

**MANAGEMENT DISCUSSION AND ANALYSIS****Results**

For the six months ended 30 June 2001, the Group has achieved a turnover of HK\$100.4 million representing a significant increase of 176% from a turnover of HK\$36.3 million over the same period in 2000. The loss from operations was HK\$18.6 million (2000: HK\$14.6 million) and HK\$26.5 million (2000: HK\$16.0 million) was attributed to shareholders loss.

**Review of Operations**

Upon the completion of the acquisitions of titles of films and television drama series and the interests in One Hundred Years of Film Company Limited (“One Hundred Years”) (a well established film production set-up) in early 2001, the Group has increased turnover and reaped extra income from the distribution of its own productions with the film-production capabilities provided by this newly acquired subsidiary and the advantage of the expanded film library.

Film Distribution Division saw an up-swing in turnover and contribution for the half year under review. An overall rise in positive audience response to locally-produced films continues to prevail. Turnover has significantly increased by 706% to HK\$80.6 million (2000: HK\$10.0 million). Contribution amounted to HK\$15.3 million in 2001 compared to HK\$(0.3) million of the previous period. The main source for contribution increase was due to outstanding box office sales for several productions from One Hundred Years and the reward of the Group’s effort in distributing Chinese films in the American and European markets. In addition, the contract with Satellite Television Asian Region Limited signed in June 2000, granting it certain rights to films released by the Group, continues to create a stable revenue stream.

Against the background of a weak economy, the operation of the Video Distribution arm achieved a well and satisfactory performance. Turnover and contribution to the Group increased in the region of HK\$16.9 million and HK\$5.5 million respectively, against HK\$7.9 million and HK\$0.4 million respectively the same period before. The increase in turnover and contribution was directly attributed to the acquisition of One Hundred Years. This subsidiary brought with it extensive archives of quality films to add to the Group’s distribution network, especially for the China market and made possible the self-distribution of self-produced works through its expanded sales team. Following the establishment of the Group’s distribution network for video disc product and the continuous launching of more new titles, the Group expects the result of this business to keep on improving.

With the changing of audience taste, the Television Drama Series Distribution was still at a down-turn. The contributed loss was decreased to HK\$1.2 million compared to some HK\$2.3 million in 2000. This arm of the Group's business is being monitored and less resources will be allocated to television dramas as and until the opportunity for growth and income presents itself again.

**Financial Review**

As at 30 June 2001, the Group had total assets of HK\$1,298.6 million. These were financed by current liabilities of HK\$210.5 million, minority interests of HK\$4.2 million, convertible loan notes of HK\$70 million and shareholders' equity of HK\$1,013.9 million. The Group had a total cash and bank balances of approximately HK\$130.5 million of which HK\$6.0 million was pledged for bank guarantee granted. In addition to the strong cash position of 30 June 2001, the Group's gearing remained low during the period with total debts of HK\$70 million against shareholders' funds of HK\$1,013.9 million. This represent a gearing ratio, calculated in the basis of the Group's total borrowings over shareholders' fund of 0.07. The capital structure of the Group remained unchanged during the period.

After the acquisition of Ocean Shores in July 2001, the Group was still fairly liquid with its cash and bank balances standing at approximately HK\$68 million.

In view of the operation of the Group, the exposure to fluctuation in exchange rates was considered limited and no hedge activity was considered necessary. At 30 June 2001, the Group had contingent liability of approximately HK\$1.2 million for corporate guarantee given to a landlord in respect of rental performance.

During the period, the Company issued convertible loan notes (the "Notes") in an aggregate amount of HK\$70 million. The Notes bear interest at 4% per annum, which will be payable semi-annually in arrears and will be matured on 30 June 2004.

The Notes carry the right to convert into shares of HK\$0.05 each in the share capital of the Company at an initial conversion price of HK\$0.20 per share on or after 1 July 2002. The net proceeds of the issue amounted to approximately HK\$68.9 million are used as to approximately HK\$30 million for the expansion of video compact disc distribution operation in China and Hong Kong and as to the balance of approximately HK\$38.9 million for general working capital purposes.

**Prospects**

The second half of this year has seen a definite improvement to the film industry, most notably as of the summer of 2001. A definite soaring in audience number was apparent in the cinemas. This continuing trend paints an encouraging picture for the film industry as a whole.

To prepare for the recovery, the Company has positioned itself well in the light of the above. With the acquisition of One Hundred Years, the Group has restructured and has set the wheels in motion for quality film production. Quality productions, each with its own related set of anecdotes, stories, interviews, bloopers, etc. are in the pipeline. It is anticipated that with this new development and the up-trend in sight, an increase of revenue will be achieved. The viewing audience has already been introduced to two successful stories, each produced and distributed by the Group: The screening of "Love on a Diet" saw remarkable box office sales; and with "The Legend of Zu", the Company is set to go international by exploring its worldwide distribution network.

In anticipation of an upward trend of the film industry, the Group acquired Ocean Shores in July 2001 with the aim to enhancing the Group's film library and distribution network. Ocean Shores holds the distribution rights to films on laser discs, video tapes, compact discs and cassette tape. The acquisition entails opening up of the Group's business to include the distribution rights of foreign films. With this development, an increase in earnings is hoped for.

The directors believe the revival of the film industry not only rests on well-produced and quality work, strong support from distribution channels also plays an important role. With the popularity of cable television, pay television, etc., major distribution channels and opportunities are constantly being opened. The Group is committed to exploring and developing its film distribution network so as to cover multi-channel and global market sales.

With China's joining the World Trade Organization in the near future, opportunities will be opened to foreign films. The Group has well positioned itself by acquiring One Hundred Years and Ocean Shores. The setting up of these distribution networks in China, with their capacity for more distribution channels in terms of outlets, cinemas, etc., gives an extremely bright outlook. China becomes a prime marketing target for future growth and expansion for the Group.

# CHINA STAR ENTERTAINMENT LIMITED

## INTERIM REPORT 2001

Market conditions are changing rapidly, not only for the film industry but also against the background of the overall world economy. The Group has positioned itself well ahead of these phenomena. It is on such a platform that the directors look to the future with optimism.

### Employees

At 30 June 2001, the Group employed 200 staffs of which 43 staffs are based in China. The directors believe that the quality of its employees is the single most important factor in sustaining the Group's reputation and improving its profitability. The staffs are remunerated based on their work performance, professional experience and prevailing industry practices. Apart from basic salaries, pension fund, medical schemes and discretionary bonuses, options are awarded to certain staffs according to the assessment of individual performance.

### DIRECTORS' INTERESTS IN SECURITIES OF THE COMPANY

As of 30 June 2001, the interests of the directors in the securities of the Company and its associated corporations as recorded in the register required to be kept under Section 29 of the Securities (Disclosure of Interests) Ordinance (the "SDI Ordinance") were as follows:

#### (a) Shares

Directors	Number of shares held		
	Personal interest	Family interest	Corporate interest
Mr. Heung Wah Keung	111,059,600	464,432,300*	126,566,100**
Ms. Chen Ming Yin, Tiffany	57,338,000	237,625,700***	407,094,300****

\* These shares are held as to 57,338,000 shares by Ms. Chen, as to 280,528,200 shares by Porterstone Limited ("Porterstone") (a company wholly-owned by Ms. Chen) and as to 126,566,100 shares by Dorest Company Limited ("Dorest"), a company wholly-owned by Glenstone Investments Limited ("Glenstone") which is in turn controlled as to 60% by Porterstone and as to 40% by Mr. Heung. Mr. Heung, the husband of Ms. Chen, is deemed to be interested in the shares held by Porterstone and Ms. Chen.

\*\* These shares are held by Dorest.

\*\*\* These shares are held as to 111,059,600 shares by Mr. Heung and as to 126,566,100 shares by Dorest. Ms. Chen is deemed to be interested in such shares.

\*\*\*\* These shares are held as to 126,566,100 shares by Dorest and as to 280,528,200 shares by Porterstone.

(b) **Share Options**

As of 30 June 2001, the directors had the following personal interests in share options to subscribe for shares in the Company granted under the Company's employee share option scheme:

<b>Name</b>	<b>Number of share options</b>	<b>Exercisable period</b>	<b>Exercise price per share HK\$</b>
Mr. Heung Wah Keung	9,682,012	21 November 1996 to 20 November 2006	2.107
	13,250,000	28 March 2000 to 27 March 2010	0.584
	6,000,000	2 June 2000 to 1 June 2010	0.283
Ms. Chen Ming Yin, Tiffany	9,682,012	21 November 1996 to 20 November 2006	2.107
	13,250,000	28 March 2000 to 27 March 2010	0.584
	6,000,000	2 June 2000 to 1 June 2010	0.283

Save as disclosed herein, as of 30 June 2001, none of the directors or any of their associates had any interests in the securities of the Company or any associated corporations as defined in the SDI Ordinance.