Management Discussion and Analysis

A. Review of 2002 Operating Results

The Group continued to achieve double digit percentage growth in total Pay TV and Broadband subscribers (16%), turnover (12%) and net profit before investment provision (14%) year-on-year against a backdrop of a weak economy and poor consumer sentiments.

Consolidated turnover increased by 12% to HK$2,161 million. Pay TV turnover grew by 7% to HK$1,711 million due to increases in both subscription and airtime sales revenues. Internet & Multimedia turnover increased by 34% to HK$450 million as the growth in Broadband subscribers was partly offset by a fall in ARPU. The Internet & Multimedia segment's share of total turnover rose to 21% in 2002 as compared to 17% in 2001.

Operating costs before depreciation increased by 9% to HK$1,430 million. The increase was attributable to higher programming costs which grew by 22% or HK$130 million primarily due to costs related to the 2002 FIFA World Cup. Network and other operating costs decreased 4% to HK$351 million, with lower international bandwidth costs partly offset by higher customer service costs. Selling, general and administrative expenses decreased by 1% to HK$347 million due mainly to lower marketing and overhead costs.

Earnings before interest, tax, depreciation and amortization or EBITDA rose by 19% to HK$731 million while EBITDA margin increased to 34% from 32% in 2001.

Depreciation increased by 16% to HK$504 million due mainly to capital investments in digital set-top boxes, Digital News Centre, cable modems and related network equipment. Operating profit improved by HK$47 million to reach HK$226 million.

Interest income dropped by 55% or HK$32 million year-on-year due to the low interest rate environment and a significant reduction in surplus funds after the early redemption of HK$1,500 million of convertible bonds in October 2002. Finance costs also decreased by HK$10 million due to the early convertible bond redemption.

Net profit before investment provision grew by 14% to HK$190 million from HK$167 million in the previous year.

The Group made a provision of HK$73 million for impairment of its venture investments in the technology sector out of a total investment cost of HK$93 million. The provision is expected to be one-off and has no impact on the Group's operations or cash flows. Following this provision, the net amount standing in the Group's balance sheet representing venture investments was HK$21 million.

Net profit attributable to shareholders for 2002 was HK$117 million, after the above impairment provision.

Basic earnings per share were 5.8 cents as compared to 8.3 cents in 2001.

B. Segmental Information

Pay Television

Turnover rose by 7% to HK$1,711 million, reflecting an 8% growth of subscribers in 2002 to surpass 605,000 and higher airtime sales revenues as a result of World Cup. Churn rate dropped to 1.6% per month from 1.8% per month in 2001 with the positive impact from the Group's anti-piracy initiatives, while ARPU increased by HK$1 to HK$233 per month. EBITDA declined slightly by HK$6 million to HK$629 million while operating profit dropped 5% to HK$332 million in 2002 primarily due to higher programming costs resulting from the 2002 FIFA World Cup.

Management Discussion and Analysis *continued*

Internet & Multimedia

Internet and Multimedia turnover grew by 34% to HK$450 million as Broadband subscribers rose by 42% to surpass 225,000. ARPU declined by 20% to HK$180 due to aggressive pricing strategy to maintain subscriber growth momentum under a competitive operating environment. EBITDA increased by 125% to HK$210 million due to increase in turnover and stable operating costs. Operating profit of HK$9 million was achieved as compared to HK$50 million loss for 2001.

C. Liquidity and Financial Resources

In October 2002, the Group made an early redemption of HK$1,500 million of its HK$1,800 million convertible bonds to reduce its net financing cost. The repayment was financed primarily by the Group's surplus cash whose average yield was less than 2% per annum, far below the 4% per annum interest payable on the fixed rate convertible bonds. The Group has also arranged HK$800 million in short term bank credit facilities to enhance its liquidity position.

The Group's net debt position as at December 31, 2002 was HK$196 million, being HK$386 million of bank loans, HK$300 million of convertible bonds bearing a fixed interest rate of 4% due to be repaid in November 2003, offset by deposits with financial institutions, investment in debt securities and, cash and bank balances. The ratio of net debt to total assets as at December 31, 2002 was 7%. All of the Group's borrowings, and cash and cash equivalents were denominated in Hong Kong dollars.

The consolidated net asset value of the Group as at December 31, 2002 was HK$1,512 million, or HK$0.75 per share. There were no charges on any of the Group's assets.

The Group's assets, liabilities, revenues and expenses were mainly denominated in Hong Kong dollars or U.S. dollars and the exchange rate between these two currencies has remained pegged. The Group thereby did not expect to be affected to any significant extent by fluctuations in exchange rates. There was also no need to make use of any financial instruments for hedging purpose.

Capital expenditure for the year amounted to HK$559 million as compared to HK$626 million in the previous year. Major items included investments on digital set-top boxes and cable modems and related equipment, and network expansion. These items are expected to continue to be the major areas of capital expenditure for the Group in 2003.

The Group is comfortable with its present financial and liquidity position. Cash to be generated from the Group's operations and funds available from external sources are expected to be adequate to fund known upcoming capital expenditures and working capital requirements.

D Significant Investments and Acquisitions

The Group had invested HK$93 million in unlisted non-trading investments since 2000 and did not engage in any material acquisitions or disposals of subsidiaries or associated companies during the year. During the year, HK$73 million provisions for impairment were made based on management's judgement of the fair value of the investments on the balance sheet date.

E. Contingent liabilities

At December 31, 2002, there were contingent liabilities in respect of guarantees, indemnities and letters of awareness given by the Company on behalf of subsidiaries relating to overdraft and guarantee facilities of banks of up to HK$19 million of which only HK$7 million was utilised by the subsidiaries.

The Group is in discussion with the Inland Revenue Department regarding the deductibility of certain interest payments claimed in previous years' tax computations with estimated maximum net exposure to the Group of HK$35 million at December 31, 2002. The outcome of the discussion is uncertain but management is of the view that there are ample grounds to support the deductibility of the interest expenses.

F. Human Resources

The Group had a total of 2,641 employees at the end of the year. Total salaries and related costs incurred in 2002 amounted to HK$722 million.

To continuously increase the overall calibre of the organization and strengthen the "pay-for-performance" culture, we reengineered our performance management, compensation and reward programmes at the beginning of the year. A portion of each employee's compensation is tied to the Group's overall results, the respective unit's achievements and the individual's performance. The Group also operates an Employee Share Option Scheme.

G. Operating Environment and Competition

The operating environment will continue to be difficult with new players entering the market and no immediate signs of an economic recovery.

In the Pay TV segment, TVB announced in February the divestiture of its stake in Galaxy to below 50%, thereby clearing a regulatory hurdle precedent to Galaxy's launch of a Pay TV service, which is generally expected before the end of this year. Yes TV, meanwhile, has been granted a one-year extension to meet the capital investment commitment under its licence. While these developments have yet to show significant real impact on the Pay TV market, the Group has started to sharpen its competitiveness on all fronts to respond to market changes.

In the Broadband segment, the Group pre-empted the competition with an aggressive marketing strategy. As a result of that, short-term margin was sacrificed in favour of long-term market share gain. This slowed the pace of growth of this segment as a revenue engine.

H. Prospects

2002 was a challenging year for Hong Kong and therefore for the Group. Nevertheless, our core businesses demonstrated exceptional capability to perform in a hostile operating environment, thanks to our first or early mover advantage.

The challenge will be even greater this year with no signs of an economic recovery, the uncertainties surrounding the military conflict in the Middle East, the launch of a new Pay Television service and keen Broadband competition.

However, with the proprietary content that the Group has secured, the state-of-the-art production and transmission facilities the Group has built up in the past year, a solid customer base, and experience and infrastructure amassed in the provision of Pay Television service, it is ready to face up to these new challenges.

On the Broadband front, the business is built on a very competitive cost structure. With expansion of our service capability, we will continue to compete effectively in a keen market. Furthermore, with the digital content that it has amassed and its ability to deliver live content, the Group is in a good position to become a content provider when 3-G mobile communication service is introduced.

The Group will celebrate its 10th anniversary later this year. In the document that was submitted in September 1992 to support our licence bid, we have committed our service to the community with the motto

"More than just television – a way of Hong Kong life today"

In the past decade, the Group has developed from an eight-channel Pay Television operator into a fully fledged, vertically integrated communications company that provides television and telecommunications services; owns and operates one of the territory's near universal networks and produces its own content with state-of-the-art digital facilities.

The Group is one of Hong Kong's leading television service providers and programme producers, consistently commanding over 35% of total viewership in subscribers' homes around the clock; one of Hong Kong's top five media; the second largest Broadband service provider; and a prominent telecommunications network operator and owner. These achievements demonstrate our tenacity to prevail over a decade of economic recession, uncertainties and competition.

The solid business foundation that we have built over these years, the active steps that we have taken to constantly improve and the investment that we have made to build for the future will steer us through the current economic difficulties.