

MANAGEMENT DISCUSSION AND ANALYSIS (Continued)

Telecast licensing continues its healthy growth. This is due mainly to a steady increase in revenue sharing from pay TV licensees in markets, such as Malaysia, Singapore and Canada as their subscriber bases grow. Video licensing showed a higher-than-expected, double-digit growth over 2002 due to strong growth in mainland China and Taiwan.

Notwithstanding the introduction of more stringent restrictions on imported programmes in 2003, revenue from programme licensing in mainland China grew substantially year-on-year. The improvement came mainly from our VCD licensing, which was supported by better distribution and a continuing effort to combat piracy.

We expect steady growth in our programme licensing business in 2004 and expect our margins to further improve through better cost management.

Overseas Satellite Pay TV Operations

(a) TVB Satellite Platform (TVBSP) USA

In the USA, the subscriber base of our 5-channel package on DirecTV grew at a remarkably high double-digit rate following the migration of TVBSP subscribers to DirecTV in March 2003. We attribute the attractive growth to intensive promotions held jointly with DirecTV and several major installers, and to the efforts of our sales staff based in the New York area.

In 2003, TVBSP was able, by means of short-term agreements, to sublease to various channel providers some of its transponder capacity. Negotiations with several other operators are in progress. If these negotiations are successful, our financial liability for the remaining portion of the transponder lease will be substantially reduced.

With the strong and steady momentum of subscriber uptake, we should also see a substantial growth in the subscriber base and profitability in 2004.

(b) TVB Australia (TVBA)

TVBA began to release a full range of fresh and current programming on its TVBJ channel in July 2003. With new subscriber growth up and churn rates down, we saw overall double-digit growth for the year. Ground promotions and events in 2003 were essential factors driving penetration, and will help to continue the momentum in 2004.

We were satisfied with the progress we made in discussions with the major service carriers. We are currently reviewing our long-term strategy for the Australia market, aiming to achieve the best efficiency.

(c) The Chinese Channel (TCC) Europe

With the new encryption system fully in place since the first quarter of 2003, general subscription renewal rate saw improvement, though not as much as we had hoped. Feedback from subscribers who did not renew after the new encryption system came on line indicates that the earlier long period of piracy fostered an expectation in many Chinese viewers that the pay TV content should be free. This has created market niches for our free-to-air broadcast competitors. Coupled with the additional fact that our competitors are bringing in live news and financial updates from Hong Kong, the progress of the business has slowed.

In response, TCC is exploring the possibility of setting up a full-time delivery channel from TVB City in Hong Kong to the TCC local playout centre in London. This will enable us to deliver effectively more live news, updates and current programmes to enhance the channel's programming.

Despite the several negative factors noted above, TCC was nevertheless able to maintain single-digit growth in subscribers in 2003.

MANAGEMENT DISCUSSION AND ANALYSIS (Continued)

Channel Operations

(a) Taiwan

Thanks to the successful restructuring of our Taiwan television operation in 2002, both advertising revenue and profits of all TVBS channels showed encouraging growth in 2003 despite the impact of SARS, slow economic recovery and political uncertainty caused by the March 2004 presidential election in Taiwan.

In 2004, TVBS will continue to enhance its programmes and production to improve further on its revenue in Taiwan and overseas. It will also focus on consolidation of its resources and on improving the cost efficiency to increase profitability.

(b) TVB8 & Xing He

The continuous growth in the number of Xing He and TVB8 subscribers in Malaysia, Singapore and the mainland has resulted in a substantial increase in revenues for the year. Capitalising on the increasing subscriber base, advertising sales also advanced considerably. In Indonesia, the Xing He channel switched from the premium to the basic package on the platform there, resulting in substantially improved home penetration and paving the way for further progress in the country.

In 2004, we will continue to strengthen home reach in the mainland and explore new markets overseas. The landing of Xing He and TVB8 on the Galaxy platform in Hong Kong will generate additional subscription revenue and broaden the footprint of the channels for advertising sales.

Other Activities

(a) Jade Animation

While maintaining its steady profit in the studio and distribution business, Jade Animation launched in 2003 its own animated drama, "The Legend of Condor Hero", based on Jin Yong's famous novel. Broadcast for 13 weeks every Saturday from 10:30 p.m. to 11:30 p.m. on the Jade channel, the series achieved an average audience share over 80% and gained satisfactory regional distribution sales and TV ratings. Jade Animation will continue to develop its own animation projects and further expand its distribution and merchandising activities in mainland China. In the coming year, Jade Animation will enhance its capabilities with 3D animation facilities to cope with market needs.

(b) Internet Operations

TVB.COM provides a value-added service to TVB's programme sponsorship clients in the form of mini-web sites and other Internet promotions based around the programme sponsorship. The robust growth in TVB's programme sponsorships in 2003 has contributed greatly to a very strong growth in advertising income for our Internet operations this year.

Broadband income also grew greatly and 3G content income took effect in the second half of the year. This has resulted in a 40% growth of revenue for the Hong Kong Internet operations.

We expect the growth in advertising income to continue. In addition, demand for 3G content is forecast to increase with the launch of other 3G services later this year and the introduction of mobile phones capable of streaming video even using 2.5G networks.

Although the provision of value-added content to broadband subscribers in Shanghai has been delayed, it is expected to commence sometime in 2004. Furthermore, new models of broadband content provision in mainland China are emerging and they may have a positive revenue impact in the later part of 2004.

MANAGEMENT DISCUSSION AND ANALYSIS (Continued)

(c) Magazine Publishing

The magazine market in Hong Kong in 2003 continued to be characterised by intense and unceasing competition for both circulation sales and advertising revenue. TVB Weekly's strategy has been to hold the cover price but to offer more value to readers through sponsored premiums. In addition, the design of our publication is continuously being improved.

On the advertising revenue side, revenue grew through increased marketing-led projects including managed events for TVB Weekly advertisers. Thus, despite the negative impact of SARS and a slight decline in magazine sales revenue, overall revenue increased by 5%.

The intense competition for circulation sales put pressure on direct costs but savings were achieved in staff and other expenses. Thus, the operating profit has been improved by 9% over the previous year.

Looking forward, we expect improved advertiser sentiment to contribute to growth despite the continuing incessant competition. Our efforts in magazine distribution, event marketing management and advertisement canvassing will continue not just in Hong Kong but also in the southern provinces of the mainland.

(d) Mainland Joint Venture

Situation 2003

The conglomeration of China's radio, film and television industries into giant media groups is a significant move for the mainland media industry. The demand for quality Chinese language content is steadily on the increase. Our joint ventures in the mainland have matured and grown rapidly in the past year.

Our Move

By setting up strategic alliances with local media partners, our joint venture has been producing a daily one hour entertainment-infotainment programme for nationwide distribution. By the end of 2003, the show had successfully made its name and been accredited by audiences and advertisers. This model of cooperation is highly successful and our joint venture will capture a significant window of opportunity as the media market continues to boom in the mainland.

We have been developing our licensing business in mainland China since the 80's. Our joint venture has also put in a lot of effort to broaden the coverage of our distribution network. In 2003, the joint venture launched a drama time block project with our local partners in major cities across 30 provinces. In order to strengthen our sales network for our time block projects, we have set up advertising sales teams in Shanghai, Beijing and Guangzhou.

Besides the traditional media business, we are leveraging our strengths in content aggregation and media foundation as well as local partner supports in order to achieve value-added revenues for our content. Through cooperation with our local partners, we have built and launched SMS content service for nationwide mobile phone users in the last quarter of 2003.

We believe our mainland joint venture is well positioned to provide syndication of high quality Chinese content to both traditional and new media markets in mainland China.