



I am pleased to be able to report that SKY Network Television Limited ("SKY") earned a net profit of \$35.3 million for the year to 30 June 2004, which compares to the profit of \$0.7 million earned in 2003.



Chairman's Letter

SKY's subscriber base increased by 33,711 (6.2%) to 576,602 for the year to 30 June 2004. While this is lower than the 39,642 net increase in 2003, it is a creditable achievement in a year when the Rugby World Cup, one of the most significant events in New Zealand television, was exclusive to a free-to-air network. The Rugby World Cup had the impact of increasing churn on the UHF network in the period October – February which impacted the level of net gain for the year.

Despite the reduced net subscriber growth in 2004 compared to 2003, SKY's revenue increased by \$49.3 million (12.6%) for the year to \$440.6 million. Operating costs increased by \$20.6 million (5.7%).

The amount of cash flow generated by the business has also increased significantly, with free cash flow up \$85.8 million to \$117.7 million. This cash flow has been applied to debt reduction, with SKY's bank debt being reduced by \$102.0 million during the year.

One of the contributing factors to the increase in free cash flow for the year was the \$43.1 million reduction in capital expenditure to \$53.2 million. This is primarily a result of a reduction in the average cost of installing new subscribers, which reduced to \$512 in 2004, from \$719 in 2003, a reduction of 28.8%. This decrease can be attributed to a reduction in the cost of decoders and the strengthening of the New Zealand dollar against the United States dollar.

The US/NZ exchange rate continues to be an important determinant of SKY's profitability as a significant proportion of SKY's programming costs are paid in US dollars. The board has adopted a policy to hedge a certain proportion of its forecast foreign currency exposures for a period of one to three years to provide some certainty as to these future costs. SKY's 2004 result reflects an average US/NZ exchange rate for the year of 50.4 cents. Based on the 2004 results, each 1 cent improvement in the exchange rate would result in a \$2.0 million reduction in SKY's programming costs.

We have been very pleased with the performance of the three new basic channels that were launched during the year: Disney, UKTV and The History Channel. They are continuing to attract solid viewing hours and have no doubt contributed to the 24% increase in the average amount of viewing of SKY digital channels in 2004. This is good for the business as the more time subscribers spend watching SKY, the greater value they are getting from their monthly subscription and the less likely they are to disconnect their service.

One of the highlights of the year was reaching agreement with Optus Networks Pty Limited ("Optus") to lease five transponders on the new D1 satellite that is scheduled to be launched by December 2005. This new satellite will be purpose built for SKY and will have considerably more power over New Zealand, which will result in less rain fade (temporary loss of signal) for our subscribers. Optus has also agreed to launch a second satellite, D2, which will provide in-orbit back-up for the D1 services in the future.

On 19 August 2004, the board of SKY announced that it had agreed in principle on a proposal to merge SKY with its parent, Independent Newspapers Limited ("INL"). The key objectives of the merger are to create a single listed company for the SKY business, provide fair value to all shareholders and ensure that there is no dilution of any shareholder's interest in the SKY business.

Under the merger proposal, a new company, Newco, would be established to acquire SKY and INL. SKY and INL shareholders would receive shares in Newco and cash payments in return for their current shareholdings.

The merger proposal would be implemented as a scheme of arrangement and requires the approval of shareholders in INL and SKY, various regulatory bodies and the High Court. At this stage, it is anticipated that the proposal would not be put to shareholders until the first quarter of calendar 2005. An independent advisor's report will be prepared for shareholders, and SKY's independent directors will play a significant role in evaluating the proposal and providing a recommendation to shareholders.

During the year, Ian Wells and Peter Wylie retired from the board, as both ceased their employment with INL following the sale of its newspaper business. We would like to thank them for their valuable contribution to the SKY board.

Finally, I would like to thank John Fellet and his team for delivering another strong result and demonstrating the value that can be created for shareholders from the pay TV business.



Peter Macourt
Chairman



“Just what you’re looking for”

[\$35.3 million dollar profit]

This is my fourth annual letter to shareholders. I am pleased to report that, in these four years, SKY has gone from a \$42.2 million dollar loss to a \$35.3 million dollar profit. Former NY Yankees’ manager, Casey Stengel, once said that “successful managing is watching other people hit home runs” (in cricket vernacular that’s hitting sixes). For the most part, today I feel a lot like Mr Stengel. The strategic plan mapped out by your board of directors and executed by your employees has positioned SKY to make this financial transformation. It has been an amazing turnaround.





STRONG TOP-LINE GROWTH

SKY continues to record strong top-line growth. In the year ending 30 June 2004, we added 33,711 net subscribers to our base. This brings the total number of subscribers to 576,602. Although the previous year's net gain was slightly higher at 39,642, I believe this year's gain was a greater accomplishment.

One of the challenges to this year's growth involved a unique programming issue. Without a doubt, New Zealand's largest television event every four years is the Rugby World Cup. In October and November 2003, the World Cup was hosted in Australia. Around eight years ago, a free-to-air network acquired the New Zealand broadcasting rights. With several years to prepare, SKY was able to take reasonable steps to defend itself against this impact.

In November and December 2003, SKY launched three new basic channels - UKTV, The History Channel and Disney. In addition, while we had no rights to any live footage of any of the World Cup rugby on our sport channels, SKY was able to provide our subscribers with prime-time news and commentary relating to this event on our channels. Overall our strategy worked. At the time of the World Cup, SKY did not only record low churn (the number of subscribers disconnecting), we actually moved forward with our subscriber count.

After the World Cup, the three new channels maintained interest, and churn on our satellite platform hit an all-time low for the year.

Due to the absence of live rugby on SKY from late October through to February, SKY did, however, record higher than normal churn in its UHF business over the height of the summer. Nevertheless, after the new rugby season started, our churn rate dropped to a lower rate than the previous year.

HIGH GROWTH IN THE FAR NORTH

On a percentage basis, the Far North recorded the highest growth in new subscribers of any of our regions. The net gain for this region, as a percentage of non-subscribers, was 6.2%, compared to the national net gain of 3.4%. Next time you are driving through Whangarei, drop in and thank Simon Butterfield for his contribution; he will be looking for similar results again this year. As of 30 June 2004, the Far North recorded 35.1% penetration. Considering the current economic conditions in this area, this result is very positive. At year-end, nationwide penetration was 37.8%, with Wellington recording the highest penetration of any zone at 49.1%.

Trying to determine exactly how many houses exist in New Zealand is, at best, an inexact science and SKY strives to be consistent with Statistics New Zealand. In the past SKY has calculated its penetration based on the census data which is produced every five years. Statistics New Zealand produces a quarterly estimate of the number of households in New Zealand, which at 30 June 2004 included an additional 140,000 homes to that reported in the last census. This is good news. While it technically drops SKY penetration down from 41.6% to 37.8%, the larger the market in which we operate, the more valuable SKY can become.

PROGRAMMING

As I have stated in previous Annual Reports, I view SKY as a large pipeline passing every home in New Zealand. It is management's responsibility to ensure that the most valuable content is sent through this pipe because the size of our pipe is limited by the size and income of the population in New Zealand.

In this respect, we spend a great deal of time determining exactly what content New Zealanders want and negotiating a fair price for it. Last year, SKY was able to launch UKTV, The History Channel, Disney, Arts Channel and SKY Sport 3 at the same time as its overall programming budget as a percentage of revenue actually decreased. SKY's programming budget now runs at \$176 million a year. We have no issue paying for a product that returns its share of viewing but we would not be in business long if we paid one dollar for a show that gives our viewers just 99 cents in value.

I believe the closer that programmers are to New Zealand, the more informed the programming decisions are. To this end, SKY has had a long history of partnering with local programmers to develop channels for SKY. These include The Living Channel, the music channels - Juice and J2, Shine Television, Trackside, Rialto and most recently, Arts Channel.

This additional and improved programming has resulted in churn dropping to an all-time low. In spite of the impact of the 2003 Rugby World Cup, churn for the year was 17.1% compared to 17.6% for the previous year.

VIEWER HOURS

One of the key drivers in the value of this company is the number of hours each subscriber home watches SKY channels. Provided that economic conditions are stable, the higher the viewership, the more valuable the SKY subscription. Over the last year, average viewing hours of SKY digital channels per household have increased 24%. This is a particularly pleasing result.

Hard negotiations on contract renewals and investing savings in additional channels has provided an environment of increased viewership, as well as a decrease in the percentage of revenue devoted to programming.

CAPITAL

I wish to now talk briefly about capital. It is easy to look at companies and measure their increase in revenue and net income without looking at the capital used to drive that growth. This is especially true for SKY which in 2004 spent 91.8% of its capital expenditure on installations for customers. In 2001, we started down a disciplined path of limiting our capital expenditure by ensuring there was a clear link to increasing shareholder value.

This regime saw us drop our capital outlay from \$153.3 million in 2001 to \$57.4 million in 2004. No doubt, we were assisted by the increase in the value of the New Zealand dollar and the decrease in the cost of digital decoders. However, SKY takes great pride in extending the useful life of all its key assets.

The longevity of our UHF decoders is one of SKY's biggest success stories. SKY has not purchased a UHF decoder since it went digital five years ago and the average age of a UHF decoder is around 7.7 years. We also hope to be able to extend the life our digital decoders for as long as possible.

UPCOMING EXPENDITURE

In spite of successfully reducing the level of capital expenditure in recent years, I believe it is prudent to expect the amount of capital expenditure to increase over the next few years, as several one-off expenditures will occur.

In 2006, we are scheduled to start utilising a new satellite and, at the same time, we will most likely start replacing compression equipment. This equipment will allow us to "squeeze" more channels out of the same amount of bandwidth. These channels will be used to attract additional viewers as well as add tiers of service to our offerings.

Hard-working SKY studio staff spend a great deal of effort keeping New Zealand's "oldest" studios in working condition and we pride ourselves on coaxing additional life out of equipment. The industry, however, is starting to make a shift to a tapeless environment for the transportation, shipment and storage of content. The option to upgrade is unavoidable as an increasing number of our programmes will arrive in digital code format, not tape. Once again, this expenditure offers additional benefits in that the services we provide will be able to be built and transported more efficiently than our current tape-based services.

We are also investigating decoders that include built-in hard drives with the ability to record up to 20 hours without the use of tapes. These types of decoders are known as PVRs, or personal video recorders. A few years ago, SKY looked into launching one but chose to delay this as the overseas penetration of PVRs was very low. Although the percentage uptake today is less than 3% in the USA and UK, there have been several advancements in PVRs. We believe the market may now be ready for them. The PVR is likely to appeal to existing subscribers as opposed to non-subscribers. While we have still to develop a marketing plan for the PVR, the goal is for it to be financially neutral if a subscriber takes a PVR or a conventional digital decoder.

APPROACH TO DEBT

With improving financial results, we are quickly paying off our outstanding debt. The increasing cash flow and decreasing debt has seen one credit ratings service, Rapid Ratings, pick SKY as the lowest risk business on the New Zealand Stock Exchange. While I am flattered by the compliment, I do not believe it is in the best interest of the shareholders for SKY to be in this lowest risk category. SKY has a history of predictable and steady operating cash flows and it makes sense to always have some debt on our books. The board is reviewing the appropriate level of debt for SKY and if this leads to any changes, these will be publicly announced.

In closing, I would like to thank you for your continued support as shareholders and look forward to delivering you another strong result in 2005.



John Fellet
Chief Executive