

# FINANCE DIRECTOR'S REPORT

Year ended 30 September	2002 £m	2001 (as restated) £m
Continuing operations EBITDA (before exceptionals)	91.7	96.6
Depreciation	<b>(23.0)</b>	(22.4)
Group EBITA before exceptional items	<b>68.7</b>	74.2
Share of operating results of joint ventures and associates	<b>(3.4)</b>	(8.4)
Total EBITA before exceptional items	<b>65.3</b>	65.8
Amortisation	<b>(15.5)</b>	(17.4)
Joint venture goodwill amortisation	<b>(2.1)</b>	–
Total operating profit (EBIT) before exceptional operating items	<b>47.7</b>	48.4
Exceptional operating items	<b>4.8</b>	(52.4)
Reported profit/(loss) before interest and tax (EBIT) on continuing businesses	<b>52.5</b>	(4.0)
Amounts written off investments	<b>(8.2)</b>	–
Net interest charges	<b>(12.0)</b>	(35.6)
<b>Continuing operations profit before taxation</b>	<b>32.3</b>	(39.6)
Discontinued operations		
– operating loss	<b>(101.7)</b>	(142.6)
– exceptional loss on sale/closure of business	<b>(86.8)</b>	(227.0)
<b>Discontinued operations loss before taxation</b>	<b>(188.5)</b>	(369.6)
<b>Total Group loss before taxation</b>	<b>(156.2)</b>	(409.2)

## OVERVIEW

In the year to 30 September 2002, profit before interest, amounts written off investments and tax from continuing businesses rose to £52.5m from a loss of £4.0m in 2001. Reported profit before tax from continuing operations was £32.3m compared to a loss of £39.6m in 2001.

## PROFIT ANALYSIS

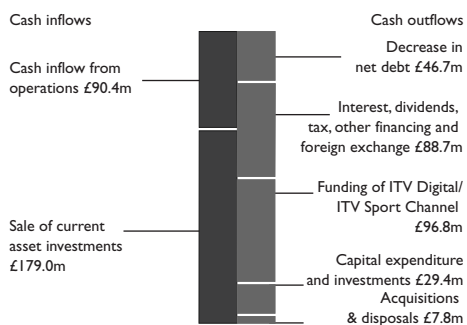
Continuing operations profit before amortisation, interest, tax, exceptional items and amounts written off investments was £65.3m in 2002 (2001: £65.8m).

Results for 2001 have been restated to reflect the closure of ITV Digital and ITV Sport Channel and the sale of other digital media businesses in discontinued operations in accordance with FRS 3.

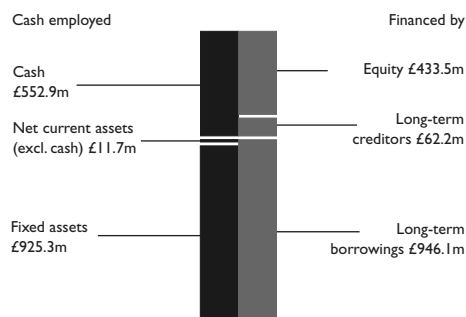
Loss before interest and tax for 2001 as restated is reconciled in the table below:

Year ended 30 September 2001	Continuing operations £m	Discontinued operations £m
Loss before interest and taxation as reported in 2001 accounts	(195.8)	(177.8)
Closure of ITV Digital and ITV Sport Channel	175.7	(175.7)
Sale of Ask Jeeves	16.1	(16.1)
<b>Loss before interest and and taxation as restated</b>	<b>(4.0)</b>	<b>(369.6)</b>

## Analysis of net cash movement – 2002



## Capital Employed – 2002



EBITDA from continuing operations, before operating exceptional items, was £91.7m, down 5 per cent on 2001 (£96.6m). The corresponding figures for the second half of the year show an increase from £22.0m to £48.0m. EBITDA is calculated as operating profit before interest, tax, depreciation, amortisation, amounts written off investments and the share of results from associates and joint ventures.

The changes in EBITDA before operating exceptional items from 2001 to 2002 is reconciled in the table below:

	£m
<b>Year ended 30 September 2001</b>	<b>96.6</b>
Year-on-year charges	
Advertising revenue and sponsorship – like-for-like	(47.8)
HTV October revenues	7.6
PQR and licence fees	18.7
Network schedule – like-for-like	(19.8)
Network schedule – Stock adjustments	(6.5)
Network schedule – HTV October costs	(4.1)
HTV – Other October costs	(5.5)
Digital satellite transmission costs	(10.3)
Cessation of loss-making activities and other cost savings achieved	54.2
Other net movements	8.6
<b>Year ended 30 September 2002</b>	<b>91.7</b>

The slowdown in advertising revenues and increased network schedule costs (resulting from both higher investment in the ITV schedule and stock adjustments) were the primary reasons for the fall in earnings in the year. These were largely offset by a series of cost saving initiatives and the scaling down of loss-making internet and digital channel activities. Operating costs and overheads were reduced by £54.2m, a 10 per cent reduction against 2001 excluding network costs and licence fees. This total comprises savings of £18.1m from operating costs and overheads and £36.1m from the scaling down of businesses.

EBITA before operating exceptional items decreased by 7 per cent to £68.7m (2001: £74.2m). This was primarily due to the reduction in television advertising revenues in the first half of the year. In the second half EBITA increased from £11.2m in 2001 to £36.0m in 2002.

## TURNOVER

A breakdown of revenues from continuing operations is set out below.

### Group Turnover

Year ended 30 September	2002 £m	2001 (as restated) £m
Broadcasting (excluding Screen Advertising)	739.4	772.7
Screen Advertising	60.1	57.4
Broadcasting	799.5	830.1
Content	165.1	181.7
Other (Screenvision US as a subsidiary)	–	28.3
<b>Total</b>	<b>964.6</b>	1,040.1

Like-for-like turnover from continuing operations, adjusted for the additional month of HTV revenue (£7.6m) and excluding Screenvision during the time that it was a 100 per cent owned subsidiary in 2001 (£28.3m), fell by 5 per cent. This was mainly due to a weaker television advertising market in the first half (down 12 per cent), partially offset by recovery in the second half (up 2 per cent). Reported turnover from continuing operations was £964.6m in 2002, 7 per cent lower than 2001 (£1,040.1m restated).

### Group EBITA before exceptional items

Year ended 30 September	2002 £m	2001 (as restated) £m	Change %
Broadcasting	67.4	83.3	(19)
Content	10.1	1.4	
Other (including Screenvision US in 2001)	(8.8)	(10.5)	16
<b>EBITA</b>	<b>68.7</b>	74.2	(7)

## BROADCASTING

Broadcasting profits were reduced primarily due to lower NAR and increased network programme budget costs. This was partly offset by reduced licence payments, increased profits from Carlton Screen Advertising and cost savings achieved from the scaling-down of loss-making digital channel operations.

## Licence payments

Payments to the Government for the Group's wholly owned broadcasting licences are a significant element of the costs. In 2002 these payments totalled £100.8m before digital satellite costs (2001: £119.5m) and were made up of cash bids of £26.0m (2001: £19.9m) and Percentage of Qualifying Revenue ("PQR") payments of £74.8m (2001: £99.6m).

The PQR rates applicable to advertising and sponsorship revenue during the year were 20 per cent for Carlton London, 17 per cent for Carlton Midlands, 13 per cent for Carlton West Country and 7 per cent for HTV.

Carlton London's cash bid was £16.9m, Carlton West Country's £1.2m, Carlton Midland's £5.7m (this rose from £2,600 per annum, plus RPI, as of 1 January 2002) and HTV's £2.2m. No PQR is payable on the proportion of revenues attributed to the viewing of digital ITV services. As digital penetration increases in the future, the proportion of the advertising and sponsorship revenues attracting PQR will fall. The effect of this was to reduce PQR payments by £35m (2001: £10m). This benefit was partly offset by digital satellite transmission costs that commenced in November 2001 at a cost of £10.3m (2001: nil).

## CONTENT

Content mainly consists of Carlton Productions and Carlton International. The improved profits have been achieved mainly through cost savings and the scaling-down of loss-making internet businesses.

## OTHER

Group overheads net of rental income and Group foreign exchange differences amount to a net cost of £8.8m (2001: £10.5m net of £3.5m profits from Screenvision as a subsidiary).

## JOINT VENTURES AND ASSOCIATES

Losses from joint ventures and associated companies before interest reduced to £3.4m before amortisation (2001: £8.4m). Amortisation costs were £2.1m (2001: £nil).

The improvement in the year resulted principally from reduced losses in ITV2 and the return to profitability of ITN. The Group's share of ITV2 losses was £7.2m (2001: £9.7m) and ITN profits were £1.8m (2001: loss £1.5m).

## EXCEPTIONAL ITEMS

Exceptional items relating to the period can be analysed as follows:

	Continuing £m	Discontinued – closure costs £m	Discontinued – sale of businesses £m	Total exceptional costs £m
<b>Exceptional operating charges</b>				
Restructuring costs	(2.8)	–	–	(2.8)
Litigation (net)	18.6	–	–	18.6
Asset write-downs	(11.0)	–	–	(11.0)
	4.8	–	–	4.8
<b>Exceptional charges</b>				
ITV Digital and ITV Sport Channel				
– Balances written-off	–	(34.6)	–	(34.6)
– Closure costs	–	(64.0)	–	(64.0)
Technicolor sale adjustments	–	–	17.9	17.9
Sale of other investments	–	–	(6.1)	(6.1)
	–	(98.6)	11.8	(86.8)

Litigation (net) is the aggregate of legal costs and settlements. Asset write-downs principally relate to asset write-downs in the content business.

## AMOUNTS WRITTEN OFF INVESTMENTS

A provision of £8.2m was made against Carlton shares held by the Group in various employee share schemes, reducing the carrying value to the year end share price.

## INTEREST

Net interest charges were £12.0m (2001: £35.6m). The tables below show the constituent elements of the net interest charge and a reconciliation from the 2001 figure.

	£m
Interest payable	(50.4)
Benefits from swaps	19.3
Money market deposits	16.0
Loan notes	4.0
Amortisation of fees and fx differences	(0.9)
Net interest charge 2002	(12.0)
Net interest charge 2001	(35.6)
Lower interest rates	15.8
Lower debt balances	5.8
Foreign exchange gains on financing	2.0
Net interest charge 2002	(12.0)

The main reason for the lower net interest charge in 2002 was the benefit gained from swapping fixed rate sterling debt into floating rate dollar cost of finance (without currency risk) prior to September 2001, before short-term US interest rates were cut to historically low levels. The low financing cost of the Exchangeable bond and lower net interest bearing balances were the other primary reasons.

## DISCONTINUED OPERATIONS

Discontinued operations relate to the pre-closure results and closure cost provisions for ITV Digital and ITV Sport Channel, further receipts from the disposal of Technicolor and other business disposals. The 2001 results have been restated to include ITV Digital and ITV Sport Channel in discontinued operations. The exceptional charges relating to ITV Digital and ITV Sport Channel in 2002 comprise £34.6m of balances written-off and a provision for closure costs of £64.0m of which cash costs to date are £14.1m.

## EARNINGS PER SHARE

Earnings per share from continuing operations, before exceptional items, amortisation and investment write-downs were 4.8p compared to 2.0p in 2001. Earnings are defined as profits after tax and preference dividends.

After amortisation and investment write-downs the figure was 1.0p (2001: (0.6)p).

<b>Basic earnings per share</b>	<b>2002</b>	<b>2001</b>
	pence	(as restated) pence
Continuing operations – pre-exceptionals	<b>1.0</b>	(0.6)
Exceptional items after tax	<b>1.0</b>	(7.5)
Continuing operations – post-exceptionals	<b>2.0</b>	(8.1)
Discontinued operations	<b>(26.8)</b>	(51.6)
<b>Reported earnings per share</b>	<b>(24.8)</b>	(59.7)
Continuing operations – pre-exceptionals (as above)	<b>1.0</b>	(0.6)
Amortisation	<b>2.6</b>	2.6
Amounts written off investments	<b>1.2</b>	–
Continuing operations pre-exceptionals, amortisation and investment write-downs	<b>4.8</b>	2.0

Diluted reported earnings per share figures are unchanged from those above.

## DIVIDENDS

The proposed final dividend of 5.0p per Ordinary share, together with the interim dividend of 3.275p per Ordinary share already paid, makes a total for the year of 8.275p per Ordinary share (2001: 8.275p).

## CASH FLOW

Net cash inflow in 2002 was £245.9m (2001: £65.0m) after tax, interest and preference dividend payments but before all investment. The increase was primarily due to the sale of loan notes in the year (£179.0m). Working capital increased by £11.6m (2001: £7.3m) primarily due to reductions in creditors as a result of the scaling down of loss-making digital ventures.

Cash outflows included capital expenditure of £11.7m and loan funding and closure cost payments relating to the ITV Digital and ITV Sport Channel businesses of £96.8m.

Net interest paid was £18.0m (2001: £32.5m). The decrease in financing costs was due to interest rate swap benefits as a result of lower interest rates offset by the purchase of a euro currency call option. The cash cost of preference dividends was £10.5m (2001: £10.5m).

Tax repaid was £4.2m (2001: £3.1m).

Capital expenditure of £11.7m (2001: £43.1m) was significantly reduced following the sale of Technicolor in March 2001.

Net outflows from acquisitions and disposals totalled £7.8m (2001: £273.5m inflow). In 2002 this related to the purchase of Screenvision Europe (£31.0m), partly offset by further consideration following the sale of Technicolor (£23.2m).

Equity dividends, primarily the final dividend for 2001, were £55.5m (2001: £89.2m).

Overall there was a net cash inflow of £322.7m, a negative exchange movement on the sterling value of net debt of £6.4m and an increase in long-term funding of £269.6m, resulting in net borrowings at the year end of £459.9m (2001: £506.6m).

## BALANCE SHEET

At 30 September 2002 the balance sheet showed net assets of £433.5m, a decrease of £230.2m since 1 October 2001. Fixed asset investments include an investment in Thomson SA ("Thomson") shares at a carrying value of £401.4m, details of the market value of which are set out below. Current asset investments include Thomson loan notes at a carrying value of £32.8m. Loan notes with a nominal value of £175.0m were sold or redeemed in the year:

Overall net debt at 30 September 2002 was £459.9m, compared with net debt at the start of the year of £506.6m. Details are analysed below, together with the carrying value and 30 September 2002 market values of Thomson assets acquired in relation to the Technicolor sale:

	30 September 2002	
	£m	
<b>Analysis of net debt</b>		
Net cash		552.9
Loans – current		(35.0)
Loans – long term		(946.1)
Finance leases		(31.7)
<b>Total</b>		<b>(459.9)</b>
	<b>Carrying value</b>	<b>Market value</b>
	<b>30 September</b>	<b>30 September</b>
	<b>2002</b>	<b>2002</b>
	<b>£m</b>	<b>£m</b>
<b>Thomson assets</b>		
15.5 million shares	401.4	155.3
Loan notes	32.8	32.8
<b>Total</b>	<b>434.2</b>	<b>188.1</b>

The Thomson shares are carried at €41.2 compared with a year-end price of €15.9. The shares have traded between €15.7 and €36.7 in the last year and the closing price on 22 November 2002 was €20.3. The table above indicates that effective net debt, i.e. net debt adjusted for the market value of the Thomson assets, was £271.8m at 30 September 2002 (2001: £7.0m).

On 30 November 2001 the Group issued a €638.6m (£397.6m) exchangeable bond, raising £389.6m (€627.4m) that was received in January 2002. The bond has a maturity date of 2007 and is exchangeable into Thomson shares at a fixed exchange price of €41.2. The investors also hold the right to put the bonds back to the Company in January 2005.

Shareholders' Funds at 30 September 2002 were £433.5m compared with £663.7m at the end of 2001. Goodwill written off on acquisitions prior to the adoption of FRS 10 has not been re-instated and the cumulative total of goodwill charged against reserves was £937.6m (2001: £937.6m).

## TAX

The tax rate on profits from continuing operations, before exceptional operating credits and amortisation, of £45.1m is 23.9 per cent (2001 restated: 42.4 per cent). Exceptional operating credits in continuing operations include net income from litigation, to which no tax has been attributed, and exceptional costs on some of which tax relief is recognised, giving rise to a tax credit of £2.0m. This results in tax on continuing operations of £8.6m, the UK corporation tax element of which is offset by consortium and other tax relief from discontinued operations including exceptional charges and by foreign exchange differences that are debited to reserves. Tax of £0.2m has been attributed to the profit on sale of businesses included in discontinued operations.

In the US, federal tax has been provided at 35 per cent and state taxes have been provided at rates between 5 per cent and 10 per cent.

## EXCHANGE RATES

The principal exchange rate affecting Carlton's translation of overseas results was the US dollar although the effect on the Group was greatly reduced following the disposal of Technicolor in 2001. The average rate of the US dollar in 2002 was US\$1.48/£ compared with US\$1.44/£ in 2001. At 30 September 2002 the rate was US\$1.57/£ compared with US\$1.47/£ at 30 September 2001.

## FINANCING

Carlton's policy is to finance itself long-term using debt instruments with a range of maturities. Carlton has traditionally raised fixed rate debt from the US and European Capital Markets, as well as obtaining bank facilities from the UK Syndicated Market.

In November 2001 Carlton issued €638.6m (£395.4m net of issue costs) exchangeable bonds which mature in 2007, carry a coupon of 2.25 per cent per annum, and have a fixed exchange price of €41.2. The bonds are exchangeable into 15.5m ordinary shares in Thomson representing Carlton's total equity interest in the company. A more detailed summary of terms is set out in note 21.

In March 2002 Carlton completed the sale of US\$175m nominal amount of loan notes issued by Thomson which were unguaranteed.

In February 2002 Carlton reduced the size of its £300m Syndicated bank facility (which matures in April 2006) to £100m. The facility has not been drawn to date.

## OBJECTIVES, POLICIES AND STRATEGIES

The most significant treasury exposures faced by Carlton are raising finance, managing interest rate and currency positions and investing surplus cash in high quality assets. Clear parameters have been established, including levels of authority, on the type and use of financial instruments to manage these exposures. Transactions are only undertaken if they relate to underlying exposures. Regular reports are provided to senior management and treasury operations are subject to periodic independent reviews and internal audit.

## INTEREST RATE MANAGEMENT

Carlton uses interest rate swaps, options and forward rate agreements to manage its interest rate exposures on its debt and cash positions with the objective of minimising its net interest cost.

The interest rate profile of Carlton's interest bearing assets and liabilities at the year end are detailed in notes 17, 18 and 24(a) respectively.

Net interest payable was £12.0m (2001: £35.6m). The main reason for the lower net interest charge in 2002 was the benefit gained from swapping fixed rate sterling debt into initially lower floating rate dollar cost of finance (without currency risk) in June 2001. During September 2001 and thereafter the Federal Open Market Committee cut US interest rates to historically low levels, significantly below the rates implied in the yield curve at the time that the swaps were entered into. The low financing cost of the Exchangeable bond relative to the interest earned on its proceeds and lower net interest bearing balances were the other primary reasons.

Borrowings are denominated in currencies that match Carlton's net assets as described below. The fair values of borrowings and cash at the year-end are compared to their book values in note 24(b).

## CURRENCY MANAGEMENT

Carlton faces currency exposure on trading transactions undertaken by its subsidiaries in foreign currencies. In addition, Carlton is also subject to currency exposures arising on its 15.5m shares in Thomson (quoted in euros), loan notes issued by Thomson (denominated in dollars) and cash and debt instruments denominated in dollars and euros.

Carlton hedges a proportion of its transactional exposures by taking out forward foreign exchange contracts of up to four years forward against its anticipated and known sales and purchases. The decision to hedge is influenced by the size of exposure, the certainty of it arising, the trading and market position of the company in which the exposure arises and the current exchange rate.

At the year-end Carlton estimated that its net purchases of foreign currency in 2003 relating to trading transactions would total less than £30m after taking into account foreign currency hedging in place. The year-end fair value of foreign exchange contracts maturing in 2003 was negative £2.9m due to forward purchases of Swiss francs to match Champions' League payments undertaken in previous years when sterling was weaker.

Carlton's balance sheet translation exposure is managed by partially matching currency assets with a combination of currency borrowings and forward foreign exchange option contracts.

Carlton's largest single balance sheet currency exposure in economic terms is in euro. The exposure relates to a €638.6m Exchangeable bond (£395.4m net of issue costs) which is offset by the value of the 15.5m shares in Thomson (worth £155.4m at year end) and the purchase of a €425m (£266.5m at the strike rate) currency call option with a strike rate of 1.5947 (at a cost of £11.0m) which matures in January 2005 and had a fair market value of £10.8m at the year end. The cost of the call option is being written off on a straight line basis over its life (32 months) and to the extent that the written down value exceeds the fair market value further provision will be made. In 2002 £1.7m of premium cost was written off.

## INVESTMENT OF CASH

Carlton operates strict investment guidelines with respect to surplus cash and the emphasis is on preservation of capital. Consequently, discretionary investments with maturity greater than one year must be rated AA or better and discretionary investments of less than one year must be rated A1 or P1 by the major credit rating agencies. There are also conservative limits for individual counter-parties. The maturity profile of investments is managed according to the forecast cash needs of the Group.

## PROPOSED MERGER WITH GRANADA

On 16 October 2002, Carlton and Granada announced they had agreed the terms of a proposed merger. The merger is conditional on clearance by the competition authorities and the ITC. Carlton Ordinary shareholders will, upon completion of the merger, receive 32 per cent of the ordinary share capital of the merged group, potentially increasing to 34 per cent in 2006 dependent on the achievement of two conditions. The first condition is that the share price of the merged group reaches the equivalent to 140 pence per Granada Ordinary share, implying a Carlton Ordinary share price equivalent to 271 pence; and the second condition is that an agreed earnings target for the year ending September 2005 is met. This potential increase to 34 per cent will be effected through the issue of convertible shares to Carlton Ordinary shareholders upon completion of the merger. Granada shareholders will receive the balance of the ordinary share capital of the merged group and £200 million of cash on completion.



**Paul Murray**

Finance Director

26 November 2002