MANAGEMENT DISCUSSION AND ANALYSIS

February 2001: SCMP Fund Manager of the Year Awards 2001
Mr. Antony Leung (Financial Secretary) and the award winners

FINANCIAL HIGHLIGHTS

- **Total Group turnover: HK$2,745.1 million**
- **Profit attributable to shareholders: HK$482.8 million**
- **Basic earnings per share: HK27.85 cents**
- **EBITDA: HK$785.6 million**
- **EBITDA margin: 28.6%**
- **Return on shareholders' funds: 22.9%**

With the change of financial year end from 30 June to 31 December, the current reporting period covers an 18-month period ended 31 December 2001. Operating results for the 18-month period ended 31 December 2001 and the comparatives for the 12-month period ended 30 June 2001 are presented below. To facilitate better understanding of the Group's performance, an additional comparison on calendar year basis for the 12-month period ended 31 December 2001 and 2000 is presented on pages 25 to 28 of this report.

Due to the adoption of new and revised Statements of Standard Accounting Practice issued by the Hong Kong Society of Accountants in the current reporting period, certain figures in the Group's profit and loss account and consolidated balance sheet for the 12-month period ended 30 June 2000 have been restated. Please refer to Note 3 of the Notes to Financial Statements on pages 48 to 51 of this report for full details.

OPERATING RESULTS OF THE GROUP FOR THE 18-MONTH PERIOD ENDED 31 DECEMBER 2001

Overview

During the 18-month period ended 31 December 2001, the Group's turnover amounted to HK$2,745.1 million (12-month period ended 30 June 2000: HK$1,912.9 million), and profit attributable to shareholders amounted to HK$482.8 million (12-month period ended 30 June 2000: HK$562.6 million). Basic earnings per share for the 18-month period was HK27.85 cents (12-month period ended 30 June 2000: HK32.49 cents).

Included in the reported earnings of HK$482.8 million were a gain of HK$51.9 million from part disposal of the listed share portfolio, revaluation deficit of HK$40.7 million in respect of investment properties and a provision of HK$95.9 million for Internet investments and a property. Excluding these items, the Group would report a net profit of HK$567.5 million.

Operating costs and expenses for the 18-month period was HK$2,090.0 million (12-month period ended 30 June 2000: HK$1,310.1 million). The major increases in operating costs came from staff cost, cost of materials and sales and rental and utility costs. Staff costs which accounted for approximately 34.7% of total operating expenses, increased following an annual salary review in July 2000 and increased staff numbers. Total headcount of the Group in June 2000 was 1,632, which increased to 1,745 in December 2000 due to new hires in several businesses of the Group. The cost of materials and sales increases were due mainly to increase in average newsprint cost by 24.5% to HK$5,000 (US$641) per metric ton compared to the previous period, and higher retail sales from the *Daily Stop* outlets. Rental and utility increases were due to (i) new office premises taken to converge and relocate the editorial and Internet operations to the same floor and relocation of the other operations of the Group to the same office area in Quarry Bay; (ii) higher rent review for the *Daily Stop* outlets located in the MTR stations; and (iii) net increase of 10 *Daily Stop* outlets (from 62 to 72 outlets, though this was partially offset by the net closure of six *Health Plus* shops, from 33 to 27 shops). Depreciation increased slightly due to additions of fixed assets. No amortisation was recorded as the pre-operating expenses and goodwill had been fully amortised in previous years.

The results of the Group in the last 12 months (January to December 2001) had been severely affected by the global economic downturn, which was further exacerbated by the terrorist attacks of September 11 in the United States. Recognising that it is particularly important in this climate to contain costs to compensate for the revenue shortfall, management undertook cost reduction measures throughout the Group, including the following:

* progressively reduced staff numbers during the year, to 1,570 employees at the end of 2001. This reduction was in all divisions. A salary freeze (the last salary increment was in July 2000) was imposed and strict controls on re-hire were implemented as staff leave through natural attrition. Certain services of the Group, such as distribution and cleaning were sub-contracted out, and the working hours and overtime rates for certain business divisions were reviewed;

* reviewed vendor agreements and further consolidated the purchasing functions within the Group; and

* suspended the publication of two magazine titles, *Champion Sports* and *Revolution*, which became unprofitable to continue with. The operations of Capital Artists were also suspended; the issues of piracy and high guaranteed fees required to retain popular artists made this business commercially unviable.

Contribution by Business Segment

The Group's core business of newspapers, magazines and other publications continued to generate the majority of the Group's turnover, EBITDA and operating profit.

	Contribution to Turnover	
HK$ million	**18-month period ended 31 December 2001**	**12-month period ended 30 June 2000**
Newspapers, magazines and other publications	**1,722.9**	1,262.7
Retailing	**610.4**	359.7
Entertainment, recreation and education services	**247.1**	173.0
Video and film post-production	**47.8**	34.7
Property holding	**116.9**	82.8
Total	**2,745.1**	1,912.9

	Contribution to EBITDA		Contribution to Operating Profit	
HK$ million	**18-month period ended 31 December 2001**	**(Restated) 12-month period ended 30 June 2000**	**18-month period ended 31 December 2001**	**(Restated) 12-month period ended 30 June 2000**
Newspapers, magazines and other publications	**632.0**	583.5	**532.5**	571.4
Retailing	**4.5**	10.9	**(1.3)**	6.4
Entertainment, recreation and education services	**32.2**	16.7	**16.3**	3.0
Video and film post-production	**8.3**	5.7	**4.2**	3.4
Property holding	**108.6**	77.5	**62.1**	73.6
Total	**785.6**	694.3	**613.8**	657.8

Newspapers, magazines and other publications

HK$ million	**18-month period ended 31 December 2001**	**(Restated) 12-month period ended 30 June 2000**
Turnover		
Newspapers	**1,589.5**	1,179.0
Magazines and other publications	**133.4**	83.7
Total turnover	**1,722.9**	1,262.7
EBITDA	**632.0**	583.5
Operating profit	**532.5**	571.4

For the 18-month period ended 31 December 2001, this division recorded turnover of HK$1,722.9 million and an operating profit of HK$532.5 million. EBITDA margin for the period was 36.7% compared with 46.2% in the year ended 30 June 2000. The decline is largely attributed to the Newspaper Division.

2001 saw a marked slowdown in recruitment activity across all sectors, with executive demand levels down by more than 50% in 2001 compared to 2000, amid a fast increasing unemployment rate in Hong Kong. Advertising revenue in *Classified Post* was severely impacted by this slowdown in recruitment activity. In the 18-month period, average volume was down by some 8.7% and average yield also decreased compared to the 12-month period ended 30 June 2000.

The slowdown in display advertising was further heightened following September 11, where, in particular, there was immediate cancellation of ad bookings from the airlines, hotels and travel related industries. Although there had been some improvement and return since then, advertisers are still cautious with their ad spend. In the 18-month period, average volume decreased by 11.9% while average yield increased slightly compared to the 12-month period ended 30 June 2000.

Circulation revenue was affected by decline in yield due to discounted subscription sales. During the first half of 2001, circulation of the *South China Morning Post* and *Sunday Morning Post* saw an increase of 1.4% to 110,115 copies and a decrease of 0.1% to 92,353 copies respectively, as compared to the corresponding period in 2000. However, during the second half of 2001, the circulation of the *South China Morning Post* and *Sunday Morning Post* saw a decrease of 2.3% to 114,028 copies and 5.7% to 89,204 copies, respectively, as compared with prior corresponding period.

The magazine titles under SCMP Hearst Publications Limited performed satisfactorily with increased revenue and contributions from the *COSMOPOLITAN* and *HARPER'S BAZAAR* titles. A new magazine title, *CosmoGIRL!* was launched in September 2001 targeting the teenage market.

Retailing

HK$ million	**18-month period ended 31 December 2001**	**(Restated) 12-month period ended 30 June 2000**
Turnover	**610.4**	359.7
EBITDA	**4.5**	10.9
Operating (loss) / profit	**(1.3)**	6.4

This division recorded revenue of HK$610.4 million but sustained an operating loss of HK$1.3 million. The operating loss was primarily due to the operating and closure costs related to the bakery business (*Bakers Oven* which was closed in May 2001) and operating losses from the *Health Plus* shops. The *Daily Stop* retail business continued to operate profitably. As at the end of December 2001, there were 72 *Daily Stop* outlets compared with 62 in June 2000 and 27 *Health Plus* shops, down from 33 in June 2000.

Entertainment, recreation and education services

HK$ million	**18-month period ended 31 December 2001**	**(Restated) 12-month period ended 30 June 2000**
Turnover	**247.1**	173.0
EBITDA	**32.2**	16.7
Operating profit	**16.3**	3.0

These divisions recorded revenue of HK$247.1 million and an operating profit of HK$16.3 million. The improvement in the results came from the recreation clubs which showed improved performance, and also as a result of lower depreciation and amortisation charges. With the leases of the two clubs expiring in 2003 and 2004 and as part of the strategy to exit non-core businesses, the Group sold the recreation clubs in December 2001 for HK$27.8 million.

Faced with continuing piracy and high guarantee fees to retain popular artists, Capital Artists ceased operation in October 2001.

Performance of the Education Division declined as the number of students fell as a result of the declining birth rate in Hong Kong. In March 2002, the Group disposed of this division for HK$28.2 million, as it continues to exit non-core businesses.

Video and film post-production

HK$ million	18-month period ended 31 December 2001	(Restated) 12-month period ended 30 June 2000
Turnover	**47.8**	34.7
EBITDA	**8.3**	5.7
Operating profit	**4.2**	3.4

This division recorded revenue and operating profit of HK$47.8 million and HK$4.2 million, respectively. The performance of this division remained stable.

Property holding

HK$ million	18-month period ended 31 December 2001	(Restated) 12-month period ended 30 June 2000
Turnover	**116.9**	82.8
EBITDA	**108.6**	77.5
Operating profit	**62.1**	73.6

The revenue and operating profit for this period was HK$116.9 million and HK$62.1 million, respectively. Rental income declined slightly on calendar year basis due to expiry of a lease rental in August 2001. The decline in operating profit was mainly due to deficit charge resulting from the revaluation of investment properties to market value.

OPERATING RESULTS OF THE GROUP FOR THE 12-MONTH PERIOD ENDED 31 DECEMBER 2001 AND 2000

The Group's consolidated operating results for the 12-month period ended 31 December 2001 and 2000 were as follows:

HK$ million, except per share amounts	12-month period ended 31 December 2001	2000	% change
Turnover	**1,693.7**	2,074.2	(18.3)
Operating cost before depreciation and amortisation	**1,307.3**	1,302.8	0.3
EBITDA	**386.4**	771.4	(49.9)
Depreciation	**88.1**	85.3	3.3
Amortisation	**–**	7.8	(100.0)
Gain on disposal of long-term investment shares	**22.8**	53.4	(57.3)
Provision for asset impairment	**72.5**	46.0	57.6
Revaluation deficit	**40.7**	–	100.0
Other revenue	**25.3**	34.7	(27.1)
Operating profit	**232.6**	719.2	(67.7)
Profit attributable to shareholders	**164.6**	603.3	(72.7)
Earnings per share (HK cents)			
Basic	**9.50**	34.83	(72.7)
Diluted	**9.49**	34.81	(72.7)

For the 12-month period ended 31 December 2001, the Group's turnover and profit attributable to shareholders amounted to HK$1,693.7 million (2000: HK$2,074.2 million) and HK$164.6 million (2000: HK$603.3 million), respectively. Basic earnings per share was HK9.50 cents (2000: HK34.83 cents).

The reported earnings of HK$164.6 million included a gain of HK$22.8 million from part disposal of the listed share portfolio, and revaluation deficit of HK$40.7 million in respect of investment properties and a provision of HK$72.5 million for Internet investments and a property. Excluding these items, the Group would report a net profit of HK$255.0 million.

Operating Costs and Expenses

HK$ million	12-month period ended 31 December 2001	2000	% change
Staff costs	**478.7**	493.5	(3.0)
Cost of production materials and sales	**499.0**	472.8	5.5
Rental and utilities	**143.3**	134.5	6.5
Advertising and promotion	**37.2**	36.0	3.3
Other operating expenses	**149.1**	166.0	(10.2)
Operating cost before depreciation and amortisation	**1,307.3**	1,302.8	0.3
Depreciation	**88.1**	85.3	3.3
Amortisation	**–**	7.8	(100.0)
Total operating costs and expenses	**1,395.4**	1,395.9	(0.04)

Total operating costs were maintained at a stable level. Staff costs decreased by 3.0% following from the headcount reductions undertaken during the year, as described on page 21. Increase in cost of production materials and sales of 5.5% was primarily due to increase in newsprint cost and higher retail sales. The average cost of newsprint for production increased by 21.6% to HK$5,234 (US$671) per metric ton. Rental and utilities increased by 6.5% due to (i) new office premises taken to converge and relocate the editorial and Internet operations to the same floor and relocation of the other operations of the Group to the same office area in Quarry Bay; and (ii) rental increase of some of the retail outlets, primarily in the MTR stations; and (iii) net increase of 10 *Daily Stop* outlets (from 62 to 72 outlets, though this was partially offset by the net closure of six *Health Plus* shops, from 33 to 27 shops). Advertising and promotion increased by 3.3%, primarily due to the launch of the new recruitment magazine, *Jiu Jik*, in June 2001, which was offset slightly by decreased advertising spend on some existing products. Other operating expenses decreased by 10.2% as a result of various cost cutting measures, though there was an increase in distribution costs related to the distribution of *Jiu Jik*. Depreciation increased by 3.3% due to addition in fixed assets. No amortisation was recorded as the pre-operating expenses and goodwill had been fully amortised in previous years.

Contribution by Business Segment

The Group's core business of newspapers, magazines and other publications continued to generate the majority of the Group's turnover, EBITDA and operating profit.

	Contribution to Turnover 12-month period ended 31 December		
HK$ million	**2001**	**2000**	**% change**
Newspapers, magazines and other publications	**1,014.1**	1,414.8	(28.3)
Retailing	**414.5**	370.6	11.8
Entertainment, recreation and education services	**155.5**	174.8	(11.0)
Video and film post-production	**32.3**	33.4	(3.3)
Property holding	**77.3**	80.6	(4.1)
Total	**1,693.7**	2,074.2	(18.3)

	Contribution to EBITDA 12-month period ended 31 December			Contribution to Operating Profit 12-month period ended 31 December		
HK$ million	**2001**	**2000**	**% change**	**2001**	**2000**	**% change**
Newspapers, magazines and other publications	**282.8**	672.7	(58.0)	**191.6**	645.6	(70.3)
Retailing	**3.1**	–	100.0	**(0.4)**	(4.6)	91.3
Entertainment, recreation and education services	**24.0**	16.3	47.2	**13.9**	1.2	1,058.3
Video and film post-production	**5.0**	7.2	(30.6)	**2.1**	3.3	(36.4)
Property holding	**71.5**	75.2	(4.9)	**25.4**	73.7	(65.5)
Total	**386.4**	771.4	(49.9)	**232.6**	719.2	(67.7)

Newspapers, magazines and other publications

	12-month period ended 31 December		
HK$ million	**2001**	**2000**	**% change**
Turnover			
Newspapers	**925.4**	1,329.7	(30.4)
Magazines and other publications	**88.7**	85.1	4.2
Total turnover	**1,014.1**	1,414.8	(28.3)
EBITDA	**282.8**	672.7	(58.0)
Operating profit	**191.6**	645.6	(70.3)

For the 12-month period ended 31 December 2001, this division recorded revenues of HK$1,014.1 million, a decrease of 28.3%, reflecting the slowdown in the global economy and the difficult operating environment experienced during 2001.

Display advertising revenue in the newspapers decreased by 25.7%, average volume decreased by 21.5% and average yield also decreased. Advertising revenue in *Classified Post* declined 41.2% compared with the corresponding period, average volume was down by some 28.5% and average yield also decreased.

Revenues from magazines and other publications for the 12-month period ended 31 December 2001 increased by 4.2%. The increase is mainly attributable to the strong performance of *COSMOPOLITAN* and *HARPER'S BAZAAR* titles which remain as market leaders in their sector, but other publications (Chinese books) showed declines as a result of the weak market.

Retailing

HK$ million	12-month period ended 31 December 2001	2000	% change
Turnover	**414.5**	370.6	11.8
EBITDA	**3.1**	–	100.0
Operating loss	**(0.4)**	(4.6)	91.3

This division recorded revenues of HK$414.5 million, an increase of 11.8% year-on-year, with 100.0% improvement on EBITDA and 91.3% improvement in operating loss, compared to the prior year. The *Daily Stop* retail business continued to operate profitably, but the operating and closure costs related to the bakery business (*Bakers Oven* which was closed in May 2001), and the operating losses from the *Health Plus* shops, resulted in a net operating loss of HK$0.4 million. This compares favourably to an operating loss of HK$4.6 million in the previous period.

As at the end of December 2001, there were 72 *Daily Stop* outlets compared with 62 in June 2000 and 27 *Health Plus* shops, down from 33 in June 2000.

Entertainment, recreation and education services

HK$ million	12-month period ended 31 December 2001	2000	% change
Turnover	**155.5**	174.8	(11.0)
EBITDA	**24.0**	16.3	47.2
Operating profit	**13.9**	1.2	1,058.3

These divisions recorded revenue of HK$155.5 million and an operating profit of HK$13.9 million. The improvement in the results came from the recreation clubs which showed improved performance, and also as a result of lower depreciation and amortisation charges. The Group disposed of the recreation club business for HK$27.8 million in December 2001.

Faced with continuing piracy and high guarantee fees to retain popular artists, Capital Artists ceased operation in October 2001.

Performance of the Education Division has been declining as a result of the falling birth rate in Hong Kong; the number of students had declined by 8.9% year-on-year. In March 2002, the Group disposed of this division for HK$28.2 million, as it continues to exit non-core businesses.

Video and film post-production

HK$ million	12-month period ended 31 December 2001	2000	% change
Turnover	**32.3**	33.4	(3.3)
EBITDA	**5.0**	7.2	(30.6)
Operating profit	**2.1**	3.3	(36.4)

Revenue for the 12-month period ended 31 December 2001 remained stable compared to the prior corresponding period. Decrease in EBITDA was due to change in sales mix resulting in lower gross profit margin.

Property holding

HK$ million	12-month period ended 31 December 2001	2000	% change
Turnover	**77.3**	80.6	(4.1)
EBITDA	**71.5**	75.2	(4.9)
Operating profit	**25.4**	73.7	(65.5)

Rental income and EBITDA from the Group's investment properties declined slightly due to expiry of one of the lease rentals. The decline in operating profit was mainly due to revaluation deficit of HK$40.7 million on investment properties.

CAPITAL EXPENDITURE

Total capital expenditure in the 18-month period ended 31 December 2001 amounted to HK$117.4 million, of which HK$23.7 million was spent on replacement items and HK$93.7 million on new capital items. Of the new capital items, HK$28.8 million was spent on convergence and relocation of the editorial and Internet operations and relocation of other operations of the Group to the same office location in Quarry Bay, HK$28.5 million was spent on equipment and software for the digital migration programme, and HK$36.4 million as part payment for two additional colour printing presses.

For the coming year, the Group has approved capital expenditure of approximately HK$99.7 million, of which HK$85.1 million is allocated for (i) further payment for the additional two colour printing presses and the digital migration programme; (ii) replacement of the editorial, advertising and accounting systems; (iii) new *Daily Stop* outlets; and (iv) computers and technology related equipment and software. The balance of HK$14.6 million is allocated for replacement items.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities was HK$793.5 million in the 18-month period ended 31 December 2001, compared with HK$668.7 million in the 12-month period ended 30 June 2000. Cash was used primarily for payment of dividends, taxation and capital expenditure.

Net cash inflow from financing activities was HK$1.9 million in the 18-month period ended 31 December 2001, compared with net outflow of HK$31.4 million in the 12-month period ended 30 June 2000. The improvement was due to reduced amount of bank loan repayment and proceeds from the issuance of shares under the employee share option scheme.

Cash generated from the Group's operations and the funds available from external sources are expected to be adequate to cover all cash requirements, including working capital needs and planned capital expenditure.

The ratio of current assets to current liabilities improved to 2.95 times as at 31 December 2001 compared to 2.22 times as at 30 June 2000.