

## BUSINESS REVIEW

### Production, Distribution and Licensing of Content



Prudent investment and stringent cost control measures were implemented on production and the Company maintained an operating profit of approximately HK\$126,000 in the year ended 31st March, 2004 (2003: HK\$2 million). The Company maintained a balanced portfolio of self-produced and co-produced films and commissioned projects with an objective to enriching its quality content library. Through various production labels, the Group produced and licensed premium Chinese entertainment content for movies, television programs and documentaries.

The Group's associated company, Applause Pictures, continued to engage in syndicate financing and initiated co-production projects during the year. *"The Eye"*, which achieved unprecedented success Asia-wide last year, was released in European and North American countries this year. The successful expansion of its regional and global distribution not only outperformed other competitors in the local market, but also strengthened the leading position of Applause Pictures in the pan-Asian film market. *"Golden Chicken 2"*, starring Miss Sandra Ng, was released in Hong Kong during the Christmas of 2003 and grossed box-office receipts of approximately HK\$10 million. *"The Eye 2"*, starring Miss Shu Qi, also grossed satisfactory box-office receipts during its debut in Asia in late March 2004.

Anytime Pictures is a new premium movie production venture wholly owned by the Company and aims to produce high quality movies targeting Hong Kong and the PRC market. Led by one of the Company's directors, eminent movie enthusiast Mr. Tsang Chi Wai, Eric, Anytime Pictures focuses on nurturing up-and-coming filmmaking talents and the development of movies with bold concepts and new elements. *"Men Suddenly In Black"*, directed by Mr. Pang Ho Cheung, was released in September 2003. It achieved satisfactory box office results and attracted significant market attention. The movie was one of the *"Best Ten Chinese Films"* at the 9th Golden Bauhinia Awards, and Mr. Tony Leung Ka Fai and Mr. Pang Ho Cheung were awarded the *"Best Supporting Actor"* and *"Best New Director"* for their respective roles at the 23rd Hong Kong Film Awards. Another movie and TV program production label of the Group, Bob, became an associated company of the Group during the year.

The Group's highly acclaimed documentary label, Discover China has been focusing on the production of quality documentaries featuring Chinese customs and traditions. The Group was appointed by Discovery Networks Asia as the supervising producer of the project *"First-time Filmmakers – 2002"* in China and produced a series of six half-hour documentaries. The series were aired on Discovery Networks Asia in June 2003 with impressive rating performance. The excellence in such documentary production won critical acclaim and international recognition, with *"The Weight of Paper"* being the winner of *"The Best Documentary"* while *"Beating Tradition"* and *"Forever Beijing"* were Runner-ups in The Asian TV Awards. The series were also finalists in the New York Festivals 2004.



Movie *"Men Suddenly in Black"*



Movie *"The Eye 2"*



Movie *"Golden Chicken 2"*



Documentary *"Myths and logic of Shaolin Kung Fu"*



Movie *"Jiang Hu"*

## Leisure Business



Leisure business contributed an operating loss of approximately HK\$17 million (2003: HK\$10 million), which comprised an operating loss of approximately HK\$18 million (2003: HK\$12 million) from theme restaurant operations and an operating gain of approximately HK\$1 million (2003: HK\$2 million) from theme restaurant franchising.

During the year, leisure business was hit by the adverse impact of SARS and operational performance had lagged behind management's expectations. Positive contribution from



Star East, Shanghai



Planet Hollywood, Tokyo

continued cost rationalization in theme restaurant operations was nullified by the negative impact of SARS. In line with the Group's strategy of concentrating on businesses with growth prospects, the Group made no further investments or expansions in theme restaurant operations and divested its interests in Planet Hollywood Asia in December 2003. Theme restaurant operation of the Group now comprises mainly Star East, Shanghai and Planet Hollywood, Japan.

## Other Businesses

### Talent Management and Music Production

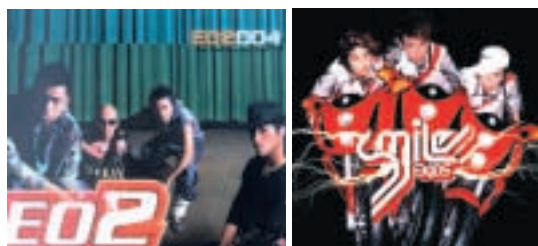


Artistes managed by Star East

Talent management and music production recorded an operating loss of approximately HK\$9 million (2003: HK\$14 million). Amidst the gloomy environment of the local music industry, the Company only released 3 new music albums during the year. Nevertheless, the Group and its artistes won a number of awards including "The Most Popular Group Song" (bronze prize) and "Outstanding Performance of the Year" (bronze prize) at TVB's "JSG Annual Awards Presentation 2003", "Karaoke Song Award" and "The Most Popular Dance Song" at Metro Radio's "Hit Radio Billboard Awards Presentation 2003"; and "The Best New Female Artist" (silver prize) at TVB8 Channel 2003. In view of the continued losses recorded in the music production

division and the increasingly competitive operating environment, the management decided to scale down the operations of music production towards the end of the year.

As at 31st March, 2004, the Group managed over 20 artistes. The negative impact of SARS during the year had resulted in cancellation or postponement of artistes' jobs, which adversely affected the performance of the talent management division. However, operational restructuring was implemented by the end of the financial year to increase cost efficiencies of the division.



CD albums published by Star East



Artistes managed by Star East

### Wireless Value-Added Services

China possesses the largest mobile subscriber base in the world which has spurred growing demand for wireless value-added services in recent years. Building on the Group's strengths in content production, the Group has embarked on the provision of exclusive entertainment content to wireless value-added service providers and invested in entities offering fee-based entertainment-oriented wireless value-added services, including short messaging services (SMS), multimedia messaging services (MMS), wireless application protocol services (WAP), color ringback tone (CRBT) and interactive voice response services (IVRS), to nationwide mobile phone users in China. Recognizing the huge market potential, the Group has been exploring further investment opportunities in the wireless value-added service market in China.



### Strategic Investment in M Channel Corporation Limited

The Group has been holding an effective interest of approximately 26.91% in M Channel. M Channel was principally engaged in the out-of-home audio and video media business through a platform of approximately 1,000 public light buses and approximately 160 fixed locations (including those within Watson's the Chemist and fast food chain stores) in Hong Kong and approximately 600 public buses in Guangzhou.



M Channel

## FUND RAISING

During the year, the Group raised new equity funding of approximately HK\$135 million pursuant to (i) a placing of 300 million new shares at a price of HK\$0.04 per share to independent third parties, which was completed on 12th June, 2003; (ii) a subscription of 500 million new shares by ITC Corporation Limited (“ITC”) at a price of HK\$0.04 per share, which was completed on 9th July, 2003; and (iii) subscriptions of 1,100 million and 1,575 million new shares by Strategic Media International Limited (“SMI”) at a price of HK\$0.04 per share, which were completed on 9th July, 2003 and 19th December, 2003 respectively.

Of the HK\$135 million equity funding raised as aforesaid, approximately HK\$20 million was applied by the Group to partially repay a shareholder’s loan, HK\$84 million was used for general working capital, and the remaining HK\$31 million was invested in media and entertainment related businesses.

## MATERIAL ACQUISITION AND DISPOSAL

On 6th November, 2003, the Company entered into a conditional sale and purchase agreement with SMI (“Realmax S&P Agreement”) for the acquisition of the entire issued share capital of Realmax Holdings Limited (“Realmax”) (which holds an indirect 20% equity interest in a Sino-foreign joint venture engaged in the research, development and production of computer software, prop scene, costumes and lighting equipment, provision of consultancy and technical support service for the aforesaid products, and leasing and sale of such products) and the shareholder’s loan extended by SMI to Realmax at an aggregate consideration of HK\$20 million. Due to the longer than expected progress to completion and the availability of other favourable investment opportunities for the Group, through mutual agreement the Realmax S&P Agreement was subsequently terminated by the parties on 16th February, 2004.

In February 2004, the Group entered into sale and purchase agreements to acquire a 50% interest in Chengdu Stellar Digital Information Company Limited (“Stellar Digital”) and a 25% interest in Stellar Cinema Investment Company Limited (now renamed Stellar Cinema Development Limited) (“Stellar Cinema”). Both companies were incorporated in the PRC with limited liability. Stellar Digital is engaged in the operations of cyber cafés and the provisions of management services to other cyber cafés in the PRC. It also provides entertainment media content and training services to its managed cyber cafés. Stellar Cinema is engaged in the development and redevelopment of cinemas, operations and management of those newly built and/or renovated cinemas and the provisions of management and other services ancillary to the operation of cinemas. The sale and purchase agreements to acquire the 50% interest in Stellar Digital were completed in June 2004, but the proposed acquisition of interests in Stellar Cinema is yet to be completed pending the fulfillment of certain conditions under the subject sale and purchase agreements.

## MAJOR EVENTS SUBSEQUENT

As announced on 1st April, 2004, for the purpose of realigning the Group’s business interests, subsidiaries of the Group had entered into sale and purchase agreements with SMI on 26th March, 2004 to dispose of the Group’s 18.36% and 26.91% interest in Leadership Publishing Group Limited and M Channel, respectively, to SMI together with the shareholder’s loan advanced by the Group to M Channel, at a total consideration of approximately HK\$27.3 million. These transactions together constituted discloseable and connected transactions for the Company under the Rules Governing the Listing of Securities on the Stock Exchange and were duly approved by the shareholders of the Company in a special general meeting held on 11th May, 2004. Up to the date of this report, these transactions have not yet been completed.

In April 2004, the Company adopted a new corporate identity and was renamed “SMI Corporation Limited” in order to reflect the change of its controlling shareholder after completion of the general offer extended by SMI to the Company’s shareholders.

In May 2004, the Company completed a placing of 355 million new shares to independent third parties at a placing price of HK\$0.055 per share. Net proceeds of approximately HK\$19 million were raised for the Group’s investments in media and entertainment related businesses.

### Proforma Consolidated Total Assets Value of the Group

The following is a summary of the adjusted unaudited proforma consolidated total assets value of the Group after completion of an announced major subsequent event which has a material impact on the total assets value of the Group:

*HK\$' million*

|  |       |
|--|-------|
| Audited consolidated total assets value of the Group as at 31st March, 2004  | 428.4 |
| Add: Issue of 355,000,000 ordinary shares in cash at the price of<br>HK\$0.055 per share pursuant to the placing completed in May 2004 | 19.0  |
| Adjusted unaudited proforma consolidated total assets value of the Group   | 447.4 |

### OUTLOOK

Robust economic growth in Mainland China is generally expected to continue and a gradual economic recovery in Hong Kong is anticipated. Given the Group's foothold in the media and entertainment industry in China with production capability and talent support from Hong Kong, 2004 will be a promising year. The Group will extend its strategic business platforms and continue to expand into the entertainment and media arena in China. The implementation of the Closer Economic Partnership Arrangement (CEPA) between Hong Kong and the PRC will also give the Company boarder access to the huge mainland market and enables the Group to outreach international competitors ahead of the WTO schedule.

To enhance its resourceful content library and to capitalize on the opportunities in the film market in China, the Group intends to sustain an optimum film production volume through various production arms. Some of the film titles that were poised to smash the box office record included "Jiang Hu", starring Mr. Andy Lau and Mr. Jacky Cheung, and "THREE 2", starring Miss Miriam Yeung and Mr. Tony Leung Ka Fai. To minimize investment risks, the Group will continue to pursue its strategy of co-producing.

With a view to expanding its market share in Mainland China and to strategically complement its content production business, the Group plans to build a resourceful pool of talents through the recruitment of new talents in Hong Kong and the PRC.

The market for wireless value-added services in China demonstrates promising growth momentum driven by the tremendous increase in the number of mobile phone users in the PRC. The Group plans to increase investment in this business sector and will continue to explore investment and collaborations opportunities in the PRC. Riding on support from its local partners and leveraging on the strengths of the Company in entertainment content aggregation and capabilities to produce exclusive compelling content, the Group is well poised to capture the immense opportunities in the wireless value-added services market in the PRC.

The acquisition of Stellar Digital and Stellar Cinema will open up a whole new horizon for the Group's business and broaden the Group's revenue streams and geographical coverage. China has the second largest internet user base in the world and internet café is one of the primary venues for internet users to surf the web and play online games. The tremendous internet market growth and booming online game industry presents an encouraging and positive outlook for the cyber café business. Through Stellar Digital, the Group will embark upon aggressive expansion focusing on second and third tier cities in the Mainland, starting with those in the Central Western provinces.

Stellar Cinema, which is engaged in the development and redevelopment, operations and management of multiplex cinemas, will focus on expanding its presence in major cities throughout the PRC such as Beijing, Shanghai, Guangzhou and Chengdu. China's cinema market is



Cinemas in the PRC





Cyber Cafés in the PRC

young with immense opportunities for growth in the future. The early entry into the film exhibition market in China will enable the Group to tap into this vast market potential. By forging ties with Stellar Megamedia Co., Ltd. in the PRC, the Group is able to leverage on its extensive connections to pursue attractive cinema development and redevelopment opportunities nationwide.

Moving forward, the Group will focus on the development of its key strategic business platforms including cyber cafés, film exhibition and wireless value-added services. The Group will continue to pursue various operational and growth initiatives including containing operating costs, consolidating its resources on core businesses and maximizing its business synergies. To strengthen its foothold in the PRC, the Group will continue to explore acquisition opportunities of other business platforms in the entertainment and media sector that have immense market potential.

With established resources coupled with the new business platforms that possess high growth potential, the Group will maintain its vision to grow into a leading integrated entertainment and media conglomerate in the Asia Pacific region. It is expected that the full benefits from the scale-down of several under-performing businesses will be reflected in the next financial year. We look forward confidently to a turnaround in the next financial year and delivering better returns to shareholders.

### LIQUIDITY, FINANCIAL RESOURCES, CAPITAL STRUCTURE AND GEARING RATIO

To support the growth of its core businesses, the Group maintained sufficient liquid funds of approximately HK\$65 million (2003: HK\$14 million), net of pledged deposit, comprising approximately HK\$40 million bank balances and cash (2003: HK\$13 million) and approximately HK\$25 million short-term marketable securities (2003: HK\$1 million). Approximately 89% of these liquid funds were denominated in Hong Kong dollars and the remainder was in foreign currencies.

The Group's total borrowings amounted to approximately HK\$179 million (2003: HK\$229 million), comprising bank borrowings of approximately HK\$137 million (2003: HK\$149 million) and other borrowings of approximately HK\$42 million (2003: HK\$80 million). The interest-bearing borrowings of approximately HK\$179 million bear interest at prevailing market rates. The bank borrowings were mainly made in Hong Kong dollars with approximately HK\$39 million denominated in Japanese Yen. The Japanese bank borrowings have been used to hedge a substantial part of the Group's foreign currency investment in Japan.

The Group's gearing ratio as at 31st March, 2004 was approximately 44% (2003: 300%), which is calculated on the basis of the Group's total interest bearing debts net of cash and bank balances, pledged deposit and short-term marketable securities over the total equity interest as at 31st March, 2004. Following the completion of the placing of shares subsequent to the balance sheet as mentioned in the paragraph headed "Major Events Subsequent", the Group's gearing ratio has been reduced to 30%.

There has not been any change in the Group's funding and treasury policies, and the Group continues to follow the practice of prudent cash management and, when necessary, will engage in currency hedging against exchange risks.

### CONTINGENT LIABILITIES

As at 31st March, 2004 and 31st March, 2003, the Group had no significant contingent liabilities.

### PLEDGE OF ASSETS

As at 31st March, 2004, certain of the Group's property interests with an aggregate carrying value of approximately HK\$48 million (2003: HK\$31 million) and the Group's bank deposits of approximately HK\$38 million (2003: HK\$40 million) were pledged to banks to secure credit facilities granted to the Company and certain of its subsidiaries.

### COMMITMENTS

In February 2004, the Group entered into sale and purchase agreements to acquire a 50% interest in Stellar Digital and a 25% interest in Stellar Cinema. The total consideration for the acquisitions was approximately HK\$38.6 million, for which deposits of approximately HK\$17.3 million were paid as at 31st March, 2004. As at the date of this report, the acquisition of interest in Stellar Digital had already completed whereas that in Stellar Cinema is yet to be completed. Other than the aforesaid, the Group had no significant capital and other commitments as at 31st March, 2004.

As at 31st March, 2003, the Group had no significant capital and other commitments.

### EMPLOYEES AND REMUNERATION POLICIES

As at 31st March, 2004, the Company and its subsidiaries had 242 employees (2003: 350). Employee remuneration, excluding directors' emoluments, for the year ended 31st March, 2004 was approximately HK\$30 million (2003: HK\$43 million). The pay scale of the Group's employees is maintained at a competitive level and employees are rewarded on a performance-related basis within the general framework of the Group's salary and bonus system, which is reviewed annually.