sses in areas such as digital imaging, digital media and interactive media. The network services group's revenue consists of fees relating to facilities and services necessary to ole and transport programming for cable and broadcast networks across the world via fiber, satellite and the Internet. Additionally, the group's revenues are also driven by syster tion and field support services, technology consulting services, design and implementation of advanced video systems, engineering project management, technical help desk an . Approximately 40% of network services group's revenue relates to broadcast services, satellite operations and fiber services that are earned monthly under long-term contracts g generally from one to seven years. Additionally, approximately 30% of revenue relates to systems integration and engineering services that are provided on a project basis ove generally ranging from three to twelve months. Corporate related items and expenses are reflected in Corporate and Other, below. Cost of services and operating expenses consi ly of production wages, facility costs and other direct costs and selling, general and administrative expenses.

***nonths ended March 31, 2005 and 2004***

| | | Three months ended March 31, | |
|---|---|---|---|
| | | 2005 | 2004 |
| | | amounts in thousands | |
| ***Segment Revenue*** | | | |
| Creative services group | $ | 74,228 | 75,166 |
| Media management services group | | 28,776 | 25,450 |
| Network services group | | 71,286 | 45,327 |
| Corporate and other | | — | — |
| | $ | 174,290 | 145,943 |
| ***Segment Operating Cash Flow*** | | | |
| Creative services group | $ | 13,051 | 14,381 |
| Media management services group | | 3,691 | 4,687 |
| Network services group | | 15,006 | 13,108 |
| Corporate and other | | (11,897) | (9,688) |
| | $ | 19,851 | 22,488 |

*venue.* Ascent Media's total revenue increased 19.4% for the three months ended March 31, 2005, as compared to the corresponding prior year period. The creative services g decreased $938,000 as a result of lower sound services for feature films and TV and the sluggish commercial market in the U.K. partially offset by increased feature film relat driven by the expansion of digital intermediate services, growth in TV post production and changes in foreign currency exchange rates of $408,000. The media management group revenue increased $3,326,000 as a result of higher lab revenue of $3,439,000 due to the acquisition of Cinetech, higher demand for DVD compression, authoring and m ervices from the large film studios and changes in foreign currency exchange rates of $229,000, partially offset by competitive pressure in the UK. The network services group increased $25,959,000, reflecting the impact of the LPC acquisition of $9,423,000 and changes in foreign currency exchange rates of $593,000. The remaining increase is prim y the timing of various large engineering and systems integration projects and higher installation services activity.

*st of Services.* Ascent Media's costs of services increased 26.3% for the three months ended March 31, 2005, as compared to the corresponding prior year period. The increas ble in part to the 2004 acquisitions discussed above which contributed $8,810,000 of the increase in cost of services. The remaining increase is primarily attributable to the cha ue mix driven by higher s engineering and integration projects in the network services group resulting in higher production and engineering labor and production material costs. Media management ser cost of services increased $1,495,000. In recent years, expenses for the media management services group have increased at a faster rate than revenue. Media management's proj ecome increasingly more integrated, with complex work flows requiring higher levels of production labor and project management. This increase in labor costs, combined with ed spending on continued development of digital technologies and services, has resulted in higher cost of services and decreasing operating cash flow margin.

*lling, General and Administrative.* Ascent Media's selling, general and administrative expenses increased 18.6% for the three months ended March 31, 2005, as compared to onding prior year period. This increase is primarily attributable to the impact of the 2004 acquisitions of $4,278,000, the growth in the revenue driving higher labor, facility and costs and changes in foreign currency exchange rates of $382,000.

orporate and Other operating cash flow (which includes DHC corporate general and administrative expenses of $1,242,000 in 2005) decreased $2,209,000 in 2005 primarily due DHC corporate expenses and higher Ascent Media corporate expenses in the U.K. as a result of higher labor, facility and professional services costs.

*preciation and Amortization.* Ascent Media's depreciation and amortization expense increased 4.4% for the quarter ended March 31, 2005, as compared to the prior year peri rease was driven by an increase in the depreciable base due to capital expenditures and the 2004 acquisitions.

*ock Compensation.* In 2001, Ascent Media granted to certain of its officers and employees stock options with exercise prices that were less than the market price of Ascent M n stock on the date of grant. Those options became exercisable for LMC shares in connection with LMC's acquisition in 2003 of the Ascent Media shares that it did not already Media is amortizing the "in-the-money" value of these options over the 5-year vesting period. Compensation expense for the three months ended March 31, 2005 was comprise 00 related to "in-the-money" stock options offset by $353,000 related to a decline in the value of the underlying stock price used to value employee stock appreciation rights, or The stock compensation expense recorded for the quarter ended March 31, 2004 related primarily to "in-the-money" stock options of $590,000 offset by $68,000 related to a de alue of the underlying stock price used to value employee SARs.

*are of Earnings of Discovery.* Our share of earnings of Discovery increased in 2005 due to increases in the net income of Discovery. Discovery's net income improved prima igher revenue.

r a more detailed discussion of Discovery's results of operations, see "—Management's Discussion and Analysis of Financial Condition and Results of Operations of Discovery

*ome Taxes.* Our effective tax rate was 35.3% and 26.7% for the three months ended March 31, 2005 and 2004, respectively. Our income tax expense was lower than the fede tax rate of 35% in 2004 primarily due to a reduction in our valuation allowance.

***nded December 31, 2004, 2003 and 2002***

cent Media's consolidated results of operations for the year ended December 31, 2004, include twelve months of results for SIC, approximately nine months of results of LPC a nately nths of results of Cinetech. The consolidated results for the year ended December 31, 2002 include twelve months of the results of Triumph, which was sold in December 2002

| | | Year ended December 31, | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| | amounts in thousands | | |
| ***t Revenue*** | | | |
| e services group | $ 295,841 | 270,830 | 275,119 |
| nanagement services group | 109,982 | 107,070 | 105,091 |
| k services group | 225,392 | 128,203 | 159,123 |
| te and other | — | — | — |
| | $ 631,215 | 506,103 | 539,333 |
| ***t Operating Cash Flow*** | | | |
| e services group | $ 55,847 | 43,786 | 50,150 |
| nanagement services group | 17,430 | 22,074 | 27,682 |
| k services group | 62,163 | 43,221 | 45,673 |
| te and other | (38,074) | (34,319) | (34,450) |
| | $ 97,366 | 74,762 | 89,055 |

*venue.* Ascent Media's total revenue increased 24.7% and decreased 6.2% for the years ended December 31, 2004 and 2003, respectively, as compared to the corresponding p 2004, the creative services group revenue increased $25,011,000 as a result of higher feature film related revenue driven by the expansion in digital intermediate services in the , expansion of creative sound services in the UK, growth in television post production activity and changes in foreign currency exchange rates of $6,382,000. The media ment services group revenue increased $2,912,000 in 2004 as a result of higher lab revenue of $2,229,000 due to the acquisition of Cinetech, higher demand for DVD masterin and changes in foreign currency exchange rates of $3,684,000, offset by the commoditization of traditional media services leading to a decline in rates and difficult market ns primarily in the United Kingdom. While competition for traditional media services remains strong, we are currently unable to predict what impact, if any, this competition w rates for these services in the future. The network services group's 2004 revenue increased $97,189,000, reflecting the full year impact of acquisition of SIC of $27,100,000, th nth impact of the LPC acquisition of $39,619,000 and changes in foreign currency exchange rates of $1,979,000. The remaining increase is driven by the timing of various larg integration projects, higher network origination and installation projects.

e creative services group revenue decreased $4,289,000 in 2003 due to early television show cancellations, competitive rate pressures in both television and commercial market on of market subsidy for high definition services impacting rates, offset by an improved feature film market in sound services, digital intermediate and visual effects services an in foreign currency exchange rates of $3,438,000. The media management services group 2003 revenue increased $1,979,000 as a result of higher volumes from the larger mo increased DVD authoring, recording and subtitling activity and changes in foreign currency exchange rates of $2,752,000 offset by fewer mid level and smaller clients due to media recovery. The network services group revenue decreased $30,920,000 resulting from the divestiture of Triumph in 2002 of $23,118,000, the renegotiation of certain lar contracts of $14,000,000 and higher volume of systems integration projects in 2002, offset by growth in the network origination business and changes in foreign currency exch $1,560,000.

*t of Services.* Ascent Media's costs of services increased 26.3% and decreased 6.5% for the years ended December 31, 2004 and 2003, respectively, as compared to the nding prior

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he 2004 increase is attributed to the 2004 acquisitions discussed above, which contributed $48,331,000 of the increase in cost of services, higher costs across all of its groups lly in production material, production personnel and equipment expenses as a result of the increased revenue and production activity noted above and changes in foreign curreno ge rates, which resulted in an increase of $6,321,000. In recent years, expenses for the media management services group have increased at a faster rate than revenue. The proje dia management services group have become increasingly more integrated, with complex work flows requiring higher levels of production labor and project management. This e in labor costs, combined with increased spending on continued development of digital technologies and services and the decline in rates for traditional media services noted al ulted in higher cost of services and decreasing operating cash flow. The 2003 decrease in cost of services is due to the divestiture of Triumph of $29,072,000, offset by higher c media management services and creative services groups primarily in production material and production personnel expenses and the impact of changes in foreign currency ge rates of $4,530,000.

*lling, General and Administrative.* Ascent Media's selling, general and administrative expenses increased 17.8% and 1.6% for the years ended December 31, 2004 and 2003, ively, as compared to the corresponding prior year. The 2004 increase is primarily attributable to growth in the business driving higher personnel, facility and selling costs, the of the 2004 acquisitions of $5,528,000 and changes in foreign currency exchange rates of $4,222,000. The 2003 increase is primarily due to slightly higher personnel and facili the groups and changes in foreign currency exchange rates of $2,051,000, offset by the divestiture of Triumph, which decreased selling, general and administrative expenses b 000.

rporate and Other operating cash flow decreased $3,755,000 in 2004 due to higher corporate expenses in the U.K. from the continued development of corporate infrastructure a ion of LPC, higher management incentive plan costs and changes in foreign currency exchange rates of $872,300, offset by lower severance and lease abandonment charges.

*preciation and Amortization.* The increases in depreciation and amortization expense in 2004 and 2003 are due to an increase in the depreciable asset base due to capital itures and acquisitions.

*ck Compensation.* In 2001, Ascent Media granted to certain of its officers and employees stock options with exercise prices that were less than the market price of Ascent M n stock on the date of grant. Those options became exercisable for LMC shares in connection with LMC's acquisition in 2003 of the Ascent Media shares that it did not already Media is amortizing the "in-the-money" value of these options over the 5-year vesting period. Compensation expense increased $173,000 and $2,650,000 for the years ended er 31, 2004 and 2003, respectively. Results for the year ended December 31, 2004 primarily included compensation expense of $2,268,000 relating to "in-the-money" stock op 7,000 increase in the value of the underlying stock price used to value employee stock appreciation rights, or SARs. The expense recorded for the year ended December 31, 200 primarily to "in-the-money" stock options of $2,491,000. The income recorded for the year ended December 31, 2002 primarily included $3,102,000 relating to a decline in the the SARs, and unearned stock compensation income of $135,000, offset by compensation expense of $3,189,000 relating to "in-the-money" stock options.

*pairment of Goodwill.* Ascent Media recorded an $83,718,000 impairment charge in fiscal 2002 resulting from its annual impairment test. Ascent Media obtained estimates o e of its reporting units from an independent valuation consultant, which used income and market approaches to estimate fair value. The impairment charges represented the exc arrying value of the goodwill over the estimated fair value. Impairment of goodwill charges in 2004 and 2003 were not significant.

*structuring Charges.* During the year ended December 31, 2003, Ascent Media recorded a restructuring charge of $3,476,000 related to the closing of certain facilities and onding reductions in headcount. These restructuring activities were implemented to improve operating efficiencies and effectiveness primarily in its creative services group. cturing charges were not significant in 2004 or 2002.

*terest Expense.* Interest expense in 2003 and 2002 related primarily to interest on Ascent Media's bank debt and subordinated notes payable due to LMC. In December 2003, Media repaid all principal and interest under its bank credit facility with cash provided by LMC. In addition, LMC contributed all amounts due under the subordinated notes pa quity of Ascent Media. As a result of the cancellation of the bank credit facility and the subordinated notes payable, Ascent Media incurred no interest expense in 2004.

*are of Earnings of Discovery.* Our share of earnings of Discovery increased in 2004 and 2003 due primarily to increases in the net income of Discovery. Discovery's net inco ed primarily due to higher revenue and improved operating margins. Prior to June 2003, John Hendricks, Discovery's Founder and Chairman, held shares of Discovery commor at were redeemable on demand. Changes in the redemption value of such shares were recorded by Discovery as adjustments to equity similar to dividends on preferred stock. d in our share of earnings (losses) of Discovery 50% of the equity adjustments related to the redeemable common stock as those adjustments represented an adjustment in earni le to common shareholders. The redeemable common stock was redeemed in June 2003. Our share of earnings (losses) of Discovery included gains of $5,700,000 and losses of 000 for the years ended December 31, 2003 and 2002, respectively, related to changes in the redemption value of the redeemable common stock and other equity transactions.

r a more detailed discussion of Discovery's results of operations, see "—Management's Discussion and Analysis of Financial Condition and Results of Operations of Discovery

*come Taxes.* Our effective tax rate was 34.6% and 21.8% for the years ended December 31, 2004 and 2002, respectively, and was not meaningful in 2003. Our income tax be er than the federal income tax rate of 35% in 2002 primarily due to the impairment of goodwill, which is not deductible for income tax purposes. In 2003, we had a pre-tax loss ,000 and we recorded tax expense of $20,156,000 primarily due to a reduction in our valuation allowance and interest expense that is not deductible for tax purposes.

*mulative Change in Accounting Principle.* Effective January 1, 2002, we adopted SFAS No. 142 and, in accordance with its provisions, we recorded a transitional impairmen of goodwill of $20,227,000 during the first quarter of fiscal 2002. This charge has been reflected as a cumulative effect of a change in accounting principle.

**ty and Capital Resources**

storically our primary sources of funds have been from operating activities and borrowed funds under a senior credit facility and a subordinated debt agreement with LMC. Dur e months ended March 31, 2005, our primary use of cash was capital expenditures ($20,921,000), which we funded with our available cash and cash generated by operating s ($11,005,000). For the year ended December, 31, 2004, our primary uses of cash were acquisitions ($44,238,000) and capital expenditures ($49,292,000). We funded these g activities with cash from operating activities of $84,322,000 and capital contributions from LMC of $30,999,000. Prior to the spin off, LMC has agreed to transfer to one of o ries $200 million in cash. Subsequent to the spin off, LMC will no longer be a long-term source of liquidity for us. For the foreseeable future, we expect to have sufficient avail ances and net cash from operating activities to meet our working capital needs and

expenditure requirements. We intend to seek external equity or debt financing after our spin off in the event new investment opportunities, additional capital expenditures or
sed operations require additional funds, but there can be no assurance that we will be able to obtain equity or debt financing on terms that are acceptable to us.

ur ability to seek additional sources of funding depends on our future financial position and results of operations, which, to a certain extent, are subject to general conditions in
ng our industry and our customers and to general economic, political, financial, competitive, legislative and regulatory factors beyond our control.

'e do not have access to the cash Discovery generates from its operations, unless Discovery pays a dividend on its capital stock or otherwise distributes cash to its stockholders.
cally, Discovery has not paid any dividends on its capital stock and we do not have sufficient voting control to cause Discovery to pay dividends or make other payments or adv

**actual Obligations**

formation concerning the amount and timing of required payments under our contractual obligations at December 31, 2004 is summarized below:

| | Payments due by Period | | | | |
|---|---|---|---|---|---|
| | Less than 1 year | 1-3 years | 4-5 years | After 5 years | Total |
| | amounts in thousands | | | | |
| *ctual Obligations* | | | | | |
| ing leases | $ 25,682 | 45,824 | 37,273 | 52,523 | 161,302 |
| se obligations | 8,152 | — | — | — | 8,152 |
| | — | — | 6,100 | — | 6,100 |
| al Contractual Obligations | $ 33,834 | 45,824 | 43,373 | 52,523 | 175,554 |

e have contingent liabilities related to legal proceedings and other matters arising in the ordinary course of business. Although it is reasonably possible we may incur losses upo
ion of such matters, an estimate of any loss or range of loss cannot be made. In the opinion of management, it is expected that amounts, if any, which may be required to satisfy
encies will not be material in relation to the accompanying consolidated financial statements.

**ccounting Pronouncements**

December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payments" ("Statement
Statement 123R, which is a revision of Statement 123 and supersedes APB Opinion No. 25, establishes standards for the accounting for transactions in which an entity exchan
y instruments for goods or services, primarily focusing on transactions in which an entity obtains employee services. Statement 123R generally requires companies to measure
employee services received in exchange for an award of equity instruments (such as stock options and restricted stock) based on the grant-date fair value of the award, and to
ze that cost over the period during which the employee is required to provide service (usually the vesting period of the award). Statement 123R also requires companies to meas
of employee services received in exchange for an award of liability instruments (such as stock appreciation rights) based on the current fair value of the award, and to remeasu
ie of the award at each reporting date.

blic companies were originally required to adopt Statement 123R as of the beginning of the first interim period that begins after June 15, 2005. On April 14, 2005, the Securitie
ge Commission amended the effective date to the beginning of a registrant's next fiscal year, or January 1,

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or calendar-year companies, such as us. Accordingly, the provisions of Statement 123R will affect the accounting for all awards granted, modified, repurchased or cancelled aft y 1, 2006. The accounting for awards granted, but not vested, prior to January 1, 2006 will also be impacted. The provisions of Statement 123R allow companies to adopt the rd on a prospective basis or to restate all periods for which Statement 123 was effective. We expect to adopt Statement 123R on a prospective basis, and will provide pro forma ation as though the standard had been adopted for all periods presented.

/hile we have not yet quantified the impact of adopting Statement 123R, we believe that such adoption could have a significant effect on our operating income and net earnings

**al Accounting Estimates**

*aluation of Long-lived Assets and Amortizable Other Intangible Assets.* We perform impairment tests for our long-lived assets if an event or circumstance indicates that the g amount of our long-lived assets may not be recoverable. In response to changes in industry and market conditions, we may also strategically realign our resources and consid turing, disposing of, or otherwise exiting businesses. Such activities could result in impairment of our long-lived assets or other intangible assets. We are subject to the possibili ment of long-lived assets arising in the ordinary course of business. We regularly consider the likelihood of impairment and recognize impairment if the carrying amount of a lo sset or intangible asset is not recoverable from its undiscounted cash flows in accordance with SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets. ment is measured as the difference between the carrying amount and the fair value of the asset. We use both the income approach and market approach to estimate fair value. O es of fair value are subject to a high degree of judgment. Accordingly, any value ultimately derived from our long-lived assets may differ from our estimate of fair value.

*luation of Goodwill and Non-amortizable Other Intangible Assets.* We assess the impairment of goodwill annually and whenever events or changes in circumstances indicat ying value may not be recoverable. Factors we consider important which could trigger an impairment review include significant underperformance to historical or projected fu ng results, substantial changes in our strategy or the manner of use of our assets, and significant negative industry or economic trends. Effective January 1, 2002, we adopted SF 2. In accordance with its provisions, during the first quarter of fiscal year 2002, we recorded a transitional impairment charge of $20,227,000 against goodwill related to our inment television reporting unit, which is part of our creative service group. Such charge was reflected as a cumulative effect of a change in accounting principle. Additionally, f our annual impairment testing, we recorded a goodwill impairment charge of $83,718,000 during the fourth quarter of fiscal 2002. Of this impairment charge, $56,818,000 of nent related to our entertainment television reporting unit and $26,900,000 related to our commercial television reporting unit, both part of our creative services group. As a res ual impairment testing, during fiscal 2004 and 2003, we recorded goodwill impairment charges of $51,000 and $562,000, respectively. The impairment charge in fiscal 2004 w Media's audio reporting unit and the impairment charge in fiscal 2003 was in Ascent Media's entertainment television reporting unit, both of which are part of Ascent Media's e services group. Fair value of each reporting unit was determined through the use of an outside independent valuation consultant. The consultant used both the income approac approach in determining fair value.

*luation of Trade Receivables.* We must make estimates of the collectibility of our trade receivables. Our management analyzes the collectibility based on historical bad debts er concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms. We record an allowance for doubtful accounts based upon cally identified receivables that we believe are uncollectible. In addition, we also record an amount based upon a percentage of each aged category of our trade receivables. Thes ages are estimated based upon storical experience of bad debts. Our trade receivables balance was $151,120,000, net of allowance for doubtful accounts of $12,104,000, as of December 31, 2004.

*Valuation of Deferred Tax Assets.* In accordance with SFAS No. 109, Accounting for Income Taxes, we review the nature of each component of our deferred income taxes for ableness. We have determined that it is more likely than not that we will not realize a portion of our tax benefits associated with certain cumulative net operating loss carry forv npairment reserves, and as such, we have reserved for a portion of our deferred income tax assets. The valuation allowance as of December 31, 2004 and 2003 was $76,452,000 470,000, respectively.

**titative and Qualitative Disclosures about Market Risk**

***gn Currency Risk***

Ve continually monitor our economic exposure to changes in foreign exchange rates and may enter into foreign exchange agreements where and when appropriate. Substantially eign transactions are denominated in foreign currencies, including the liabilities of our foreign subsidiaries. Although our foreign transactions are not generally subject to signi exchange transaction gains or losses, the financial statements of our foreign subsidiaries are translated into United States dollars as part of our consolidated financial reporting fluctuations in exchange rates affect our financial position and results of operations.

**gement's Discussion and Analysis of Financial Condition and Results of Operations of Discovery**

**iew**

Ve hold a 50% ownership interest in Discovery and account for this investment using the equity method of accounting. Accordingly, in our financial statements we record our sh ery's net income or loss available to common shareholders and reflect this activity in one line item in the statement of operations as "Share of earnings (losses) of Discovery." ng financial information of Discovery for the three months ended March 31, 2005 and March 31, 2004 and the years ended December 31, 2004, 2003 and 2002 and related ion is presented to provide the reader with additional analysis of the operating results and financial position of Discovery. Because we do not control the decision-making proce s management practices of Discovery, we rely on Discovery to provide us with financial information prepared in accordance with GAAP that we use in the application of the e l. The information included in this section should be read in conjunction with the audited financial statements of Discovery for the year ended December 31, 2004 included else The following discussion and analysis of Discovery's operations and financial position has been prepared based on information that we receive from Discovery and represents nd understanding of their operating performance and financial position based on such information. Discovery is not a separately traded public company, and we do not have th to cause Discovery's management to prepare their own management's discussion and analysis for our purposes. Accordingly, we note that the material presented in this section erent if Discovery's management had prepared it.

**months ended March 31, 2005 and 2004**

he following discussion of Discovery's results of operations is presented on a consolidated basis. In order to provide a better understanding of Discovery's operations, we have a d a summarized presentation of revenue and operating cash flow of Discovery's three operating groups: Discovery networks U.S., or U.S. networks, Discovery networks tional, or international networks, and Discovery commerce, education & other. See "Management's Discussion and Analysis of Financial Condition and Results of Operations o ery Holding—Operating Cash Flow" for our definiton of operating cash flow.

ne U.S. networks is Discovery's largest division. It owns and operates 12 cable and satellite channels and provides distribution and advertising sales services for BBC America. tional networks manages a portfolio of channels, led by the Discovery Channel and Animal Planet brands, that are distributed in virtually every pay-television market in the wo infrastructure that includes major operational centers in London, Singapore, New Delhi and Miami. Discovery commerce, education & other includes Discovery's retail chain st ons and other direct consumer marketing activities as well as Discovery education which was recently formed to manage Discovery's distribution of education content.

**idated Results**

| | Three months ended March 31, | |
|---|---|---|
| | 2005 | 2004 |
| | amounts in thousands | |
| **Revenue** | | |
| Advertising | $ 273,386 | 262,284 |
| Subscriber fees | 281,642 | 227,297 |
| Other | 46,443 | 37,781 |
| *Total revenue* | 601,471 | 527,362 |
| **Expenses** | | |
| Cost of revenue | (218,259) | (181,737) |
| Selling, general & administrative ("SG&A") expense | (234,758) | (208,208) |
| Operating cash flow | 148,454 | 137,417 |
| Expenses arising from long-term incentive plans | (22,867) | (28,780) |
| Depreciation & amortization | (28,821) | (30,833) |
| Operating income | 96,766 | 77,804 |
| **Other Income (Expense)** | | |
| Interest expense, net | (44,908) | (40,734) |
| Unrealized gains from derivative instruments, net | 12,253 | 1,441 |
| Minority interests in consolidated subsidiaries | 2,252 | (2,793) |
| Other | 12,895 | 468 |
| Income before income taxes | 79,258 | 36,186 |
| Income tax expense | (33,629) | (15,335) |
| Net income | $ 45,629 | 20,851 |

ess Segment Results

| | | Three months ended March 31, | |
|---|---|---|---|
| | | 2005 | 2004 |
| | | amounts in thousands | |
| **Revenue** | | | |
| U.S. networks | $ | 416,126 | 381,015 |
| International networks | | 158,916 | 127,000 |
| Discovery commerce, education & other | | 26,429 | 19,347 |
| Total revenue | $ | 601,471 | 527,362 |
| **Operating Cash Flow** | | | |
| U.S. networks | $ | 147,437 | 139,209 |
| International networks | | 24,549 | 16,295 |
| Discovery commerce, education & other | | (23,532) | (18,087) |
| Total operating cash flow | $ | 148,454 | 137,417 |

)iscovery commerce, education & other includes intercompany eliminations.

*venue.* Discovery's consolidated revenue increased 14% for the three months ended March 31, 2005, as compared to the corresponding prior year period. Increased revenue v ly due to a 24% increase in subscriber fee revenue. Advertising revenue increased 4% during the same period. Other revenue increased 23% due to increased commerce revenu in Discovery's education business.

bscriber fee revenue grew 24% and 23% at the U.S. networks and the international networks, respectively, for the three months ended March 31, 2005, as compared to the onding prior year period. The increase in subscriber fees at the U.S. networks is due to a 14% increase in paying subscription units combined with lower launch support ation. Free viewing periods related to a number of U.S. networks, principally networks that are carried on the digital tier, expired in 2004 and Discovery is now recognizing ɔer fees for those networks. U.S. networks subscriber fee increases were helped by reduced launch fee amortization, a contra-revenue item, as a result of extensions of certain on agreements. Launch amortization at the U.S. networks declined from $25.8 million during the first quarter of 2004 to $20.2 million in 2005 primarily due to these extensions es in subscriber fees at the international networks were driven principally by increases in subscription units in Europe and the international joint venture channels due to recentl d networks.

e increase in advertising revenue, which includes revenue from paid programming, was primarily due to a 40% increase at the international networks. More than half of the ional networks' advertising revenue is generated by its operations in the U.K. and Europe. The increase in international networks advertising revenue was due primarily to highe ing rates and audience growth in the U.K., combined with advertising revenue generated by new channels launched in Europe. Advertising revenue at the U.S. networks was lly flat as higher advertising rates at substantially all of the U.S. networks were offset by lower audience delivery at certain networks. Paid programming, where Discovery sell of time primarily for infomercials that are aired during the overnight hours on certain networks, represented 7% and 8% of total advertising revenue for the three months ended 1, 2005 and 2004, respectively.

e increase in other revenue was primarily due to an increase in education revenue due to growth in the business and acquisitions combined with a 12% increase in store revenue in store revenue was due to a 20% increase in same store sales offset by a 7% decrease in the average number of stores.

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*'ost of Revenue.* Cost of revenue increased 20% for the three months ended March 31, 2005 as compared to the corresponding prior year period. As a percent of revenue, cost ie was 36% and 35% for the three months ended March 31, 2005 and 2004, respectively. This increase resulted primarily from higher programming expense due to continued nent across all U.S. networks in original productions and high profile specials. At the international networks, Discovery began investing in an initiative to highlight and strengtl les category, particularly in Europe during the fourth quarter of 2004, which has resulted in increased programming costs.

*G&A Expenses.* SG&A expense increased 13% for the three months ended March 31, 2005, as compared to the corresponding prior year period. Within the different groups, expenses increased 3%, 23% and 42% at the U.S. networks, international networks and Discovery commerce, education & other, respectively. The increase at the international ks was caused by increases in personnel expense resulting from adding headcount as the business expanded combined with higher marketing expense associated with branding ness efforts in association with the lifestyles category initiative. The increase in SG&A expenses at Discovery commerce, education & other is primarily due to the growth in ery's education business, resulting from both acquisitions and organic growth.

*xpenses Arising from Long-term Incentive Plans.* Expenses arising from long-term incentive plans are related to Discovery's unit-based, long-term incentive plan, or LTIP, fo yees who meet certain eligibility criteria. Units are awarded to eligible employees and generally vest at a rate of 25% per year. Upon exercise, participants receive a cash payme rease in value of the units from the unit value on the date of issuance. Unit value is determined annually by the year over year change in Discovery's aggregate equity value as ted by an external investment firm, using a consistent methodology. The appreciation in unit value of LTIP awards outstanding is recorded as compensation expense over the ve s. The aggregate number of units that are currently authorized to be granted under the LTIP plan approximates an 8% sharing in the change in Discovery's equity value. The 21% ,000, decrease in LTIP expense in 2005 is the result of units being exercised in 2004, which increased the weighted average exercise price of vested options.

*epreciation and Amortization.* The decrease in depreciation and amortization for the quarter ended March 31, 2005 is primarily due to a decrease in the depreciable asset base ng from a reduction in the number of retail stores.

**Income and Expense**

*terest Expense.* The increase in interest expense for the quarter ended March 31, 2005 is primarily due to a higher average outstanding debt balance during the first quarter of s compared to the first quarter of 2004, combined with an increase in average interest rates.

*nrealized Gains from Derivative Instruments, net.* Unrealized gains from derivative transactions relate primarily to Discovery's use of derivative instruments to modify its exp est rate fluctuations on its debt. These derivative contracts include a combination of swaps, caps, collars and other structured instruments. As a result of unrealized mark to mar nents, Discovery recognized $12,253,000 and $1,441,000 in gains on these instruments during the quarters ended March 31, 2005 and 2004, respectively. The foreign exchange g instruments used by Discovery are spot, forward and option contracts. Additionally, Discovery enters into forward contracts to hedge non-dollar denominated cash flows and currency balances. The unrealized gains were primarily driven by increases in interest rates during the quarter resulting in an increase in value of the underlying derivatives.

*inority Interests in Consolidated Subsidiaries.* Minority interest represents increases and decreases in the estimated redemption value of mandatory redeemable interests in aries which are initially d at fair value. Discovery accretes or decretes the mandatorily redeemable interest in a subsidiary to its estimated redemption value through the redemption date. Based on its m estimates, Discovery recorded a net minority interest decretion of $1,650,000 during the three months ended March 31, 2005, compared to a net minority accretion of $2,793,00 e months ended March 31, 2004.

*her.* Other represents Discovery's share of earnings (losses) of affiliates and gains (losses) on sales of investments. During the first quarter of 2005, Discovery recognized a g 1,000 related to a sale of an available for sale investment.

*come Taxes.* Discovery's effective tax rate was 42% for both the three months ended March 31, 2005 and 2004, respectively. Discovery's effective tax rate differed from the income tax rate of 35% primarily due to foreign and state taxes.

**nded December 31, 2004, 2003 and 2002**

e following discussion of Discovery's results of operations is presented in two parts to assist the reader in better understanding Discovery's operations. The first section is an ov ion of Discovery's consolidated operating results. The second section includes a more detailed discussion of revenue and operating cash flow activity of Discovery's three opera Discovery networks U.S., or U.S. networks, Discovery networks international, or international networks, and Discovery commerce, education & other.

**idated Results**

| | Years ended December 31, | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| | amounts in thousands | | |
| **e** | | | |
| sing | $ 1,133,807 | 1,010,585 | 829,936 |
| ber fees | 976,362 | 747,927 | 646,500 |
| | 255,177 | 236,535 | 240,339 |
| venue | 2,365,346 | 1,995,047 | 1,716,775 |
| **es** | | | |
| revenue | (846,316) | (751,578) | (699,737) |
| expense | (856,340) | (735,017) | (638,405) |
| rating cash flow | 662,690 | 508,452 | 378,633 |
| s arising from long-term incentive plans | (71,515) | (74,119) | (96,865) |
| ation & amortization | (129,011) | (120,172) | (112,841) |
| sale of patents | 22,007 | — | — |
| rating income | 484,171 | 314,161 | 168,927 |
| **ncome (Expense)** | | | |
| expense, net | (167,420) | (159,409) | (163,315) |
| ed gains (losses) from derivative instruments, net | 45,540 | 21,405 | (11,607) |
| interests in consolidated subsidiaries | (54,940) | (35,965) | (45,977) |
| | 2,470 | (2,170) | (6,141) |

| | | | |
|---|---|---|---|
| Income (loss) before income taxes | 309,821 | 138,022 | (58,113) |
| Income tax (expense) benefit | (141,799) | (74,785) | 10,057 |
| Net income (loss) | $ 168,022 | 63,237 | (48,056) |

*evenue.* Discovery's consolidated revenue increased 19% and 16% for the years ended December 31, 2004 and 2003, respectively, as compared to the corresponding prior ye
sed revenue was primarily due to increases of 31% and 16% in subscriber fee revenue for 2004 and 2003, respectively, as well as increases of 12% and 22% in advertising rever
same periods. Changes in other revenue did not have a significant impact on the overall revenue increase for either year. Increased subscriber fee revenue is primarily due to
ctual rate increases, subscriber growth and a reduction in launch support amortization as certain affiliation agreements were extended. Subscriber fees also benefited from contr
ements whereby certain subscribers that were previously covered under free carriage periods with distributors were converted to paying subscribers. Increases in advertising rev
includes revenue from paid programming, were primarily due to increased advertising rates at the U.S. networks combined with positive developments in international network
sing sales resulting from continued growth in subscription units. Paid programming, where Discovery sells blocks of time primarily for infomercials that are aired during the
ght hours on certain networks, represented 6%, 6% and 7% of total advertising revenue for the years ended December 31, 2004, 2003, and 2002, respectively.

*ost of Revenue and SG&A Expense.* Consolidated operating expenses, which for purposes of this discussion includes cost of revenue and SG&A expenses, increased 15% an
years ended December 31, 2004 and 2003, respectively, as compared to the corresponding prior year. Operating expenses increased primarily as a result of higher programmin
or Discovery's U.S. networks as well as higher personnel and marketing costs at both the U.S. and international networks. Expenses related to programming, personnel and mar
p approximately 64% of Discovery's consolidated operating expenses in 2004. Historically, these costs have not increased at the same rate as revenue due to the benefits of sca
nics, combined with ongoing cost management initiatives, as described below. As a result, Discovery has been able to increase its operating cash flow as a percent of revenue f
2002 to 25% in 2003 and 28% in 2004.

*xpenses Arising from Long-term Incentive Plans.* Expenses arising from long-term incentive plans are related to Discovery's unit-based, long-term incentive plan, or LTIP, fo
yees who meet certain eligibility criteria. Units are awarded to eligible employees and generally vest at a rate of 25% per year. Upon exercise, participants receive a cash payme
rease in value of the units from the unit value on the date of issuance. Unit value is determined by the year over year change in Discovery's aggregate equity value as estimated
l investment firm, using a consistent methodology. The appreciation in unit value of LTIP awards outstanding is recorded as compensation expense over the vesting periods. T
ate number of units that are currently authorized to be granted under the LTIP plan approximates an 8% sharing in the change in Discovery's equity value.

*epreciation and Amortization.* The increase in depreciation and amortization in both 2004 and 2003 is due to an increase in intangible assets resulting from acquisitions comb
creases in Discovery's depreciable asset base resulting from capital expenditures.

*ain on Sale of Patents.* In 2004, Discovery recorded a gain on the sale of certain of its television technology patents. The $22 million gain represents the sale price less the co
d to sell the patents. The cost of developing the technology had been expensed in prior years to SG&A expense. Discovery does not expect a significant amount of income from
sales in the future.

*ngoing Cost Management Initiatives.* Discovery has an extensive library of programming and footage that provides a high quality programming resource for launching new
s quickly while minimizing incremental costs. Existing programming is re-edited and updated to provide topical programming content in a cost-effective manner. In addition,
ery has expanded its internal post-production capacity to contain programming costs further. Marketing efficiencies have been achieved through the use of internal promotion ti
in personnel has been contained through economies of scale and workflow improvements.

**Income and Expense**

*iterest Expense.* The increase in interest expense in 2004 is primarily due to higher levels of outstanding debt in 2004 as well as a slight increase in interest rates. Interest exp wer in 2003, as compared with 2002 due primarily to a modest reduction in average interest rates.

*Inrealized Gains (Losses) from Derivative Instruments, net.* Unrealized gains and losses from derivative transactions relate, primarily, to Discovery's use of derivative instrum lify its exposure to interest rate fluctuations on its debt. These instrument contracts include a combination of swaps, caps, collars and other structured instruments. At December he variable to fixed interest rate instruments have a notional principal amount of $800,000,000 and have a weighted average interest rate of 5.93%. At December 31, 2004, the able interest rate agreements have a notional principal amount of $240,000,000 and have a weighted average interest rate of 6.46%. As a result of unrealized mark to market nents, Discovery recognized $44,060,000, $21,548,000 and $(13,375,000) in gains (losses) on these instruments during the years ended December 31, 2004, 2003 and 2002, ively. The foreign exchange hedging instruments used by Discovery are spot, forward and option contracts. Additionally, Discovery enters into forward contracts to hedge non- inated cash flows and foreign currency balances. At December 31, 2004, the notional amount of foreign exchange derivative contracts was $92,800,000.

*Iinority Interests in Consolidated Subsidiaries.* Minority interest represents increases and decreases in the estimated redemption value of mandatory redeemable interests in aries which are initially recorded at fair value.

*come Taxes.* Discovery's effective tax rate was 46%, 54% and 17% for 2004, 2003 and 2002, respectively. Discovery's effective tax rate differed from the federal income tax primarily due to foreign and state taxes.

**ss Segment Results**

s noted above, we have classified Discovery's operations into three groups: U.S. networks, international networks and Discovery commerce, education & other.

| | Years ended December 31, | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| | | amounts in thousands | |
| **ie** | | | |
| tworks | $ 1,605,032 | 1,351,336 | 1,121,149 |
| ional networks | 583,062 | 473,890 | 409,221 |
| ery commerce, education & other | 177,252 | 169,821 | 186,405 |
| l revenue | $ 2,365,346 | 1,995,047 | 1,716,775 |
| **ing Cash Flow** | | | |
| tworks | $ 599,954 | 486,580 | 416,946 |
| ional networks | 97,073 | 68,439 | 15,744 |
| ery commerce, education & other | (34,337) | (46,567) | (54,057) |
| l operating cash flow | $ 662,690 | 508,452 | 378,633 |

)iscovery commerce, education & other includes intercompany eliminations.

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*letworks*

| | Years ended December 31, | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| | | amounts in thousands | |
| **ue** | | | |
| ising | $ 943,454 | 865,239 | 717,684 |
| iber fees | 611,458 | 444,953 | 384,614 |
| | 50,120 | 41,144 | 18,851 |
| al revenue | 1,605,032 | 1,351,336 | 1,121,149 |
| revenue | (501,313) | (420,251) | (349,898) |
| expense | (503,765) | (444,505) | (354,305) |
| rating cash flow | $ 599,954 | 486,580 | 416,946 |

**ue**

2004, advertising revenue increased 9%, subscriber fees increased 37% and other revenue increased 22%. Substantially all of the U.S. networks saw increases in advertising e. Such increases were principally due to higher advertising sell-out and rates. While overall subscription units increased 5%, subscriber fees increased at a higher rate primarily ractual rate increases at most U.S. networks combined with a 14% increase in paying subscribers. Free viewing periods related to a number of U.S. networks, principally netwo carried on the digital tier, expired in 2004 and Discovery began to recognize subscriber fees for those networks. Subscriber fee increases were also helped by reduced launch f zation, a contra-revenue item, as a result of extensions of certain affiliation agreements. Launch amortization declined from $118,888,000 in 2003 to $93,763,000 in 2004 prima hese extensions. Other revenue primarily increased as a result of increased revenue from Discovery's representation of BBC America.

evenue increased 21% in 2003 primarily due to a 21% increase in advertising revenue and a 16% increase in subscriber fees. Higher advertising revenue was primarily attributa rates and ratings across nearly all of the U.S. networks. Increased subscriber fees were due to a 20% increase in cumulative subscription units as well as a modest reduction in support amortization from $122,429,000 to $118,888,000. Other revenue increased as a result of increased revenue from Discovery's representation of BBC America due to ed distribution of that channel.

e U.S. networks group has five networks (Discovery Channel, TLC, Animal Planet, Travel Channel and Discovery Health), which are currently, or pursuant to contractual laun ments are reasonably anticipated to be, among the most widely-distributed networks in the U.S. pay television industry. Discovery's other U.S. networks are distributed primar stems and the digital packages of cable systems and have been successful in maximizing their distribution within this more limited universe. There is, however, no guarantee t gital networks will ever be able to gain the distribution levels or advertising rates of Discovery's five major networks. Discovery's contractual arrangements with U.S. distribut ewed or renegotiated from time to time in the ordinary course of business. Discovery has renewed long-term contracts with distributors representing approximately 75% of the vision universe, the majority of which have terms through 2009. Only 1% of the U.S. networks aggregate subscription units are carried under agreements that are either expire n the next twelve months.

**f Revenue and SG&A Expense**

2004, cost of revenue increased 19%, due primarily to an increase in programming costs. Programming expense increased due to continued investment across all U.S. network l productions and high profile specials. The U.S. networks increased the number of hours related to first run premiere programming and exhibited one high profile special produ quarter on the Discovery Channel. SG&A expenses increased 13% due to an increase in marketing and other variable expenses. Marketing expense increased as the company ed to invest in brand promotion, gaining audience share in a highly competitive market, and securing quality distribution of the U.S. networks. Other variable expenses increase of the increase in revenue.

2003, cost of revenue increased 20%, primarily due to a 19% increase in programming costs. The increase in programming costs was primarily due to Discovery's renewed is on original productions with a significant increase in the number of programming hours dedicated to first run premiere programming. SG&A expense increased 25% due to e in personnel costs and a 41% increase in marketing costs. Personnel costs increased across all of the U.S. networks resulting from the growth of the division. Marketing costs ed at most of the U.S. networks as Discovery invested in campaigns designed to raise channel awareness and increase ratings.

*tional Networks*

| | Years ended December 31, | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| | amounts in thousands | | |
| ie | | | |
| sing | $ 190,185 | 144,971 | 112,110 |
| ber fees | 364,911 | 302,973 | 261,887 |
| | 27,966 | 25,946 | 35,224 |
| l revenue | 583,062 | 473,890 | 409,221 |
| revenue | (258,108) | (236,555) | (225,595) |
| expenses | (227,881) | (168,896) | (167,882) |
| rating cash flow | $ 97,073 | 68,439 | 15,744 |

**e**

2004, Discovery's international networks revenue increased 23% primarily as a result of a 20% increase in subscriber fees and a 31% increase in advertising revenue. Increases er fees were driven principally by increases in subscription units in Europe and the international joint venture channels. More than half of the international networks' advertisin is generated by its operations in the United Kingdom with the remainder principally coming from Asia, Latin America and Continental Europe. Specific reasons for the increas ing revenue include: (1) higher advertising rates and higher viewership ratings in the U.K. and Latin America and (2) increased distribution in Asia.

2003, revenue increased 16% as a result of a 16% increase in subscriber fees and a 29% growth in advertising revenue offset slightly by a decrease in other revenue. Subscriber d due to subscription unit growth of 24% and subscription rate increases on paying subscription units across substantially all of its regions. Subscriber fee revenue grew at a slo the overall increase in subscription units due to many of the new subscription units initially being in free preview status. Advertising revenue increased as a result of audience n the U.K. and Europe partially offset by ess in Latin America. Other revenue decreased due to a reduction in programming sales to third parties.

uring the years ended December 31, 2004, 2003 and 2002, the international networks group's fluctuations in revenue and operating cash flow were impacted favorably by chan change rates of various foreign currencies. In the event the U.S. dollar strengthens against certain foreign currencies in the future, the international networks group's revenue and ng cash flow will be negatively impacted. Had there been no impact from changes in exchange rates of foreign currencies, the international networks would have increased reve erating cash flow 16% and 35% during the year ended December 31, 2004 and 9% and 208% during the year ended December 31, 2003.

**f Revenue and SG&A Expense**

2004, cost of revenue increased primarily due to a 2% increase in programming costs combined with the effects of foreign currency fluctuations. Discovery's ability to leverag ogramming library in international markets at minimal translation costs has helped reduce programming expense as a percentage of revenue. SG&A expense for Discovery's tional networks increased 35% due to a 20% increase in personnel costs and a 40% increase in marketing expenses. Increases in personnel expense are the result of adding head business expands particularly in the U.K. and Europe. Higher marketing expenses were experienced across all of the regions as the division continues to brand and create aware channels. Discovery also began investing in an initiative to highlight and strengthen its lifestyles category, particularly in Europe, in the fourth quarter of 2004. Increases in oth es were primarily due to the continued expansion of the business and unfavorable foreign currency exchange rates.

ost of revenue increased 5% in 2003 due to small increases in programming expense due primarily to the effects of foreign currency fluctuations. SG&A expenses were relative ent, only increasing 1% during the year ended December 31, 2003. Relatively modest increases in expense items despite the larger increase in revenue reflects the benefits of sc nics achieved by the international networks in 2003.

iscovery's international businesses are subject to a number of risks including fluctuation in currency exchange rates and political unrest. In addition, the economies in many of t where Discovery's international businesses operate have recently experienced moderate to severe recessionary conditions, including among others, Argentina, Germany and Ja ecessionary conditions have strained consumer and corporate spending and financial systems and financial institutions in these areas. As a result, Discovery's operations in thes ave experienced a reduction in consumer spending and demand for services.

***ery Commerce, Education & Other***

| | Years ended December 31, | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| | amounts in thousands | | |
| **ie** | | | |
| | $ 202,586 | 189,666 | 193,641 |
| tions | (25,334) | (19,845) | (7,236) |
| l revenue | 177,252 | 169,821 | 186,405 |
| revenue | (86,895) | (94,772) | (123,779) |
| expense | (124,694) | (121,616) | (116,683) |
| rating Cash Flow | $ (34,337) | (46,567) | (54,057) |

he majority of the financial results included in Discovery commerce, education & other are derived from Discovery's chain of retail stores in the United States. Over the past l years, pursuant to an initiative that began at the beginning of 2003, Discovery has closed retail outlets that were not profitable. The average number of retail stores was 122, 14 r the years ended December 31, 2004, 2003 and 2002, respectively.

**ue**

he increase in revenue of 4% for Discovery commerce, education & other for the year ended December 31, 2004 was primarily due to an increase in education revenue due to itions, offset by a 5% decrease in store revenue. The decrease in store revenue was due to the closure of unprofitable stores, which resulted in a 15% reduction in the average nu es. Discovery began an initiative in 2003 to close stores that were not profitable. Lower revenue as a result of fewer stores was partially offset by a 4% improvement in same sto

1 2003, overall revenue declined slightly due to 14% fewer retail stores, offset by a 30% increase in sales through Discovery's website and catalog. Store revenue was also negat ed by a 1% decline in same store sales.

**f Revenue and SG&A Expense**

1 2004, cost of revenue declined 8% due to fewer stores. This decrease was offset slightly by disposals of obsolete inventory. SG&A expenses increased due to additional expen ted with acquired businesses within Discovery's education division combined with store closure costs offset by a reduction in store personnel costs due to lower headcount at th as a result of store closures throughout 2004 and 2003.

2003, cost of revenue declined as a result of fewer stores as well as improvements in gross margin from changes in product mix. In 2003, Discovery increased its focus on tary products which typically yield higher gross margins.

s a result of certain acquisitions and other initiatives in 2004 Discovery believes it will incur additional operating losses in its education division, which could be significant ove veral years.

**ity & Capital Resources**

iscovery generated $30,152,000 of cash from operations during the three months ended March 31, 2005 and used $202,435,000 of cash from operations during the comparable riod. The company's source of cash from operations during the three months ended March 31, 2005 was its operating cash flow offset by interest expense of $44,908,000 and g capital fluctuations. During the three months ended March 31, 2004, the company's use of cash from operations resulted from operating cash flow less cash paid for interest e, working capital fluctuations and payments associated with the company's long-term incentive plan in the amount of $207,504,000.

uring the three months ended March 31, 2005, Discovery paid $92,874,000 to acquire mandatorily redeemable securities related to minority interests in certain consolidated aries. Discovery also spent $35,459,000 on capital expenditures during the period. Cash flows used for investing purposes during the first quarter of 2004 were not significant.

addition to cash provided by operations, Discovery funds its activities with proceeds borrowed under various debt facilities, including a term loan, a revolving loan facility and senior notes payable. During the three months ended March 31, 2005 and 2004, net incremental borrowings under debt facilities aggregated $102,000,000 and $254,000,000, ively. Total commitments of these es were $3,490,000,000 at March 31, 2005. Debt outstanding on these facilities aggregated $2,580,000,000 at March 31, 2005, providing excess debt availability of $910,000,00

ll term and revolving loans and senior notes are unsecured. They contain covenants that require Discovery to meet certain financial ratios and place restrictions on the payment nds, sale of assets, additional borrowings, mergers, and purchases of capital stock, assets and investments. Discovery has indicated they are in compliance with all debt covenant 31, 2005.

2005, including amounts discussed above, Discovery expects to spend approximately $125,000,000 for capital expenditures, $170,000,000 for interest expense, and approxima 0,000 for LTIP obligations. Amounts expensed and payable under the LTIP are dependent on future annual calculations of unit values which in turn are affected primarily by ch overy's value as estimated by an external investment banking firm, annual grants of additional units, redemptions of existing units, and changes to the plan. Discovery believes flow from operations and borrowings available under its credit facilities will be sufficient to fund its working capital requirements, including LTIP obligations.

iscovery generated $124,690,000, $154,191,000 and $139,010,000 of cash from operations during the years ended December 31, 2004, 2003 and 2002, respectively. In 2004, th se in cash provided by operations was due to payments of LTIP obligations partially offset by improved net income. Additionally, Discovery paid $148,880,000 for the acquisiti rity interest in Discovery Health. As part of his long-term incentive plan with Discovery, John Hendricks, Discovery's Founder and Chairman, had a ten-year incentive agreeme nted him a cash award equal to 1.6% of the difference between Discovery's value at December 31, 1993 and December 31, 2003 for his services as Chairman and Chief Execut during the period. This cash award was paid out to Mr. Hendricks in two installments, one in December 2003 and one in February 2004. The portion of the cash award that was February 2004 along with payments to other members of the Discovery management team during 2004 totaled $240,752,000 in connection with the redemption of units pursuan ns of the LTIP. For a further discussion of Discovery's LTIP, please see Note 15 to the Discovery consolidated financial statements on pages F-57 to F-58.

addition to previous long-term incentive plans that have expired and have been paid out as described herein, Mr. Hendricks has been awarded long-term compensation units, w Mr. Hendricks with a total 2.5% participation in Discovery's increase in valuation in accordance with Discovery's LTIP.

2003, the increase in cash provided by operations was principally attributed to Discovery reporting net income of $63,237,000 in 2003 compared to a net loss of $48,056,000 in n 2003, Discovery paid the first installment of the previously mentioned cash payment under John Hendricks' LTIP, along with payments to other members of management, in t of $51,023,000. Additionally, Discovery repurchased $55,334,000 of its common equity pursuant to a put right held by John Hendricks, the Founder, Chairman and then Chief ve Officer of Discovery. Other than obligations under Discovery's LTIP, Discovery is not obligated under any other put rights with respect to Discovery equity securities and d e any additional obligations to repurchase equity or equity-based securities of Discovery. However, under certain circumstances, Discovery may be required to buy out the min s in certain channels that are not currently wholly owned by Discovery. See "—Contractual Obligations."

*ontractual Obligations.* Discovery has agreements covering leases of satellite transponders, facilities and equipment. These agreements expire at various dates through 2019. ery is obligated to license programming under agreements with content suppliers that expire over various dates. Discovery also has other contractual commitments arising in the y course of business.

summary of all of the expected payments for these commitments as well as future principal payments under the current debt arrangements and minimum payments under capita
t December 31, 2004 is as follows:

| | | Payments due by period(2) | | | | |
|---|---|---|---|---|---|---|
| | | Total | Less than 1 year | 1-3 years | 4-5 years | After 5 years |
| | | amounts in thousands | | | | |
| rm debt | $ | 2,478,000 | — | 534,000 | 1,488,000 | 456,000 |
| leases | | 32,267 | 5,063 | 11,206 | 7,583 | 8,415 |
| ng leases | | 477,755 | 80,088 | 129,987 | 88,932 | 178,748 |
| n license fees | | 638,666 | 296,826 | 128,039 | 112,903 | 100,898 |
| incentives | | 67,837 | 33,509 | 34,328 | — | — |
| ) | | 241,185 | 66,170 | 107,458 | 63,477 | 4,080 |
| l | $ | 3,935,710 | 481,656 | 945,018 | 1,760,895 | 748,141 |

Represents Discovery's obligations to purchase goods and services whereby the underlying agreements are enforceable, legally binding and specify all significant terms. The m significant purchase obligations include: agreements related to audience ratings, market research, contracts for entertainment talent and other education and service project agreements.

Table does not include certain long-term obligations reflected in the Discovery consolidated balance sheet as the timing of the payments cannot be predicted or the amounts wil be settled in cash. The most significant of these obligations is the $322.4 million accrued under Discovery's LTIP plans. In addition, amounts accrued in the Discovery consolid balance sheet related to derivative financial instruments are not included in the table as such amounts may not be settled in cash or the timing of the payments cannot be predict

scovery is subject to certain contractual agreements that may require Discovery to acquire the ownership interests of minority partners. At the end of 2004, Discovery estimates te obligations thereunder at approximately $319,567,000. The put rights are exercisable at various dates, certain of which have already been exercised at December 31, 2004. T s due associated with the put rights that have already been exercised is $142,874,000.

connection with the execution of long-term distribution agreements for certain of its European cable networks, Discovery is committed to pay a distributor a percentage increas e of these networks, if any, at the termination of the contract on December 31, 2006. Discovery adjusts its recorded liability for changes in the value of these networks each per r, Discovery is currently unable to predict the likelihood or the terms and conditions of any renewal or extension of the distribution agreements. Discovery will record the effec l or extended distribution agreement when such terms are in place. The effect of a renewed or extended agreement could result in a payment for an amount significantly greater unt currently accrued.