. is one of the nation's largest direct marketers of entertainment products such as music and videos. Its products are sold, both as single products and products in sets, by direct response, including mail order, television and telephone, through retail channels and catalogs, and in some markets by independent distributors. Music and video rights are acquired through outside sources and compiled internally into finished products. Time Life's domestic direct response fulfillment activities are conducted from a centralized facility in Richmond, Virginia.

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In early 2000, Book-of-the-Month Club, Inc. ('BOMC') formed a 50-50 joint venture with Bertelsmann AG's Doubleday book clubs business to operate the U.S. book clubs of BOMC and Doubleday jointly. The joint venture, named Bookspan, acquires the rights to manufacture and sell books to consumers through clubs. Multimedia, audio and video products and other merchandise are also offered through the clubs. Bookspan operates its own fulfillment and warehousing operations from two locations in Pennsylvania.

BOOKS

Time Inc.'s trade publishing operations are conducted primarily by Time Warner Trade Publishing Inc. through its two major publishing houses, Warner Books and Little, Brown. In 2000, Time Warner Trade Publishing placed 37 books on The New York Times best-seller lists.

Time Warner Trade Publishing handles book distribution for Little, Brown and Warner Books, as well as other publishers, through its state-of-the-art distribution center in Indiana. The marketing of trade books is primarily to retail stores, online outlets and wholesalers throughout the United States, Canada and the United Kingdom. Through their combined United States and United Kingdom operations, Little, Brown and Warner Books have the ability to acquire English-language publishing rights for the distribution of hard and soft-cover books throughout the world.

Oxmoor House, Inc., Leisure Arts, Inc. and Sunset Books publish and distribute a variety of how-to books for the cooking, home repair, gardening, craft, needlework, decorating and travel markets.

POSTAL RATES

Postal costs represent a significant operating expense for the Company's magazine and book publishing activities. Publishing operations strive to minimize postal expense through the use of certain cost-saving measures, including the utilization of contract carriers to transport books and magazines to central postal centers. It has been the Company's practice in selling books and other products by mail to include a charge for postage and handling, which is adjusted from time to time to partially offset any increased postage or handling costs.

COMPETITION

Time Inc.'s magazine operations compete for audience and advertising with numerous other publishers and retailers, as well as other media. These businesses compete for advertising directed at the general public and also advertising directed at more focused demographic groups.

Time Inc.'s circulation efforts, as well as those of most other magazine publishers, have been adversely affected by developments in two principal distribution channels. The effectiveness of sweepstakes-based subscription efforts has declined significantly and recent consolidation among independent magazine wholesalers has resulted in decreased efficiencies for Time Inc. in retail magazine distribution.

Time Inc.'s direct marketing operations compete with other direct marketers through all media for the consumer's attention. In addition to the traditional media sources for product sales, the Internet is becoming a strong vehicle in the direct marketing business.

REGULATION AND LEGISLATION

The Company's cable television system, cable and broadcast television network and original programming businesses are subject, in part, to regulation by the Federal Communications Commission ('FCC'), and the cable television system business is also subject to regulation by some state governments and substantially all local governments in which the Company has cable systems. In addition, in connection with regulatory clearance of the AOL-Time Warner merger, the Company's cable system and Internet businesses are subject to compliance with the terms of the Consent Decree (the 'Consent Decree') issued by the Federal Trade Commission ('FTC'), the Order to Hold Separate issued by the FTC, the Memorandum Opinion and Order ('Order') issued by the FCC, and the Decision issued by the European Commission and the undertakings thereunder. The Company is also subject to an FTC consent decree (the 'Turner Consent Decree') as a result of the FTC's approval of Time Warner's acquisition of Turner Broadcasting System, Inc. in 1996.

The following is a summary of the terms of these orders as well as current significant federal, state and local laws and regulations affecting the growth and operation of these businesses. In addition, various legislative and regulatory proposals under consideration from time to time by Congress and various federal agencies have in the past materially affected, and may in the future materially affect, the Company.

FTC CONSENT DECREE

On December 14, 2000, the FTC issued a Consent Decree that imposes certain requirements that Time Warner Cable must follow in providing its subscribers with a choice of multiple Internet Service Providers ('ISPs') as part of its cable modem service. The Consent Decree terminates after five years.

The Consent Decree provides that, in each of Time Warner Cable's 20 largest divisions, Time Warner Cable cannot make available an 'affiliated broadband ISP' (e.g., America Online), other than Road Runner, until Earthlink (an unaffiliated ISP) is made available by Time Warner Cable in that division. Once an affiliated ISP, such as America Online, is made available in one of these Time Warner Cable divisions, that division must enter into two additional agreements with unaffiliated ISPs within 90 days. These agreements must be approved by the FTC.

In the remaining Time Warner Cable divisions, there is no requirement that Earthlink be made available before Time Warner Cable can begin providing service from an affiliated broadband ISP. However, once an affiliated broadband ISP is offered, Time Warner Cable must enter into agreements within 90 days with three additional unaffiliated broadband ISPs to serve those divisions. These agreements must be approved by the FTC. Earthlink's agreement with Time Warner Cable has been approved by the FTC.

The Consent Decree prohibits Time Warner Cable from discriminating against unaffiliated ISPs on the basis of affiliation in negotiations with unaffiliated cable broadband ISPs. However, Time Warner Cable may decline either to negotiate or to enter into agreements with ISPs based on cable broadband capacity constraints, cable broadband technical considerations or other cable broadband business considerations. The Consent Decree prohibits Time Warner Cable from

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interfering, on the basis of affiliation, with any content passed along bandwidth used by a non-affiliated ISP pursuant to its ISP agreement with Time Warner Cable, or from discriminating on the basis of affiliation in the transmission of content that Time Warner Cable has contracted to deliver to its subscribers. Furthermore, the Consent Decree prohibits Time Warner Cable from interfering with any interactive television signals, triggers or content that Time Warner Cable has agreed to carry.

The Consent Decree requires America Online to continue to offer and promote digital subscriber line service in areas served by Time Warner Cable on terms similar to the terms offered in areas not served by Time Warner Cable. America Online is also prohibited from entering into agreements with cable MSOs that restrict the ability of that MSO to enter into agreements with other ISPs or interactive television providers.

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FTC ORDER TO HOLD SEPARATE

On December 14, 2000, the FTC issued an Order to Hold Separate (the 'HSO') that requires the Company to hold separate and apart the businesses of America Online and Road Runner and prohibits the use of America Online in any way to advantage Road Runner and vice-versa. Joint marketing or advertising activities, cross-links or references to each other's services, the offering of similar formats or designs, and the hiring of each other's employees are specifically prohibited. The HSO terminates cable division-by-division as each Time Warner Cable division satisfies the conditions of the Consent Decree related to multiple ISPs described above.

FCC MEMORANDUM OPINION AND ORDER

On January 11, 2001, the FCC issued an Order imposing certain requirements over a five-year period regarding Time Warner Cable's provision of multiple ISPs. Specifically, the Order requires Time Warner Cable to provide ISP customers with a list of available ISPs upon request, to allow ISPs to determine the content on their first screen, and to allow ISPs to have direct billing arrangements with the subscribers they obtain. The Order prohibits Time Warner Cable from requiring customers to go through an affiliated ISP (e.g., America Online) to reach an unaffiliated ISP, from requiring ISPs to include particular content, and from discriminating on the basis of affiliation with regard to technical system performance (e.g., caching, quality of service mechanisms).

The FCC's Order also imposes conditions regarding possible future enhancements to America Online's instant messaging service. The Order prohibits America Online from offering 'advanced' instant messaging services (which are defined as streaming video applications that are not upgrades to America Online's current instant messaging products) that utilize a names and presence database ('NPD') over Time Warner Cable broadband facilities unless America Online satisfies one of three conditions: (i) America Online implements an industry-wide standard for server-to-server interoperability; (ii) America Online contracts with at least one unaffiliated provider of NPD based instant messaging services before offering 'advanced' instant messaging and, within 180 days thereafter, enters into two additional such contracts; or (iii) America Online demonstrates that these conditions no longer serve the public interest due to materially changed circumstances, e.g., if America Online shows that it has not been a dominant provider of NPD services for at least four consecutive months.

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In addition, the FCC's Order prohibits the Company from entering into any agreement with AT&T that gives any ISP affiliated with the Company exclusive carriage rights on any AT&T cable system for broadband ISP services or that affects AT&T's ability to offer rates or other carriage terms to ISPs that are not affiliated with the Company. The Order also requires the Company to notify the FCC of any increase in ownership interest in General Motors and/or Hughes Electronics within 30 days of such increase.

EUROPEAN COMMISSION DECISION/UNDERTAKINGS

On October 11, 2000, the European Commission issued a Decision pursuant to which the Company entered into a series of agreements known as 'undertakings.' These undertakings include a mechanism that is in place pursuant to which Bertelsmann AG will progressively exit from AOL Europe SA and AOL Compuserve France SAS. Until such exit is complete, Bertelsmann cannot exercise operational control over AOL Europe or AOL Compuserve France, and its relationship with America Online must be nonexclusive as to its provision and formatting of online music and as to its promotion of America Online's ISP services.

TURNER FTC CONSENT DECREE

The Company is also subject to the terms of a consent decree (the 'Turner Consent Decree') entered in connection with the FTC's approval of the acquisition of Turner Broadcasting System, Inc. ('TBS') by Time Warner in 1996. Certain requirements imposed by the Turner Consent Decree, such as carriage commitments for Time Warner Cable for the rollout of at least one independent national news video programming service, have been fully satisfied by the Company. Various other conditions remain in effect, including certain restrictions which prohibit the Company from offering programming upon terms that (1) condition the making available of,

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or the carriage terms for, the HBO service upon whether a multichannel video programming distributor carries a video programming service affiliated with TBS; and (2) condition the making available of, or the carriage terms for, CNN, WTBS and TNT upon whether a multichannel video programming distributor carries any video programming service affiliated with TWE. The Turner Consent Decree also imposes certain restrictions on the terms by which a Turner video programming service may be offered to an unaffiliated programming distributor that competes in areas served by Time Warner Cable.

Other conditions of the Turner Consent Decree prohibit Time Warner Cable from requiring, as a condition of carriage, that any national video programming vendor provide a financial interest in its programming service or that such programming vendor provide exclusive rights against any other multichannel programming distributor. In addition, Time Warner Cable may not discriminate on the basis of affiliation in the selection, terms or conditions of carriage for national video programming vendors. The Turner Consent Decree expires in 2006.

CABLE SYSTEM REGULATION

FEDERAL LAWS. The Communications Act of 1934, as amended (the 'Act') regulates the business of operating cable television systems, including, with

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respect to: (i) cable systems rates for basic service, equipment and installation (cable rates for nonbasic service tiers have not been regulated since March 31, 1999); (ii) access to cable channels for public, educational and governmental programming and for leased access; (iii) horizontal and vertical ownership of cable systems; (iv) consumer protection and customer service requirements; (v) franchise renewals; (vi) television broadcast signal carriage requirements and retransmission consent; (vii) technical standards; (viii) certain restrictions regarding ownership of cable television systems and (ix) privacy of customer information.

Rate Regulation. The FCC's rate regulations assess the reasonableness of existing basic service rates, although cable operators can, in some cases, justify rates above the applicable benchmarks. The regulations also address future basic service rate increases. Local franchising authorities are generally empowered to order a reduction of existing rates that exceed the maximum permitted level for basic service and associated equipment, and refunds can be required. If a cable operator can establish that it is subject to 'effective competition' from other multi-channel video providers (e.g., DBS) in a community, rate regulation ceases.

Signal Carriage and Retransmission Consent. The Act allows commercial television broadcast stations that are 'local' to a cable system to elect every three years either to require the cable system to carry the station, subject to certain exceptions, or to negotiate for consent to carry the station. Broadcast stations may seek monetary or non-monetary compensation in return for granting retransmission consent. Local non-commercial television stations are also generally given mandatory carriage rights. In addition, cable systems must obtain retransmission consent for the carriage of all 'distant' commercial broadcast stations, except for certain 'superstations,' i.e., commercial satellite-delivered independent stations such as WGN. Time Warner Cable has obtained retransmission consent agreements for the current three year election cycle, which ends December 31, 2002, with the majority of broadcasters, but certain broadcasters have only agreed to short-term arrangements to permit continued negotiations. If Time Warner Cable and a particular broadcaster cannot agree on retransmission consent terms, the broadcaster could require Time Warner Cable to cease carriage of the broadcaster's signal, possibly for an indefinite period.

Ownership. Local exchange telephone companies ('LECs') generally may not acquire more than a 10% equity interest in an existing cable system operating within the LEC's service area, although they may operate cable television systems in those areas. LECs and others also may operate 'open video systems' ('OVS') which are not subject to the full array of regulatory obligations imposed on traditional cable systems, although OVS operators can be required to obtain a franchise by a local governmental body and/or to make payments in lieu of cable franchise fees. A number of separate entities have been certified to operate open video systems in areas where the Company operates cable systems, including New York City, Milwaukee, Kansas City and a number of cities in Texas. Current FCC rules also restrict cable/television station cross-ownership in a given location. Time Warner Cable is currently a party to a federal court litigation challenging the validity of this requirement. Under the Act, cable operators are also generally

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prohibited from having common ownership, control or interest in MMDS facilities or SMATV systems with overlapping service areas, except in limited circumstances. There is also an ongoing rulemaking before

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the FCC to determine whether cable operators should be restricted from owning or operating a competing direct broadcast satellite service ('DBS').

Horizontal and Vertical Ownership Limits. Pursuant to the Act, the FCC had adopted limits on the number of cable subscribers an operator may reach through systems in which it holds an attributable interest. The FCC's rule imposes a limit of 30% of all cable, DBS and other multi-channel video provider subscribers nationwide. Pursuant to the Act, the FCC also adopted rules that, with certain exceptions, preclude a cable television system from devoting more than 40% of its first 75 activated channels to national video programming services in which the cable system owner has an attributable interest. Those rules have now been invalidated by the Court of Appeals for the District of Columbia and remanded to the FCC for further consideration.

In addition to the Act, cable television systems are also subject to federal copyright licensing covering carriage of broadcast signals. In exchange for making semi-annual payments to a federal copyright royalty pool and meeting certain other obligations, cable operators obtain a statutory license to retransmit broadcast signals. The amount of this royalty payment varies, depending on the amount of system revenues from certain sources, the number of distant signals carried, and the location of the cable system with respect to over-the-air television stations.

STATE AND LOCAL REGULATION. Because a cable television system uses local streets and rights-of-way, cable television systems are subject to local regulation, typically imposed through the franchising process, and certain states have also adopted cable television legislation and regulations. Cable franchises are nonexclusive (and municipalities are entitled to operate competing systems), granted for fixed terms and usually terminable if the cable operator fails to comply with material provisions. No Time Warner Cable franchise has been terminated due to breach. Franchises usually call for the payment of fees (which are limited under the Act to a maximum of 5% of the system's gross revenues from cable service) to the granting authority. The terms and conditions of cable franchises vary materially from jurisdiction to jurisdiction, and even from city to city within the same state, historically ranging from reasonable to highly restrictive or burdensome.

RENEWAL OF FRANCHISES. In the renewal process, a franchising authority may seek to impose new and more onerous requirements, such as upgraded facilities, increased channel capacity or enhanced services, although protections available under the Act require the municipality to take into account the cost of meeting such requirements. Time Warner Cable may be required to make significant additional investments in its cable television systems as part of the franchise renewal process. Although Time Warner Cable has been successful in the past in negotiating new franchise agreements, there can be no assurance as to the renewal of franchises in the future. The Act contains renewal procedures and criteria designed to protect incumbent franchisees against arbitrary denials of renewal.

NETWORK REGULATION

Under the Act and its implementing regulations, vertically integrated cable programmers like the Turner Networks and the Home Box Office Services, are generally prohibited from offering different prices, terms, or conditions to competing unaffiliated multichannel video programming distributors unless the differential is justified by certain permissible factors set forth in the regulations. The rules also place certain restrictions on the ability of vertically integrated programmers to enter into exclusive distribution arrangements with cable operators. Certain other federal laws also contain provisions relating to violent and sexually explicit programming, including relating to the voluntary promulgation of ratings by the industry and requiring manufacturers to build television sets with the capability of blocking certain

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coded programming (the so-called 'V-chip').

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DESCRIPTION OF AGREEMENT WITH LIBERTY MEDIA CORPORATION

The following description summarizes certain provisions of the Company's agreement with Liberty Media Corporation (an affiliate of AT&T) and certain of its subsidiaries (collectively, 'LMC') that was entered into in connection with the merger of Turner Broadcasting System, Inc. in 1996 (the 'TBS Transaction') and the Turner Consent Decree. Such description does not purport to be complete and is subject to, and is qualified in its entirety by reference to, the provisions of the Second Amended and Restated LMC Agreement dated as of September 22, 1995 among the Company, Time Warner Companies, Inc. and LMC (the 'LMC Agreement').

OWNERSHIP OF AOL TIME WARNER COMMON STOCK

Pursuant to the LMC Agreement, immediately following consummation of the TBS Transaction, LMC exchanged the 50.6 million shares of Time Warner common stock, par value \$.01 per share ('Time Warner Common Stock'), received by LMC in the TBS Transaction on a one-for-one basis for 50.6 million shares of Series LMCN-V Common Stock. In June 1997, LMC and its affiliates received 6.4 million additional shares of Series LMCN-V Common Stock pursuant to the provisions of an option agreement between Time Warner and LMC and its affiliates. In May 1999, the terms of the Series LMCN-V Common Stock were amended which effectively resulted in a two-for-one stock split. At the time of the AOL-Time Warner merger, each share of Series LMCN-V Common Stock was exchanged for one and one half shares of a substantially identical Series LMCN-V Common Stock of AOL Time Warner. Each share of Series LMCN-V Common Stock receives the same dividends and otherwise has the same rights as a share of AOL Time Warner Common Stock except that (a) holders of Series LMCN-V Common Stock are entitled to 1/100th of a vote per share on the election of directors and do not have any other voting rights, except as required by law or with respect to limited matters, including amendments to the terms of the Series LMCN-V Common Stock adverse to such holders, and (b) unlike shares of AOL Time Warner Common Stock, shares of Series LMCN-V Common Stock are not subject to redemption by the Company if necessary to prevent the loss by the Company of any governmental license or franchise. The Series LMCN-V Common Stock is not transferable, except in limited circumstances, and is not listed on any securities exchange.

LMC exchanged its shares of Time Warner Common Stock for Series LMCN-V Common Stock in order to comply with the Turner Consent Decree, which effectively prohibits LMC and its affiliates (including TCI) from owning voting securities of the Company other than securities that have limited voting rights. Each share of Series LMCN-V Common Stock is convertible into one share of AOL Time Warner Common Stock at any time when such conversion would no longer violate the Turner Consent Decree or have a Prohibited Effect (as defined below), including following a transfer to a third party.

OTHER AGREEMENTS

Under the LMC Agreement, if the Company takes certain actions that have the effect of (a) making the continued ownership by LMC of the Company's equity securities illegal under any federal or state law, (b) imposing damages or penalties on LMC under any federal or state law as a result of such continued

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ownership, (c) requiring LMC to divest any such Company equity securities, or (d) requiring LMC to discontinue or divest any business or assets or lose or significantly modify any license under any communications law (each a 'Prohibited Effect'), then the Company will be required to compensate LMC for income taxes incurred by it in disposing of all the Company's equity securities received by LMC in connection with the TBS Transaction and related agreements (whether or not the disposition of all such equity securities is necessary to avoid such Prohibited Effect).

The agreements described in the preceding paragraph may have the effect of requiring the Company to pay amounts to LMC in order to engage in (or requiring the Company to refrain from engaging in) activities that LMC would be prohibited under the federal communications laws from engaging in. Based on the current businesses of the Company and LMC and based upon the Company's understanding of applicable law, the Company does not expect these requirements to have a material effect on its business.

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DESCRIPTION OF CERTAIN PROVISIONS OF THE TWE PARTNERSHIP AGREEMENT

The following description summarizes certain provisions of the TWE Partnership Agreement relating to the ongoing operations of TWE. Such description does not purport to be complete and is subject to, and is qualified in its entirety by reference to, the provisions of the TWE Partnership Agreement.

MANAGEMENT AND OPERATIONS OF TWE

PARTNERS. The limited partnership interests in TWE are held by the Class A Partners consisting of a subsidiary of AT&T, MediaOne TWE Holdings, Inc. ('MediaOne') and wholly owned subsidiaries of the Company and the general partnership interests in TWE are held by the Class B Partners consisting of wholly owned subsidiaries of the Company (the "AOLTW General Partners").

BOARD OF REPRESENTATIVES. The business and affairs of TWE are managed under the direction of a board of representatives (the 'Board of Representatives' or the 'Board') that is comprised of representatives appointed by subsidiaries of AOL Time Warner (the 'AOLTW Representatives') and representatives appointed by AT&T (the 'AT&T Representatives').

The AOLTW Representatives control all Board decisions except for certain limited, significant matters affecting TWE as a whole, which matters also require the approval of the AT&T Representatives.

The managing general partners, both of which are wholly owned subsidiaries of AOL Time Warner, may take any action without the approval or consent of the Board if such action may be authorized by the AOLTW Representatives without the approval of the AT&T Representatives.

CABLE MANAGEMENT COMMITTEE. Prior to August 1999, the businesses and operations of the cable television systems ('Cable Systems') of TWE and the TWE-A/N Partnership were governed by a Cable Management Committee (the 'Management Committee') comprised of six voting members, three designated by MediaOne and three designated by TWE. In August 1999, TWE received a notice from MediaOne concerning the termination of its covenant not to compete with TWE. As a result of the termination notice and the operation of the TWE partnership

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agreement, MediaOne's rights to participate in the management of TWE's businesses, including its rights to membership on the Management Committee, terminated immediately and irrevocably. However, MediaOne retains its representation on the TWE Board of Representatives as described above.

DAY-TO-DAY OPERATIONS. TWE is managed on a day-to-day basis by the officers of TWE, and each of TWE's principal divisions is managed on a day-to-day basis by the officers of such division.

CERTAIN COVENANTS

COVENANT NOT TO COMPETE. AT&T ceased to be bound by the covenant not to compete as of August 2000. For so long as any other partner (or affiliate of any partner) owns in excess of 5% of TWE and in the case of any AOLTW General Partner, for one year thereafter, such partner (including its affiliates) is generally prohibited from competing or owning an interest in the principal lines of business of TWE -- cable television systems, pay cable programming networks and filmed entertainment, subject to certain exceptions (which include TBS and its businesses). The covenant not to compete also does not prohibit (i) any party from engaging in the cable business in a region in which TWE is not then engaging in the cable business, subject to TWE's right of first refusal with respect to such cable business, or (ii) any party from engaging in the telephone or information services business.

TRANSACTIONS WITH AFFILIATES. Subject to agreed upon exceptions for certain types of arrangements, TWE has agreed not to enter into transactions with any partner or any of its affiliates other than on an arm's-length basis.

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REGISTRATION RIGHTS

Within 60 days after June 30, 1999,