MANAGEMENT DISCUSSION AND ANALYSIS

(i) Results of operations

In spite of the difficult economic environment, the Group continued to deliver consistent and robust growth in 2001. On the Pay TV business, widespread piracy and weak consumer sentiment slowed down our growth from the previous year. On the Internet & Multimedia business, however, we were able to exceed market expectations and consolidate our position as one of the two principal providers of Broadband access service in the market.

Turnover in 2001 increased by HK$282 million or 17% to HK$1,931 million, from HK$1,649 million in 2000. Internet turnover grew by HK$227 million or tripled with the rapid growth in Broadband subscribers being the driving force. However, Pay TV turnover grew by only HK$54 million or 4%. Internet turnover therefore accounted for 17% of total turnover in 2001, compared to 7% in 2000, and we expect it will continue to grow with the anticipated rapid increase in Broadband penetration in Hong Kong over the next few years.

The Group contained the increase in its total operating costs including depreciation to 6% due to the significant leverage of its business and disciplined cost control. Programming costs have been tightly controlled to rise by less than 8% to HK$602 million, notwithstanding the costs from the new carriage agreement with the STAR Group. Selling, general and administrative costs rose by 8% to HK$351 million mainly due to higher marketing, advertising and sales related staff costs. Network and other operating costs rose by 12% to HK$364 million, primarily attributable to increase in network and customer services costs associated with the rollout of the Broadband service.

Earnings before interest, taxes, depreciation and amortisation ("EBITDA") rose by HK$172 million or 39% to HK$614 million, with EBITDA margin increasing to 32% from 27% in 2000. Depreciation decreased by 3% to HK$435 million as many of the analogue set-top boxes and TV production facilities become fully depreciated. Operating profit improved by HK$187 million to reach HK$180 million. However, interest income dropped by HK$43 million or 42% to HK$59 million as yield declined in a low interest environment while finance expense on the fixed rate convertible bonds remained flat at HK$72 million.

Net profit attributable to shareholders therefore grew seven-fold to reach HK$167 million in 2001, as compared to HK$20 million in 2000. Earnings per share were 8.3 cents as compared to 1.0 cent in 2000.

(ii) Segmental information

Pay Television

Turnover rose 4% to HK$1,595 million due mainly to subscriber growth. Pay TV subscribers grew 8% year-on-year to over 560,000. Churn rate increased to 1.8% per month from 1.5% in 2000 as a result of the piracy problem. ARPU declined by 7% to HK$232 per month, due mainly to the loss of higher yield subscribers to pirated viewing or for other reasons and replacement by lower yield subscribers. Notwithstanding the slower growth experienced for the year, there are encouraging signs that our anti-piracy measures are beginning to have a positive impact. The declining trend in Pay TV revenue started to stabilise in the fourth quarter of the year.

EBITDA increased by 5% to HK$634 million as the rise in operating cost before depreciation was controlled at 3%. EBITDA margin improved slightly from 39% to 40%. Depreciation decreased by HK$112 million to HK$285 million resulting from the expiration of the depreciation cycle for production equipment and decoders, and a higher portion of the depreciation on shared network infrastructure being allocated to the Internet & Multimedia Segment as the rollout of the Broadband service expanded. Operating profit rose by 66% to HK$349 million in 2001 as a result.

Internet & Multimedia

Turnover more than tripled to HK$336 million as Broadband subscribers increased by over 100,000 to nearly 160,000. Network rollout continued at a rapid pace as the number of Broadband ready homes exceeded 1.6 million by the end of the year. The subscriber growth resulted from a combination of more new homes passed as well as deeper penetration of existing homes passed. Penetration of Broadband ready homes increased from 6% in the beginning of the year to 10% at the end of the year. Our estimated market share of the residential Broadband market has grown to about 30% by the end of 2001. Notwithstanding increased competition from a few operators with inferior network coverage, ARPU for the Broadband service has been relatively stable at HK$224 as compared to HK$227 in 2000 while churn for the year was at slightly below 1% per month.

A positive EBITDA of HK$94 million was achieved in 2001 as compared to a negative EBITDA of HK$66 million in 2000 due to the rapid subscriber and turnover growth and competitive cost structure. EBITDA margin rose rapidly to 28% for the full year and reached 39% in the second half. Operating loss for the full year declined to HK$50 million from HK$113 million in 2000, as the segment started to report an operating profit in the second half of 2001.

MANAGEMENT DISCUSSION AND ANALYSIS *continued*

(iii) Liquidity and financial condition

The Group continues to be in a comfortable and stable financial position. Net cash from operating activities in 2001 amounted to HK$792 million. As at the end of financial year 2001, the Group had a current ratio of 162%, with HK$1,397 million of current assets against HK$862 million of current liabilities. Net cash balance amounted to HK$1,516 million including an investment of HK$312 million in long-term deposits to enhance the yield of the Group's surplus funds.

The Group's only significant borrowing was HK$1,800 million of convertible bonds held by the Wharf Group. The term of the bonds is to November 23, 2003, with interest at the rate of 4% per annum.

The ratio of net debt to total assets was 10% as at December 31, 2001. This gearing ratio was calculated as the ratio of long-term debt net of cash balance and long-term deposits to total assets net of cash balance and long-term deposits. Details regarding the Group's contingent liabilities are disclosed in Note 36 to the Accounts on pages 74 and 75.

The Group's assets, liabilities, revenues and expenses are mainly denominated in Hong Kong dollars or U.S. dollars and the exchange rate between these two currencies is pegged. The Group does not thereby expect to be affected to any significant extent by fluctuations in exchange rates.

The consolidated net asset value of the Group as at December 31, 2001 was HK$1,443 million, or HK$0.72 per share. Capital expenditure for the year was HK$626 million. This included HK$164 million for the rollout of the Broadband service, HK$171 million for construction of fibre and coaxial network, and HK$116 million for the digitisation of its news broadcasting facilities.

The main areas of future capital expenditures will consist of cable modems and equipment for the Broadband service, digital set-top boxes for the Pay TV service, network construction and digitisation of TV production facilities. As our fibre network and Broadband infrastructure rollout will be substantially completed in 2002, future capital expenditures are expected to become more subscriber and capacity driven. The Group expects internal reserves and cash flow from future operating activities will be more than sufficient to cover future capital expenditures required for the existing businesses.

(iv) Significant investments and acquisitions

The Group did not engage in any material acquisitions or disposals of subsidiaries or associates during the year.

(v) Prospects

Despite the weak market environment and economic conditions that prevailed in 2001, the Group's forward looking investment strategy and timely introduction of new services when they are proven in overseas markets have enabled the Group to outperform the market. As a result, the Group was able to report sustained, robust growth.

To enhance its leadership position and competitiveness, the Group has started to digitise its production, broadcasting and distribution facilities. Digitisation will not only bring greater efficiency to programme production, but will also facilitate multimedia content development, expand channel capacity and provide better security to protect subscription revenue. In addition, it will pave the way for the introduction of interactive television and transactional services when the technology and market are ready.

The Group's business foundation is solid, our cost structure is competitive and our early investments are beginning to pay dividends. However, there is absolutely no place for complacency in the rapidly changing environment in which we operate. We continue therefore to build the Company for the future so that we can be ready to seize new opportunities when they arise.

(vi) Employees' Remuneration

The Group had a total of 2,482 employees at the end of the year, which represented a 1.5% increase over the beginning of the year. Total salaries and related costs incurred in 2001 amounted to HK$732 million.

The Group operates an Employee Share Option Scheme. In February 2001, the Group issued stock options to all employees at that time, giving every member of staff a stake in the Group's continued success.

As part of our continuing efforts to increase the calibre and productivity of our staff and strengthen a "pay for performance" culture, we have been re-engineering our performance management, compensation and reward programmes. In 2002, we will be expanding our pay for performance system and all staff will have a portion of their compensation tied to the Company's and the individuals' performances.