

# REVIEW OF OPERATIONS

## OVERVIEW

Turnover from continuing operations was £964.6 million (2001 restated: £1,040.1 million). The decline is primarily due to a reduction of £35.7 million in advertising revenues.

Operating costs are under tight control. A stringent review last year identified £45.0 million in annual savings in the second full year, including Carlton's share of savings in ITV. Delivery is well ahead of target with savings of £54.2 million achieved by end-September.

Total continuing operating profit before amortisation and exceptional items was maintained at £65.3 million (2001: £65.8 million). The total amortisation charge, including joint ventures, was £17.6 million (2001: £17.4 million) and operating exceptional items totalled £4.8 million (2001: charges £52.4 million).

Net interest charges were £12.0 million (2001: £35.6 million). The fall is attributable to lower effective interest rates and lower net interest bearing balances. Amounts written off investments were £8.2 million (2001: nil).

Profit on continuing operations before taxation was £32.3 million (2001: loss of £39.6 million).

## BROADCASTING

Turnover was £799.5 million (2001: £830.1 million) and profits were £67.4 million (2001: £83.3 million).

Carlton's television advertising revenues recovered to show an increase of 2 per cent in the second half of the year, compared to the same period last year. After a difficult first six months, year-on-year growth resumed in May. For the year as a whole Carlton's Net Advertising Revenue ("NAR") was £660 million (2001: £695 million), including a full year of HTV which was acquired at the end of October 2000. On a like-for-like basis the decline in NAR was 6 per cent for the year.

ITV's advertising performance continued to be influenced by the penetration of multi-channel television and exposure to global brands that were affected by the worldwide economic climate. Although revenues in many product categories were lower than last year, cars, cosmetics, pharmaceuticals and home entertainment were all higher. ITV's share of total UK television advertising revenues for the year is estimated at 54 per cent (2001: 57 per cent).

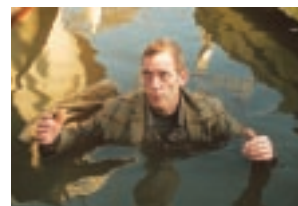
ITV's programme schedulers have worked hard with advertising sales to ensure that the strongest possible commercial schedules are



June Brown and Penelope Keith star in *Margery & Gladys*, a Carlton production for 2003.



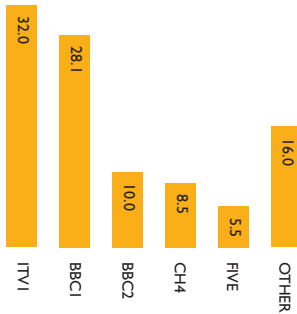
ITV has extended its rights to show *Bond* movies on TV.



Hugh Laurie in *Fortysomething*, a Carlton production, for transmission in 2003.



ITVI is the most watched channel in peak time (% of share of viewing 12 months to Sept 2002)



David Harewood returns as Inspector Joe Robinson in the fifth series of *The Vice*.



*Pop Idol Extra: The Final* was the highest rated show on ITV2 since launch with 2.27m viewers. (The most popular non-terrestrial show in the last two years).



delivered to advertisers. The promotion of ITV has been a key priority and a major conference, "TV Matters", was held to reinforce to the advertising industry the unique power of commercial television to connect with consumers. A follow-up study entitled "TV and the Brain", which looked at why television is the most powerful advertising medium, was presented earlier this month.

During the year, it became clear that the management structure of ITV should be streamlined to improve its decision-making process and that extra investment in the schedule was both needed and justifiable in anticipation of a recovery in advertising demand.

Carlton Television's Chief Executive, Clive Jones, was made Joint Managing Director of ITV. Closer cooperation was introduced between programmers and the marketing teams that led to an effective "ITV Upfront" roadshow to promote and market the channel directly to individual advertising agencies and media buyers this autumn. An upbeat message of more drama, more entertainment and more feature films in 2003 was well received by ITV's clients. The launch of a new on-screen identity for ITV and the appointment of Nigel Pickard from the BBC as the new Director of Programmes were two further positive developments at ITV.

One of the most important benefits of the proposed merger with Granada will be to simplify ITV's decision-making. For the first time, ITV will be managed with a single set of objectives for the benefit of advertisers, viewers and shareholders.

ITVI's programme budget was boosted by an additional £25 million lifting the total for the year to £773 million (2001: £735 million). This investment contributed to an improvement in audience share in the final quarter of the year: A further increase in the network programme budget to £815 million has been agreed for the 2003 fiscal year, and to almost £1 billion including local news and regional programming. This is the largest programme budget of any single commercial channel in Europe and demonstrates our confidence in ITV.

ITVI remains the most popular peak-time channel delivering an audience share of 32 per cent during the year; a 4 percentage point lead over BBC1. ITVI's average peak time share is almost 4 times Channel 4's, nearly 6 times Five's and double all cable and satellite channels combined – in fact greater than all of the other commercial channels combined.

ITVI's lead over its terrestrial commercial rivals is even greater in multi-channel homes.

This reflects the popularity of ITV's original, domestically-produced programming compared to other commercial channels that rely heavily on imported or repeated programmes.

Carlton's share of ITVI network schedule costs was £326.5 million, an increase of 6.4 per cent before programme stock provisions of £6.5

million. Total licence fees (including digital satellite transmission costs) fell to £111.1 million (2001: £119.5 million). This was due to lower NAR and the effect of the increased penetration of digital television, offset by an increase in payments following the renewal of the Carlton Midlands licence and by the first year digital satellite transmission costs.

ITV2, 44 per cent owned by Carlton, is extending the ITV brand in multi-channel homes. ITV2's progress this year has been well ahead of expectations and it enjoyed the biggest rise in popularity of any channel in multi-channel homes. The number of brands advertising on the channel has doubled and its revenues grew from £9.5 million last year to £12.9 million, benefiting from its launch on digital satellite last November. ITV2 is now available to nearly 50 per cent of the population and achieved its highest ratings since launch with extensions to top ITV1 shows such as *Pop Idol*, *Who Wants To Be A Millionaire* and *I'm a Celebrity...*, as well as Champions League football. Since September, ITV2 has been the second most watched non-terrestrial channel and in early November started morning weekday transmissions in response to rising demand from advertisers. Carlton's share of losses in ITV2 reduced to £7.2 million from £9.7 million last year and is expected to fall further as revenue growth continues in 2003.

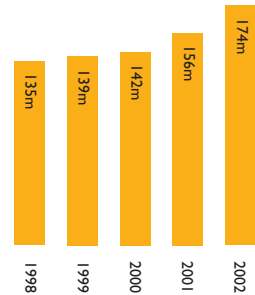
**Cinema Advertising:** Turnover for the year was £60.1 million (2001: £57.4 million).

Carlton Screen Advertising ("CSA") had its best year ever. It is the world's leading cinema advertising specialist and has developed state-of-the-art campaign management systems for the cinema. Carlton is now building on this expertise by investing in joint ventures in the much less developed US and continental European markets.

The rise in cinema audiences and advertising revenue continued in the UK, supported by a strong slate of blockbuster films. CSA retained its important UCI Cinema advertising contract accounting for 386 screens across the UK and Ireland. Its contract with UGC ended in January, which impacted second half growth, but it won National Amusements/Showcase just after the year end. CSA now operates on over 2,100 screens accounting for 63 per cent of the 174 million cinema admissions in the UK this year.

The Screenvision joint venture with Thomson in the US expanded its coverage through the acquisition of Val Morgan in September and now accounts for 54 per cent of all US cinema advertising screens. Screenvision Europe was formed with Thomson in June to acquire cinema advertising interests across continental Europe including France, Belgium and Spain for £62 million of which Carlton's share was £31 million. The financial impact of these ventures, which are in the early stage of development, was small.

Cinema admissions have reached their highest level since 1971



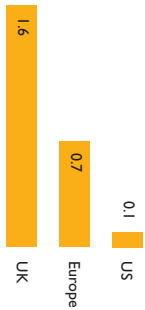
Frank Skinner and Zoe Ball hosted The BRIT Awards 2002.



The ITV News Channel is cross-promoted from ITV1.



Cinema advertising as a % of total display advertising, 2002, showing growth potential in Europe and the US



The Moving Picture Company created major visual effects sequences for *Harry Potter and the Chamber of Secrets* (the flying Ford Anglia/Whomping Willow) and for *Harry Potter and the Philosopher's Stone* (pictured).



Stuart Milligan and Jane Asher are providing the glitz as Max and Angel Samson, the new management at *Crossroads*.



**Facilities:** Turnover was £40.8 million (2001: £33.4 million).

The Moving Picture Company ("MPC"), Carlton's post-production house, enjoyed a very successful year with turnover advancing by 30 per cent to £21.7 million. MPC has invested in new equipment and software enabling it to create more exciting special visual effects for feature films. MPC's output included work on several of this year's top films such as *Harry Potter and the Chamber of Secrets* and the latest Bond film *Die Another Day*. Work is now starting on a new *Tomb Raider* film due next year. MPC continues to provide high-end post-production services for television commercials for major advertisers such as Adidas, Nike, the Royal Mail and Stella Artois.

Carlton 021 provided outside broadcasting facilities for major sporting and entertainment events including the Champions League final which was broadcast to countries throughout Europe and to the US.

## CONTENT

Turnover was £165.1 million (2001: £181.7 million) and profits, before amortisation, were £10.1 million (2001: £1.4 million), including significantly reduced losses from the interactive businesses previously included in digital operations.

**Carlton Productions:** Turnover for the year was £75.5 million (2001: £100.6 million).

Carlton continues to produce some of the best entertainment, drama and factual programmes on television. However, delays in ITV commissioning and the ending of the *Big Breakfast* contract for Channel 4 contributed to a reduction in output for the year.

Successful drama productions in 2002 included *Bertie and Elizabeth*, broadcast in over 30 territories and *Pollyanna*, seen in more than 50 countries. Importantly, Carlton Productions now has one of its strongest ever forward order books. We will be producing approximately 30 per cent of ITV's new drama output in 2002/2003 including shows such as *Making Waves*, *Fortysomething*, *Margery & Gladys* and *Sweet Medicine*. The successful hard-hitting police series, *The Vice*, is returning in a new one hour format and *Crossroads* has been re-commissioned for the key tea-time slot with a new production and editorial team.

Entertainment productions included *The Vault*, *Catchphrase* and more recently *Today with Des and Mel*, the new centrepiece of ITV's daytime schedule. Key televised awards events included *The Brit Awards*, *The Soap Awards*, *The Multicultural Awards* and *The Evening Standard Theatre Awards*. Carlton also won a broad range of commissions from other broadcasters including Sky, Channel 4 and BBC Choice. Award-winning factual programmes included *Kelly and her Sisters* and we

produced and sold further historical documentaries in the ...*In Colour* series both in the UK and overseas.

Carlton's production ventures in the US made encouraging progress. We formed a new enterprise, Carlton Productions LLC, to develop factual programming and to build on existing relationships with Newsweek Inc. and the PBS Network. An international production fund, established with PBS in 2001, has approved five important projects for production totalling over \$7 million, including a major film on the Watergate scandal. Carlton also signed a joint entertainment development deal with the Gurin Company, makers of *The Weakest Link* in the US, to exchange ideas on new shows and formats.

Combining Carlton's production activities with Granada's will create the UK's leading commercial production company with original programme and content sales of approximately £700 million. Greater critical mass and resources will allow more effective and efficient production for ITV and for other national and international channels.

**Carlton International:** Turnover for the year was £89.5 million (2001: £81.1 million).

Carlton International's sales grew by 10 per cent despite difficult conditions in the international television market. It has the largest English language film library outside of Hollywood and enjoyed strong demand for its films from broadcasters in Europe, Latin America and Asia. Recent sales included its largest ever deal with China that will bring the famous *Carry On* movies to Chinese audiences for the first time. Award-winning acquisitions such as *Bob and Rose* have been sold to over 40 territories worldwide. Other recent deals include *The Planman*, Robbie Coltrane's first TV project for several years, and the big budget production *Boudica* starring Alex Kingston.

Carlton America added nine new US television movies to its library of productions and co-productions. One major new project going to production is a biographical drama based on the life of former New York mayor Rudy Giuliani. Carlton is building an increasingly valuable contemporary TV movie catalogue with films that perform strongly on the main US networks and also sell well in Europe, making Carlton America the biggest independent supplier of US TV movies to the international market.

The long term development of Carlton's ever-popular *Thunderbirds* brand will be underpinned by the release of a Hollywood live action film in 2004. It will be followed by a new TV series and major licensing and publishing initiatives. Boxed sets of *Thunderbirds* DVDs have been selling very well in Japan. This helped Carlton Visual to its best year to date. Other strong DVD sales included collections of classic titles such as *Inspector Morse*, *Auf Wiedersehen Pet* and *Sapphire & Steel*.



Des O'Connor and Melanie Sykes' new ITV1 daily entertainment and talk show has been recommissioned for a second run in 2003.



Award winning *The British Empire in Colour*, a TWI/Carlton production.



Joe 90, the cult Supermarionation series, released by Carlton in the UK as a five disc digipack and 8 video box set.





Carlton America's *Amy and Isabelle* was the highest rated movie on ABC last year.



Carlton America's *Atomic Twister* was the second highest rated movie on a cable network in the US this year.



The British Gas Energy Efficiency campaign was developed by Carlton.

A combined Carlton and Granada will have a huge library of new and classic TV programmes and feature films, creating new opportunities to sell programmes and licence rights for music and merchandising to customers in over 200 countries.

### DISCONTINUED - ITV DIGITAL

Deloitte & Touche was appointed administrator of ITV Digital on 27 March 2002. On 30 April, it announced the closure of the business and on 18 October, Grant Thornton was appointed as liquidator to the company.

Carlton's share of ITV Digital's and ITV Sport Channel's pre-closure losses was £99.1 million. As announced at the half year, an exceptional charge of £98.6 million was taken as a result of the decision to place ITV Digital in administration. This was made up of a £34.6 million balance sheet write-off and a £64.0 million provision for Carlton's share of closure costs. No further charges were incurred in respect of ITV Digital in the second half of the year, nor are any further charges expected in the future.

In August, the High Court ruled that Carlton and Granada were not liable for the £131.8 million claimed by the Football League from ITV Digital. Subsequently, ITV and the Football League have agreed a broadcasting contract for certain rights during the 2002/03 and 2003/04 seasons.

### PROPOSED MERGER WITH GRANADA

Following the initial announcement in October of merger proposals with Granada, a detailed submission has been made to the Office of Fair Trading for regulatory consideration. In the meantime Carlton and Granada are working together to deliver early efficiency gains and cost savings from sharing resources in areas that are not sensitive from a regulatory perspective, including transmission, purchasing and certain support services.