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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

PARAMOUNT COMMUNICATIONS INC. and KDS ACQUISITION CORP., Plaintifffs,	:	
- against -	:	
TIME INCORPORATED, TW SUB INC., JAMES F. BERE, HENRY C. GOODRICH, CLIFFORD J. GRUM, MATINA S. HORNER, DAVID T. KEARNS, GERALD M. LEVIN, J. RICHARD MUNRO, N.J. NICHOLAS, JR., DONALD S. PERKINS, CLIFTON R. WHARTON, MICHAEL D. DINGMAN, EDWARD S. FINKELSTEIN, HENRY LUCE III, JASON D. McMANUS, JOHN R. OPEL, and WARNER COMMUNICATIONS INC. Defendants.	:	C.A. No.

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

AFFIDAVIT OF STEPHEN M. WATERS

STEPHEN M. WATERS, being duly sworn, states:

1. I am a managing director of Morgan Stanley & Co. Inc. ("Morgan Stanley"), which has acted as financial advisor to Paramount Communications Inc. ("Paramount") on various matters, including its potential acquisition of defendant Time Incorporated ("Time"). Paramount has acquired an equity interest in Time, and, through KDS Acquisition Corp., intends to acquire Time. I submit this affidavit in support of Plaintiffs' application to enjoin Defendants from taking any steps to implement the terms of

the Time Warner Share Exchange Agreement, as amended ("Lock-Up Stock Swap").

2. I received a B.A. from Harvard College in 1968 and an MBA from Harvard Business School in 1974 after serving as an officer in the U.S. Navy. After receiving my MBA, I joined Lehman Brothers as an Associate in investment banking and became a Managing Director in 1980. From 1985 through 1988 I co-managed the Mergers and Acquisitions Department of Shearson Lehman Brothers. In 1988 I joined Morgan Stanley as a Managing Director in the Mergers and Acquisition Department. In the 15 years that I have worked as an investment banker, I have participated in dozens of transactions involving mergers and acquisitions, representing a variety of clients in both unsolicited and negotiated transactions.

3. I have reviewed publicly available information concerning Time and the proposed merger of Time and Warner, Inc. ("Warner"), including, among other information, the following documents which are included in Plaintiffs' Appendix of Exhibits: Time's Restated Certificate of Incorporation, dated April 16, 1987 (Exhibit E); the Agreement and Plan of Merger between Time and Warner, dated March 3, 1989 ("Merger Agreement") (Exhibit B); the Lock-Up Stock Swap, dated March 3, 1989, as amended (Exhibit D); and the Time Warner Joint Proxy Statement, dated May 22, 1989 ("Proxy Statement") (Exhibit C).

The Merger Transfers Control of Time

4. Under the terms of the Merger Agreement, each share of Warner stock is to be exchanged for 0.465 of a share of Time, and Warner is to be merged into a Time subsidiary. Time's current stockholders will retain their shares of Time. The name of Time will be changed to Time Warner and all Time shares, including those shares issued to Warner stockholders and those shares now held by current Time stockholders, will become Time Warner shares.

5. The Time/Warner "merger" constitutes in reality a sale of control of Time to Warner stockholders, who will control a majority of the voting power of Time when the transaction is completed. Indeed, at the exchange ratio of 0.465 set forth in the Merger Agreement, Warner stockholders will control approximately 62% of the voting power of Time Warner, while the interest of the present Time stockholders will be reduced from 100% to 38%.

6. Moreover, besides losing control of Time, the Time stockholders will also suffer a more immediate economic loss because they will receive less than the market equivalent in Warner shares for the newly issued Time stock. For the year preceding the Time/Warner transaction the exchange ratio for an equal exchange of shares based upon the respective market prices of Time and Warner ranged from 0.30 of a Time share for each Warner share to 0.420 of a Time share for each Warner share.

However, seemingly to induce Warner to enter the merger, Time management agreed to a premium exchange ratio of 0.465 for each Warner share; a severe penalty to Time even when compared to the 0.420 high. The result is that control (62%) of Time is being sold by management at a discount from market price, in stark contrast to the normal sale of control at a substantial premium.

7. Based upon the March 3, 1989 price of the respective stocks and the exchange ratio fixed in the Merger Agreement, Warner stockholders received a premium of $4.87 per share or 10.6% over the then-market value of their holdings. At the March 3 prices, the total premium Time agreed to pay to exchange its shares for the 166,432,716 outstanding Warner shares was $810,527,327. Since there are 56,977,150 outstanding shares of Time stock, this cost translates into a per share cost for Time stockholders of $14.23 per Time share or 13%. Thus, Time stockholders are surrendering control of their company, while Warner stockholders are simultaneously acquiring their controlling interest at a discount.

8. Time and Warner entered into a Lock-Up Stock Swap on the same day that they entered the Merger Agreement, March 3, 1989. Under the terms of the Lock-Up Stock Swap, Time and Warner agreed to exchange 7,080,016 shares of Time common stock (11% after dilution) for 17,292,747 shares of Warner common stock (9.4% after dilution). As originally conceived, the Lock-Up Stock Swap

permitted Time and Warner to effect the exchange at any time prior to the proposed merger after satisfying several nominal conditions.

9. On April 12, 1989, Time acknowledged in Amendment No. 2 to its Form 13D relating to the Lock-Up Stock Swap ("Amendment No. 2") (Plaintiffs' Exhibit D) that the Securities and Exchange Commission ("SEC") had informed Time and Warner that if the share exchange contemplated by the Lock-Up Stock Swap were to occur, the merger could not receive "pooling of interests" accounting treatment. Without the benefit of such "pooling of interests" treatment, the newly-formed Time Warner will be forced to charge substantial non-deductible amounts of "goodwill" against the income of the combined companies. In my opinion this factor will adversely effect the price of the Time Warner shares if Time and Warner nonetheless proceed to implement the merger.

10. Both Time and Warner understand the detrimental effect of losing pooling of interests treatment. Indeed, the Merger Agreement expressly provides that either party may terminate the Agreement in the event that the exchange of shares contemplated by the Lock-Up Stock Swap occurs and precludes pooling of interests treatment. As disclosed in Amendment No. 2, Time and Warner responded to the SEC's adverse accounting decision by amending the Lock-Up Stock Swap to provide, in effect, that the exchange of shares will occur only upon the demand

of either party issued after the announcement of a competing bid for either Time or Warner. Upon such demand, the exchange must occur within five business days.

11. In light of this amendment and the fact that either party may terminate the merger if the share exchange occurs, the only conceivable purpose for the Lock-Up Stock Swap is to discourage competing bids. There simply is no legitimate corporate purpose served by a share exchange agreement that will have such substantial negative effects on Time Warner and its stockholders in the event that an exchange of shares actually occurs.

12. The restrictions placed on the Lock-Up Stock Swap shares confirm that the transaction has no legitimate business purpose. For example: (i) the shares have no independent voting rights, except in the event of a third-party proxy solicitation concerning matters unrelated to the proposed Merger (including the business combination Plaintiffs intend to effect following the consummation of Plaintiffs' offer); (ii) neither Time nor Warner may sell, assign, pledge or otherwise dispose of or transfer the shares it has acquired pursuant to the Lock-Up Stock Swap prior to the termination of the Warner Merger Agreement and thereafter significant restrictions limit sale or transfer; and (iii) the Lock-Up Stock Swap prohibits each party from acquiring additional shares or joining a group owning additional shares in, proposing a

business combination with, soliciting proxies with respect to the shares of, or acquiring material assets of the other party.

Stephen M. Waters

Sworn to before me this
6th day of June, 1989

Virginia De Angelo
Notary Public

VIRGINIA DE ANGELO
Notary Public, State of New York
No. 52-4707035
Qualified in Suffolk County
Commission Expires April 30, 1991