

MANAGEMENT DISCUSSION AND ANALYSIS

REVIEW OF OPERATIONS

(a) Overview

For the year ended 31 December 2004, the Group achieved a turnover of approximately HK\$3,817 million (2003: HK\$3,311 million), which represented an increase of 15%. Cost of sales amounted to approximately HK\$1,842 million (2003: HK\$1,692 million), which represented an increase of 9%. Gross profit for the year amounted to approximately HK\$1,975 million (2003: HK\$1,619 million), which represented a gross profit percentage of 52% (2003: 49%).

Selling, distribution and transmission costs amounted to approximately HK\$450 million (2003: HK\$443 million), which represented an increase of 2%. General and administrative expenses amounted to approximately HK\$513 million (2003: HK\$574 million), which represented a decrease of 11%. The reason for the reduction in this expenditure was principally due to the relocation from the former base in Clear Water Bay to TVB City in Tseung Kwan O which resulted in savings in rental and rates charges. The effect of this reduction had more than offset the additional depreciation charges at TVB City. Finance costs for the year amounted to HK\$7 million (2003: HK\$17 million) which showed a reduction of 59%. This was the result of the repayments of bank borrowings in Hong Kong.

Share of losses of jointly controlled entities, was reduced from HK\$47 million to HK\$6 million. However, the Group's share of the losses of an associated company, Galaxy Satellite Broadcasting Limited, increased from HK\$16 million to HK\$166 million for the year, which represented the share of losses since the commercial launch of pay TV operations on 18 February 2004 to 31 December 2004.

Overall, the profit attributable to shareholders amounted to HK\$719 million (2003: HK\$441 million), which represented an increase of 63%. Earnings per share was HK\$1.64 (2003: HK\$1.01).

Included in cost of sales was the cost of programme, film rights and stocks which amounted to approximately HK\$1,311 million (2003: HK\$1,151 million). Increase in the spending in programmes was due to the costs for the coverage of the 2004 Olympic Games in Athens during August 2004 and an increase in output of drama production for Hong Kong and overseas consumption.

(b) Comments on segmental information

Revenue from terrestrial television broadcasting, which comprised predominantly local advertising revenue, increased from HK\$1,725 million to HK\$2,007 million, which represented an increase of 16%. Cost of sales, which comprised costs of own produced TV programmes and film rights, was kept under tight budgetary control and, as a result, the gross margin saw a single-digit percentage improvement over last year. Other costs were also lower than 2003 and, as a result, gave rise to an operating profit for this segment of HK\$519 million (2003: HK\$175 million).

Revenue from programme licensing and distribution increased from HK\$653 million to HK\$679 million, which represented an increase of 4%. Our costs of distribution were in line with the growth of the business. As noted in the business review, the primary area of growth came from key markets, such as Singapore and mainland China, in terms of telecast and licensing of programmes. This segment contributed an operating profit of HK\$375 million (2003: HK\$363 million).

Revenue from overseas satellite pay TV operations, which comprised TVB Satellite Platform ("TVBSP") USA, TVB Australia ("TVBA") and The Chinese Channel ("TCC") Europe, showed a small reduction from HK\$231 million to HK\$214 million, which represented a decrease of 7%. In 2003, provision was made for an onerous contract in relation to a transponder lease with a satellite company, which was not repeated in 2004. Subsequent write back of the over provided amount in relation to the transponder lease in 2004 had resulted in a substantial reduction in costs in 2004. This segment contributed an operating loss of HK\$7 million (2003: an operating loss of HK\$97 million). We anticipate that the profitability of this business should further improve.

MANAGEMENT DISCUSSION AND ANALYSIS (Continued)

Revenue from channel operations, which comprised TVBS operating under Liann Yee Production Co. Ltd. (“LYP”) in Taiwan, the two channels - TVB8 and Xing He and the supply of channels to Galaxy, showed a marked increase of 30% from HK\$710 million to HK\$922 million. Improvement in revenue from LYP, TVB8 and Xing He were noted due to the increase in advertising revenue and the subscriber base. This segment contributed an operating profit of HK\$171 million (2003: HK\$83 million).

(c) Business Review and Prospects

Terrestrial Television Broadcasting

A strong showing in March 2004 heralded the start of a good year. March sales were up more than 25% when compared to 2003. This was followed by robust revenue growth in April and May, which recorded growth of more than 50% over the same two months in 2003. (These two months in 2003 were the worst affected by SARS). Throughout the summer and autumn period of July to October, revenue growth over 2003 was in excess of 20%. The stellar performance between March and October helped push the percentage revenue growth for the year into the high teens.

This result is higher than what was expected from the 2004 advance commitments that we received at the end of 2003 and at the beginning of 2004, at which time we forecast around a 10% growth in revenue. Undoubtedly, this strong showing has been greatly assisted by the substantial budget increases on the part of advertisers in a few key categories. Mobile phone networks resumed their aggressive marketing activities, more than doubling their spending with us in 2004. Banks, finance companies and credit cards companies showed very significant growth in spending, as they normally do when the consumer economy improves significantly. Among packaged consumer goods, the most notable growth came from skin care products, which is also now our largest category of advertisers in terms of revenue.

Growth in sponsorship revenue continued to exceed expectations in 2003. We see further potential for growth in this area in 2005 and in the coming years. Revenue from the English language channel, Pearl, also met and exceeded our aggressive growth target by 30%. The high double-digit revenue growth on Pearl for 2003 and 2004 confirms our success in rejuvenating advertisers’ interest in the English language TV channel.

The economic growth forecasts for 2005 are somewhat lower than they were for 2004 a year ago. Thus, the expectation for growth in 2005 must be lower than what has been achieved in 2004, particularly since 2003 was a year afflicted by SARS. The total advance commitment for 2005 showed a healthy growth over the same period last year, and this bodes well for the growth prospects of 2005.

TVB Jade and Pearl continued to be the preferred channels for the majority of the people in Hong Kong, with an overall weekday prime time average* of 81% among terrestrial Chinese channels for Jade and a weekly average of 74% among terrestrial English channels for Pearl during the year in review.

* Prime time audience share refers to average share from 7:00 p.m. to 11:00 p.m. on Jade, and 7:00 p.m. to midnight on Pearl.

The Jade Channel

Jade’s drama production, variety extravaganzas and event programming continued to excel in 2004.

The period drama “War and Beauty” became the talk of the town and made media headlines with its plot and dialogues likened to modern day office politics. It captured the attention of 2.1 million viewers on average per episode and the series’ final episode was a major TV event of the year as nearly 3 million viewers watched its conclusion.

The attraction of Jade dramas was also further enhanced by the infusion of innovative narrative style and dramatic elements. The top rating drama of the year “To Catch The Uncatchable” incorporated cartoon-like characters and comic elements into a police drama and attracted 2.1 million viewers per episode. “To Get Unstuck In Time,” a detective story for the ages and the

MANAGEMENT DISCUSSION AND ANALYSIS (Continued)

love-hate relationship between father and son, captured 2.0 million viewers per episode. “Split Second”, a story of undercover cops which was filmed partly in Thailand, attracted 1.7 million viewers per episode. “The Last Breakthrough” which portrayed touching stories of medical professionals serving patients in developing countries, and filmed with parts on location in Kenya, captured 1.8 million viewers per episode. The well-received sitcom “Virtues of Harmony II” entertained 1.9 million viewers every evening on weekdays throughout the year.

As to variety extravaganzas and event programming, “TVB 37th Anniversary Special” was the highest-rating non-drama programme of the year and attracted 2.3 million viewers. “Miss Hong Kong Pageant 2004” held at the eve of the opening of the Olympic Games attracted 1.9 million viewers. Jointly performed by the Olympic champions of Chinese national team and local artistes, “Sports Extravaganza - Chinese Olympic Gold Medallists 2004” captured 2.2 million viewers.

Variety, musical and entertainment programmes featuring celebrities are evergreen on Jade. For example, “The Super Trio Continues...”, the hilarious celebrity game show, attracted an average of 2.1 million viewers per episode. “Anita Mui’s Everlasting Glamour on Stage”, a retrospective of the late superstar pop idol, captured 1.9 million viewers.

TVB’s coverage of the 2004 Athens Olympic Games also achieved outstanding ratings during the two weeks of events. In particular, the live coverage of Hong Kong team’s Ko Lai-chak and Li Ching who took a silver medal at the table tennis men’s final attracted 1.7 million viewers.

Jade also explored new themes and formats for drama and non-drama programming during the year. “Sunshine Heartbeat”, a youth drama, successfully attracted young audience on Sunday evenings. “Hong Kong Live”, a live talk-magazine programme on events around town and financial information, began in late November on weekday mornings and afternoons.

The Pearl Channel

Blockbuster movies remained the most popular programme genre on Pearl. 70 of the top 100 programmes on terrestrial English TV were Pearl’s movies. Mega movie “The Mummy Returns” and Pic of the Year “Jurassic Park III” gained the highest ratings, attracting 768,000 and 679,000 viewers respectively.

Pearl also carried extensive coverage of the 2004 Athens Olympic Games. In particular, the live telecast during prime time achieved an average share of 75% of terrestrial English television channels.

Live coverage of three critical soccer matches of Asian Cup 2004 was a highlight of the year for Pearl. The final match of China Vs Japan attracted an average of 1 million viewers and broke the rating record of sport programmes on English channels. It was also the highest rated programme of English channels in 2004.

Apart from the well-received drama series “24” and “ER”, Pearl also offered other popular series such as “Las Vegas”, “Without a Trace” and “Miss Match”. Mini series “Taken” by Stephen Spielberg, “Stephen King’s Rose Red” and “Helen of Troy” were also acclaimed by viewers.

Wildlife documentaries such as “Jungle”, “The Most Extreme” and “Big Cat Diary” were still favourites of Hong Kong viewers. Reality programmes such as “The Apprentice”, “America’s Next Top Model” and “Queer Eye For The Straight Guy” were also well-received.

Commendations and Awards

TVB continued to receive international recognition for excellence in current affairs and entertainment programmes, production and promotion in 2004. At the New York Festival, “The Pearl Report: Virus” won a Gold World Medal in the category of Health/Medical Issues. “Newscast: Hong Kong People Power - Article 23 Protest” won the 2004 RTNDA R. Murrow Award for Overall Excellence. The programme promotion of “Band of Brothers” won the Gold Prize of PROMAX 2004 in the