Management Discussion and Analysis

FINANCIAL HIGHLIGHTS

• **Revenue**	**$ 1,213.2 million**
• **Operating profit from principal activities**	**$ 377.6 million**
• **Operating profit**	**$ 419.6 million**
• **Profit attributable to shareholders**	**$ 338.6 million**
• **Earnings per share**	**$ 0.22**
• **Total dividend per share**	**$ 0.19**

OPERATING RESULTS OF THE GROUP

The Group's consolidated operating results for the years ended 31 December 2006 and 2005 were as follows:

(HK$ millions, except per share amounts)	**2006**	2005	% Change
Revenue	**1,213.2**	1,120.4	8
Staff costs	**(377.1)**	(369.3)	2
Production costs	**(178.3)**	(170.4)	5
Rental and utilities	**(35.2)**	(30.8)	14
Advertising and promotions	**(31.0)**	(30.5)	2
Other operating expenses	**(148.4)**	(154.1)	(4)
Operating costs before depreciation and amortisation	**(770.0)**	(755.1)	2
Depreciation and amortisation	**(65.6)**	(78.0)	(16)
Operating profit from principal activities	**377.6**	287.3	31
Other income	**4.4**	3.8	16
Fair value gain on investment properties	**40.1**	50.4	(20)
Impairment of non-current assets	**(16.2)**	(35.7)	(55)
Gain on disposal of financial assets available for sale	**13.7**	0.7	*
Operating profit	**419.6**	306.5	37
Net interest income/(expense)	**2.1**	(0.1)	*
Share of profits of associates	**5.8**	4.4	32
Income tax expense	**(80.1)**	(58.9)	36
Minority interests	**(8.8)**	(5.5)	60
Profit attributable to shareholders	**338.6**	246.4	37
Earnings per share (HK cents)	**21.7**	15.8	37

* *Represents an increase in excess of 100%*

Revenue rose by 8% to $1.2 billion and operating profits from principal activities increased 31% to $377.6 million, mainly due to the strong notices revenue. Profit attributable to shareholders reached $338.6 million, the highest level in the past six years and a 37% increase year-on-year.

Revenue

The consolidated revenue for the years ended 31 December 2006 and 2005 by business segment and for the Group were as follows:

(HK$ millions)	**2006**	2005	% Change
Newspaper publishing	**1,023.4**	936.6	9
Magazine and book publishing	**148.8**	140.4	6
Investment properties	**17.6**	16.3	8
Video and film post-production	**19.0**	22.6	(16)
Music publishing	**4.4**	4.5	(2)
Total revenue	**1,213.2**	1,120.4	8

Operating Costs and Expenses

Operating costs and expenses for the years ended 31 December 2006 and 2005 were as follows:

(HK$ millions)	**2006**	2005	% Change
Staff costs	**377.1**	369.3	2
Production costs	**178.3**	170.4	5
Rental and utilities	**35.2**	30.8	14
Advertising and promotions	**31.0**	30.5	2
Other operating expenses	**148.4**	154.1	(4)
Depreciation and amortisation	**65.6**	78.0	(16)
Total operating costs and expenses	**835.6**	833.1	–

Increases in staff cost, production cost, and rental and utilities were offset by savings in other operating expenses and lower depreciation. Staff costs increased due to salary increments. Production costs increased 5% due to higher newsprint cost. The average cost of 48.8gsm newsprint rose 9% from US$563 to US$613 per metric ton. Newsprint consumption dropped 2%, with a noticeable reduction in the second half of the year. This is attributable to the more efficient new printing presses and tight monitoring of ad ratios. Rental and utilities expenses rose 14% mainly due to the lease renewal of office premises at a higher rent, rates and utility expenses of vacant properties for lease and for billboards which were constructed in 2006.

Operating Profit and EBITDA

Operating profit and EBITDA for the years ended 31 December 2006 and 2005 by business segment and for the Group were as follows:

	Contribution to EBITDA			Contribution to Operating Profit		
(HK$ millions)	**2006**	2005	% Change	**2006**	2005	% Change
Newspaper publishing	**404.3**	339.3	19	**358.4**	241.4	48
Magazine and book publishing	**24.4**	19.4	26	**23.2**	17.5	33
Investment properties	**12.6**	12.7	(1)	**52.7**	63.1	(16)
Video and film post-production	**0.1**	(7.6)	*	**(16.5)**	(16.9)	(2)
Music publishing	**1.8**	1.5	20	**1.8**	1.4	29
Total	**443.2**	365.3	21	**419.6**	306.5	37

* *Represents an increase in excess of 100%*

FINANCIAL REVIEW BY BUSINESS

Publishing

(HK$ millions)	**2006**	2005	% Change
Revenue			
Newspaper publishing	**1,023.4**	936.6	9
Magazine and book publishing	**148.8**	140.4	6
Total	**1,172.2**	1,077.0	9
EBITDA	**428.7**	358.7	20
Operating profit	**381.6**	258.9	47
Net profit	**313.0**	198.6	58
EBITDA margin	**37%**	33%	
Operating margin	**33%**	24%	

Publishing revenues grew 9% and accounted for 97% of the turnover of the Group. EBITDA and operating profit margin improved significantly because of higher revenue contribution from notices which have higher margins.

The circulation of *South China Morning Post* and *Sunday Morning Post* was stable in the first half and showed a 2% drop in the second half owing to a decline in newsstand sales across the industry. However, lower retail sales was partly offset by gains in subscriptions and hotel sales.

Display advertising revenue increased 10%, outperforming the 4% growth in newspaper ad spending in Hong Kong. Yield was 5% higher year-on-year, following an increase in rate cards at the beginning of the year and strong color ad bookings.

Classified revenue recorded a 13% growth mostly due to the strong growth in notices advertising. Notices revenue from IPOs, results announcements, tenders and other notices rose 42%. Revenue from IPOs doubled year-on-year as a result of an increase in size, number and oversubscription of listings from mainland companies. Revenue from results announcements increased 19% and contributed 6% to the Newspaper Division's advertising revenue in 2006. Other company announcements, like connected parties transactions, discloseable or other major transactions, rose 16% and contributed 6% to the Newspaper Division's advertising revenue in 2006. Recruitment advertising revenue increased 1% despite a 7% drop in number of positions advertised in all recruitment publications, according to Nielsen Media's report.

The Magazine Division posted an 83% increase in net profit due to the strong performance of *Cosmopolitan* and *Harper's Bazaar* and cost cutting at unprofitable titles. *Cosmopolitan* maintained its position as the leading international women's title in the market. *Harper's Bazaar* benefited from higher ad spend by luxury brands.

Investment Properties

(HK$ millions)	**2006**	2005	% Change
Revenue	**17.6**	16.3	8
EBITDA	**12.6**	12.7	(1)
Revaluation surplus	**40.1**	50.4	(20)
Operating profit	**52.7**	63.1	(16)
Net profit	**40.3**	60.9	(34)

The operating profit includes a revaluation surplus of $40.1 million compared with $50.4 million in 2005. Rental income increased due to contribution from billboards.

Video and Film Post-Production

(HK$ millions)	**2006**	2005	% Change
Revenue	**19.0**	22.6	(16)
EBITDA	**0.1**	(7.6)	*
Operating loss	**(16.5)**	(16.9)	(2)
Net loss	**(16.5)**	(14.5)	14

* *Represents an increase in excess of 100%*

The operating loss in 2006 includes a provision for asset impairment of $12.5 million due to the weak operating environment in Guangzhou.

The Hong Kong operation became profitable following a restructuring at the end of 2005. TV commercial and documentary tapes business benefited from strong economic growth while post-production and tape transfer business continued to suffer from the weakness in the local film industry.

Higher losses were incurred in the Guangzhou operation. The business faced aggressive price competition in post-production work from many small post-production houses using unlicensed software and equipment. A restructuring was carried out in mid-2006 to focus on developing higher value added business.

Music Publishing

(HK$ millions)	**2006**	2005	% Change
Revenue	**4.4**	4.5	(2)
EBITDA	**1.8**	1.5	20
Operating profit	**1.8**	1.4	29
Net profit	**1.8**	1.4	29

Net profit increased 29% mainly from the release of DVD & VCD formats of "Anita Mui Final Concert Live" and improved royalty income from industry associations.

LIQUIDITY AND CAPITAL RESOURCES

The Group's main source of liquidity is recurring cash flows from the publishing business which is supplemented from time to time by committed banking facilities. The Group's financial position as at 31 December 2006 and 2005 were as follows:

(HK$ millions)	**2006**	2005	% Change
Cash and bank balances	**255.3**	181.4	41
Bank overdraft	**12.9**	6.7	93
Bank loan – current portion	**2.0**	51.9	(96)
non-current portion	**17.0**	17.0	–
Shareholders' funds	**1,882.8**	1,720.5	9
Ratios:			
Gearing	**–**	–	
Current ratio	**2.2**	1.7	

As at 31 December 2006, the Group had total borrowings of $31.9 million. Borrowings comprised of a $17.0 million three-year unsecured floating rate loan denominated in Hong Kong dollars, a $2.0 million short-term revolving bank loan and a $12.9 million bank overdraft denominated in Renminbi payable within one year. A $50.0 million unsecured short-term revolving bank loan was paid in 2006. The Group's cash and bank balances are held predominantly in Hong Kong dollars and the Group has no significant exposure to foreign exchange fluctuations.

As at 31 December 2006, the Group had no gearing (after deducting bank balances and deposits). The ratio of current assets to current liabilities was 2.2 times compared with 1.7 times as at 31 December 2005.

The Group expects its beginning cash balances, cash generated from operations and funds available from external sources to be adequate to meet its working capital requirements, repay bank loans, finance planned capital expenditures and pay dividends.

Operating Activities

The newspaper publishing business was the major source of the Group's cash flow from operating activities. Net cash generated from operating activities for the year ended 31 December 2006 was $369.7 million compared with $338.4 million for the same period last year. The higher cash inflow was partly offset by tax payments during the year.

Investment Activities

Net cash inflow from investing activities was $8.3 million compared with a net cash outflow of $98.0 million in 2005. Cash was raised from the sale of investment shares ($19.7 million), dividend income ($7.5 million) and interest income ($5.3 million). These inflows were partially offset by capital expenditures of $24.4 million, of which $12.3 million was spent on (i) development of websites and content management system; (ii) upgrading accounting and magazine circulation systems; and (iii) office renovation and billboard construction work. The balance was spent on computer related equipment and replacement items. Net cash outflow from investing activities of $98.0 million in 2005 was mainly for the purchase of four new printing presses.

Financing Activities

Net cash used in financing activities was $310.4 million, comprising dividend payments of $249.8 million to shareholders of the Group and $7.5 million to a minority shareholder of a subsidiary, and the repayment of a bank loan of $50.0 million.

OUTLOOK

In 2007, the Hong Kong economy is expected to grow although at a more moderate pace than last year. The government forecasts GDP growth at 4.5% to 5%. This favorable economic environment should benefit our publishing business which derives revenues primarily from advertising.

Circulation is expected to be stable although it is declining for the industry as a whole. We expect display advertising to outperform the market due to the attractiveness of the readership profile of our newspaper and magazine titles. The editorial coverage of the newspaper will be strengthened with a focus on China and business coverage. The revamp of our websites and the launch of new digital products will further enhance our digital capabilities.

The most significant risks to continuing growth in our business are the expected loss of revenue from notices when the stock exchange eliminates the requirement for listed companies to publish announcements in newspapers, the volatile nature of revenue from IPOs which are outside our control and the online trend in recruitment advertising and its effect on the established print recruitment advertising business.

Our focus in 2007 and beyond is to play on our strengths in our core publishing business where there is still much that can be done to generate reliable profits and cash flow, while carefully developing new multimedia products and business models that would be future growth drivers for the Group.