

Management Discussion & Analysis



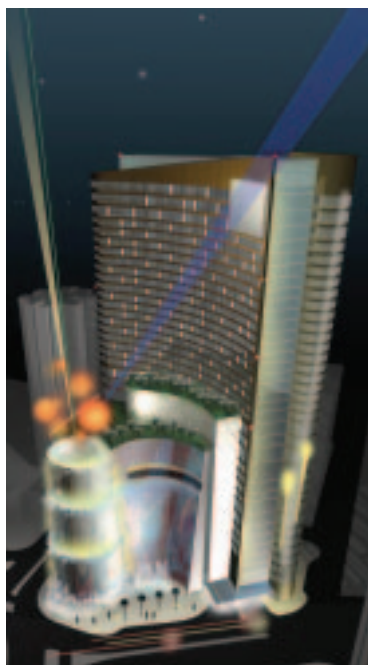
2004 was an important year for **Melco**. It marked the beginning of our foray into the highly lucrative Macau gaming sector. From here on, leisure, gaming and entertainment is expected to become the core business for the Group. As the gaming division is still in its investment phase, contribution to profitability was not yet meaningful in 2004. Having said that, Mocha Slots, despite being acquired only in the latter half of the year, has already started to contribute to our bottom-line.

The three non-core businesses, i.e. investment banking, technology, and property and other investments, have all performed satisfactorily. Overall, group turnover for the year increased to HK\$408.08 million (2003 - HK\$165 million), representing an increase of 147%. Net profit attributable to shareholders was HK\$65.16 million as compared to a net loss of HK\$26.33 million in the previous year.

Leisure, Gaming and Entertainment

For the year under review, the Leisure, Gaming & Entertainment Division recorded a turnover of HK\$123 million (2003 - HK\$54.9 million) and segmental profit before interest and tax amounted to HK\$5.6 million (2003 Loss - HK\$11.7 million).

Currently, there are 3 sub-divisions within our Leisure, Gaming and Entertainment Division, namely, Mocha Slots, Park Hyatt Macau and Jumbo Kingdom.



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→ MOCHA SLOTS



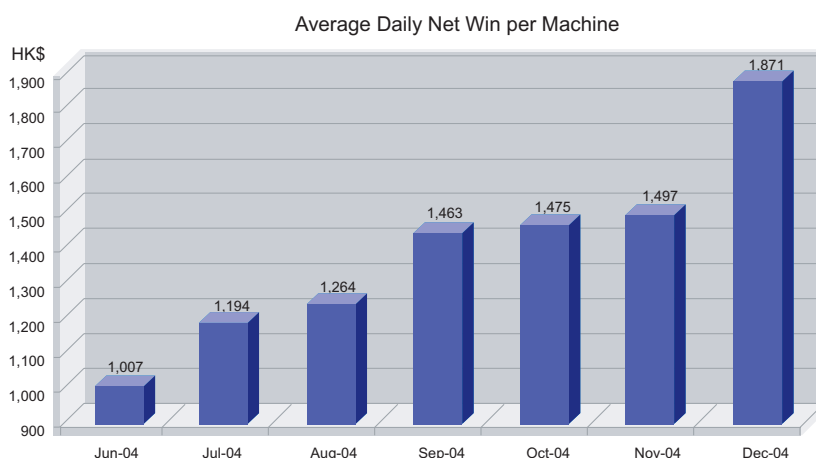
Recognizing that in other gaming centers such as Las Vegas and Atlantic City, over 50% of gaming revenue comes from slot machines and electronic gaming, the Group acquired Mocha Slot Group Limited (Mocha Slots) in June 2004.

Mocha Slots targets the grind (lower end) market, in particular, the exponential growth of lower end gamblers arriving from China under the Individual Travellers Scheme. It operates a chain of slot machine lounges with upmarket décor providing a leisurely and relaxing cafe style ambience all over the Macau enclave. The slot machines installed in these lounges are no longer the mechanical boxes belonging to the last century, but state-of-the-art machines run on centralized computer networks. These lounges also incorporate multi-player machines such as electronic Roulette, Baccarat, Sic-bo (骰寶) and Caribbean Stud, all of which are popular table games played in casinos.

As at 31 March 2005, the Group had four outlets with around 700 machines in operation, accounting for roughly 25% of the total number of slot machines operating in Macau.

Total revenue generated by Mocha Slots in 2004 was HK\$47.7 million* (2003 - HK\$Nil). The figure only covers the operating period from 10 June 2004 (the date of acquisition of Mocha Slots) to 31 December 2004.

Despite the fact that Mocha Slots is still at its early stage of development, the key performance indicator, i.e. the average daily net win or average daily gross revenue per machine has been very encouraging. A graph showing the average daily net win per machine is shown below, one can immediately see that it is in an increasing trend.

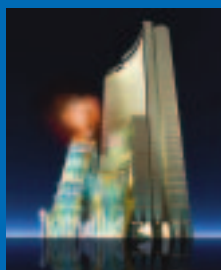


It is our plan to open another 2 to 3 outlets in 2005. Our preferred venues would be in areas with high tourist flows, particularly within or near 2-star or 3-star hotels.

*Total revenue generated by Mocha Slots represents 31% of Gross Gaming Revenue.

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→ PARK HYATT MACAU



Recognizing that over 70% of Macau's gaming revenue is derived from VIP gaming or high limit players, we announced our plan in September 2004 to build the first ever 6-star luxury hotel cum casino complex in Macau to tap the high roller market. This hotel will be managed by Hyatt International under the "Park Hyatt" brand name.

When completed, the new hotel/casino complex is expected to be the tallest building at Taipa, with a building height of 512 feet. It is expected to feature 18 guestroom floors, 5 functional floors and 6 casino floors. The gross floor area for the complex will be approximately 823,000 square feet, out of which approximately 260,000 square feet will be dedicated to gaming space and approximately 563,000 square feet will be for hotel use. The complex will be characterised by a sense of spaciousness and hyper luxury decor.

Total construction cost for this project is expected to be around HK\$1.45 billion. Construction of the project has already begun. The Group's target completion date is the end of 2006. The **Melco/PBL** joint venture will be responsible for the marketing and branding of the hotel/casino complex, which will involve strategic cross-marketing between Park Hyatt Macau and **PBL**'s casinos in Australia, including the highly acclaimed Crown Casino in Melbourne.

The Group initially embarked on the Park Hyatt project in collaboration with Sociedade de Turismo e Diversões de Macau (STDM) on a 50:50 basis. However, after a series of shareholder value enhancing acquisitions from STDM, the **Melco/PBL** joint venture would own 100% of the project. Under the joint venture agreement, Melco would have an effective interest of 60% in the Park Hyatt project whilst **PBL** would own the remaining 40%.

As the project is still in its construction phase, it made no contribution to the Group financial performance in 2004.



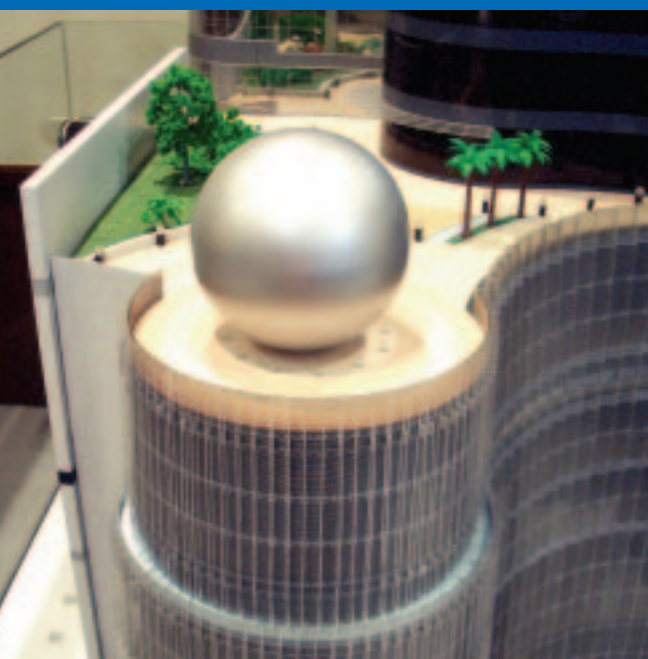
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→ JUMBO KINGDOM

Total revenue generated by Jumbo Kingdom in 2004 was HK\$75 million (2003 - HK\$55 million), representing an increase of 37%. However, the division continued to register a loss in 2004 due to write-offs of fixed assets not previously depreciated and the high re-branding and promotion costs incurred during the year.

Jumbo Kingdom includes the Jumbo and Tai-Pak floating restaurants located at Aberdeen, Hong Kong. During the year, conscious effort was made to revamp the famous floating complex and transform it into a "premium dining palace". All the upgrading work has now been completed and the much-loved tourist landmark is once again operating at full capacity. Jumbo Kingdom has now been transformed into a modern complex that incorporates fine dining, shopping, sightseeing and cultural attractions. Popular new attractions include the "Dragon Court" restaurant, conference and banquet facilities, sampan dining offering "Typhoon Shelter" seafood meals, retail and souvenir shops, a ferry pier plaza and an open-air cafe.

Following the completion of renovation work, the Group launched an extensive marketing campaign to promote the attraction. Patronage is steadily increasing. In recognition of its iconic status in Hong Kong, Jumbo Kingdom won the Hong Kong Superbrands Award in 2004.



OTHER PROSPECTS IN GAMING



During the year, the Group concluded a deal with the Australian gaming and media giant, **PBL**, to form a joint venture to co-expand their gaming business in Asia. **PBL** owns and operates the highly acclaimed Crown Casino in Melbourne and Burswood Casino in Perth. Both casinos derive substantial revenue from Asian high rollers.

Under this deal, both parties have undertaken to co-invest with each other on an exclusive basis in any future gaming ventures in Asia, including Singapore, Thailand, Japan and the Greater China region, but excluding Australia and New Zealand. Within the Greater China region (i.e. Macau, Hong Kong, Taiwan and Mainland China), the Group will always maintain an effective interest of 60% in any new ventures while **PBL** would own the remaining 40%. Outside the Greater China region, **PBL** will always have an effective interest of 60% while the Group will own the remaining 40%.

As a first step in our expansion plan beyond Macau, we have recently, via the **Melco/PBL** joint venture, submitted our proposed concept for the establishment of an "integrated resort" comprising gaming, leisure and entertainment facilities in Singapore.

As a result of Macau's economic success, many Asian governments are now considering the legalization of gaming in order to boost their economies and tourism. This includes countries such as Thailand and Japan. Looking ahead, we believe that there are many lucrative opportunities available in the gaming industry in Asia and the **Melco/PBL** joint venture provides us with a perfect platform to capitalize on these opportunities.



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Investment Banking and Financial Services

The Group conducts its investment banking and financial services through its 67.57% owned listed subsidiary, Value Convergence Holdings Limited (Value Convergence, Stock Code: 8101) acquired in February 2003. This subsidiary offers a broad range of investment banking and brokerage services, as well as capital market and corporate finance advisory services to regional and international clients.

Total revenue generated by the Group's Investment Banking Division in 2004 was HK\$126.4 million (2003 - HK\$76 million), representing an increase of 67%. Segmental profit before tax and interest amounted to HK\$14.8 million (2003 - HK\$3 million), representing an increase of 392%.

The performance of the brokerage business depends very much on the market trading activity. Taking advantage of the active market activities, the financial performance of the Group's brokerage sub-division improved substantially in 2004. During the year, it increased market share in the local stock market, while the investment banking sub-division completed several placements and IPO transactions. A subsidiary was set up in Macau to provide advisory services to selected clients. This may open up new opportunities and build up brand recognition of this division's business in Macau.

Looking forward, investment banking will remain a non-core business of the Group. However, effort will be made to expand its business to Macau in order to leverage off the Group's established network and connections over there.

Technology

The Group's technology division was created in May 2004 following a group reorganization which resulted in the full acquisition of iAsia and Elixir from Value Convergence. These two units are now grouped under Melco Technology Group Limited, a wholly-owned subsidiary of the Group and become the Group's gaming IT infrastructure arm.

Results for the Technology Division in 2004 were very encouraging. Turnover amounted to HK\$154.8 million (2003 - HK\$29.2 million), representing a spectacular increase of 430%. Segmental profit before tax and interest amounted to HK\$14.5 million, as compared to a loss of HK\$9.4 million in 2003.

Based in Macau, Elixir has established itself as a premier gaming IT infrastructure specialist offering clients a full range of system integration and network services. During the year, leveraging off the Group's strong ties to SJM, Elixir managed to secure several lucrative agreements in the provision of gaming IT infrastructure for the largest gaming concession holder in Macau. It is expected that Elixir will continue to be one of the largest IT solution providers for SJM in due course.

The iAsia group of companies, based in Hong Kong, is engaged in the provision of comprehensive online trading and related systems and services to financial institutions and intermediaries, principally in Asia. During the year, iAsia developed a new and well-received Bullion Deal Matching System. It has continued to improve and integrate its existing online trading modules and related systems, and the new Bullion Deal Matching System has enhanced the systems comprehensiveness. The Group's IT systems for investment banking and financial services are all supported by iAsia, and iAsia has contributed significantly to improving the technological sophistication of the Group's financial services unit.

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Property and Other Investments

During the year, turnover and segment profit of this division was HK\$3.9 million (2003: HK\$5.7 million) and HK\$65.3 million (2003: HK\$2.3 million) respectively. The decline in turnover is due to the fact that the Group's investment property in Stubbs Road (Art Court) was sold in June 2004 with a profit of HK\$57 million being recorded.

LIQUIDITY AND CAPITAL RESOURCES



As at 31st December 2004, total asset of the Group was HK\$1,585 million which was financed by shareholders' fund of HK\$1,225 million, minority interests of HK\$76 million and current liabilities of HK\$136 million and non-current liabilities of HK\$148 million. The current ratio of the Group was 6.2 (31st December 2003: 2.9).

During the year ended 31st December 2004, the Group recorded a net cash inflow of HK\$252 million. As at 31st December 2004, cash and cash equivalents of the Group totaled at HK\$395 million. Gearing ratio, expressed as a percentage of total borrowings over shareholders' fund, is 0.15 time as at 31 December 2004. The Group adopts a prudent treasury policy. The cash and bank balances consisted of about 35% cash and bank balances and 65% short term fixed deposits, most of which are denominated in Hong Kong dollars to maintain minimum exposure to foreign exchange risks.

As at 31st December 2004, the Group's total available banking facilities amounted to HK\$224.8 million, of which HK\$70 million were secured by margin clients listed securities, and banking facilities for HK\$49.8 million were secured by the pledging of HK\$77 million of the Group's assets. As at 31 December 2004, the Group utilized HK\$15 million of unsecured banking facilities and the amount had been matured and repaid on 5th January 2005.

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SIGNIFICANT INVESTMENTS AND CAPITAL EXPENDITURE



In the past year, the Group made several very significant investments. In June 2004, the Group acquired 80% of Mocha Slot Group Limited, which owns and operates the Mocha Slot lounges, for HK\$353 million. The consideration was settled by issuing to the vendors a total of 153,478,261 of the Company's shares. In about the same time, the Company acquired the iAsia business and group (including, inter alia, to Elixir) from its subsidiary, Value Convergence, for HK\$27.9 million, which was settled by setting off indebtedness owed by the vendor to the Company. In November 2004 and February 2005, the Group purchased a total of 70% of Great Wonders, Investments, Limited ("Great Wonders") from Sociedade de Turismo e Diversoes de Macau, S.A.R.L. ("STDM") for a total consideration of HK\$156 million, which was settled by the Company's issuing two convertible notes to the vendor. In March 2005, the Group entered into a further agreement with STDM to purchase the latter's remaining 30% interest in Great Wonders for HK\$400 million. The transaction is subject to independent shareholders' approval, and will be paid for by an issue of the Company's shares to STDM. Pursuant to a Subscription Agreement dated 23rd December 2004, the Company formed a joint venture with PBL in March 2005 to undertake the new gaming and hospitality business in Macau and Asia. Following this, PBL paid a sum of US\$163 million (HK\$1.27 billion) to the joint venture in March 2005.

During the year, capital expenditure of HK\$117 million was incurred. Of this amount, HK\$92 million was used for the gaming business.

During the year, HK\$370 million was recorded as additional intangible assets which were mainly attributable to the recognition of goodwill arising from the acquisition of subsidiaries.

CONTINGENT LIABILITIES



As at 31st December 2004, the Group had provided a corporate guarantee for a subsidiary, VC Brokerage Limited, amounting to HK\$70 million (2003: HK\$50 million) to a bank in respect of banking facilities granted to the subsidiary.

EMPLOYEES



As at 31 December 2004, the Group employed a total of 710 employees (2003: 380), of which 412 are located in Hong Kong while the remaining are located in Macau and the PRC. The related staff costs for 2004, including Directors' emoluments, amounted to HK\$107 million (2003: HK\$76 million). Increase in staff costs was mainly attributed to the substantial increase in the number of employees as a result of the Group's acquisition of the Mocha Slot Group.

The Group's remuneration policy is to provide its employees with a consistent and fair remuneration system that drives the performance of the Group and the individual employees. Its key components include base salary, discretionary bonus and share option scheme. It also provides the appropriate fringe benefits and training and development opportunities to retain and attract its talents.

賭場
CASINO

2631.96平方米

F.F.L. 12.90
S.F.L. 12.85





LOOKING BEYOND MACAU

Taking the Group's expertise across Asia

