FINANCIAL REVIEW

OVERVIEW

CONTINUING OPERATIONS

For the year ended 31 December 2016, the Group's continuing operations comprised Hong Kong TV broadcasting, Hong Kong digital new media, programme licensing and distribution, overseas pay TV operations, channel operations and other activities, including movie, music entertainment and publications.

The Group recorded a revenue under continuing operations of HK$4,210 million (2015: HK$4,455 million), a decrease of 5%. Cost of sales increased from HK$2,009 million to HK$2,299 million, an increase of 14%. As a result, gross profit decreased from HK$2,446 million to HK$1,911 million, a decrease of 22%. Gross profit percentage stood at 45% (2015: 55%).

Income from Hong Kong TV broadcasting, comprising mainly advertising revenue from the terrestrial TV channels, decreased because of the weak advertising market in Hong Kong prevailing throughout the year. However, licencing revenue from Malaysia and Singapore, remained steady. After the final settlement of the dispute with a major online operator in Mainland China, a licence revenue of HK$126 million was agreed and booked during the year.

Cost of sales increased from HK$2,009 million to HK$2,299 million, an increase of 14%. Included in the cost of sales were the cost of programmes and film rights amounted to HK$1,759 million (2015: HK$1,515 million), an increase of 16% which was mainly contributed by the licence rights and the production costs for the broadcast of the Rio 2016 Olympic Games, which was a non-recurring event, and the extended broadcast of drama on Jade into the weekends' prime time since May 2015.

Selling, distribution and transmission costs amounted to HK$639 million (2015: HK$577 million), an increase of 11%. The increase was attributed to an increase in costs due to the launch of myTV SUPER service in April 2016.

General and administrative expenses amounted to HK$949 million (2015: HK$853 million), an increase of 11% which was mainly due to the launch of myTV SUPER service during the year and an additional provision for impairment loss on trade receivables.

In 2016 the Group acquired further approximately 9.99% interest in TVB Pay Vision Holdings Limited ("TVBPVH"), the holding company of TVB Network Vision, to hold a total interest of approximately 99.99%. The reason for the purchase was to enable the Group to use this vehicle as a subsidiary to further its new business. A settlement loss of HK$70 million arising from this acquisition was included in the other losses. In addition to the settlement loss, the Group incurred exchange losses (mainly related to the re-translation of various foreign currencies such as Renminbi and Malaysian Ringgit) and a write-off of a movie investment totalling HK$56 million.

In August 2016, the Group completed the disposal of the property in Neihu, Taipei at a consideration of NT$4,000 million (approximately HK$971 million). The Group realised a disposal gain of HK$280 million before provision for deferred tax liabilities in relation to the withholding tax on the distributable profits attributable to the disposal in the sum of approximately HK$56 million.

Adjustment of an over-provision of impairment loss on amounts due from TVB Network Vision of HK$71 million was taken up during the year following a review of the fair value of TVBPVH when it became a subsidiary from an associate at the date of acquisition of the additional interest.

Profit before income tax for the year amounted to HK$553 million (2015: HK$126 million), an increase of 337% over 2015.

Due to a smaller assessable profit from Hong Kong TV broadcasting this year, a lower income tax of HK$105 million (2015: HK$144 million), representing a decrease of 27%, was booked. Whilst the profits tax rate for Hong Kong remains at 16.5%, the Group's major subsidiaries operate in the countries whose effective rates vary from 0% to 40%.

Overall, the Group's profit attributable to equity holders for continuing operations for the year amounted to HK$429 million (2015: loss of HK$4 million).

DISCONTINUED OPERATIONS

On 10 March 2016, the Group completed the disposal of its remaining 47% equity interest in Liann Yee Production Co., Ltd and its subsidiaries ("Liann Yee

Group" for a cash consideration of NT$4,343 million (approximately HK$1,021 million). A gain on disposal of HK$78 million was taken up in the year. In view of a plan to repatriate the proceeds to Hong Kong in the form of dividend upon completion, an additional deferred tax provision of HK$7 million had been made in 2016. Upon this disposal, the Group does not have any further interest in the Liann Yee Group. Details of this disposal were set out in Note 31.

EXCEPTIONAL ITEMS

During the year, the Group recorded a net exceptional gain of HK$295 million which comprised of (i) a net gain on the disposal of 47% interest in Liann Yee Group amounting to HK$71 million as detailed in the "discontinued operations" section above; and (ii) a net gain after tax from the disposal of Neihu property in Taiwan of HK$224 million. In 2015, the Group recorded a net exceptional gain of HK$410 million which comprised of (i) a net gain of HK$1,232 million (after deduction of related taxes of HK$164 million) from the disposal of 53% interest in Liann Yee Group; (ii) an impairment loss on loan to and amounts due from TVB Network Vision of HK$695 million; (iii) an impairment loss on a property of HK$88 million; and (iv) professional fees totalling HK$39 million incurred in relation to an aborted corporate transaction. In comparing the net exceptional gains for the two years, the smaller net exceptional gain of HK$115 million in 2016 had contributed to the overall decrease in profit attributable to equity holders.

EARNINGS PER SHARE

Overall, the Group's profit attributable to equity holders for continuing operations and discontinued operations for the year amounted to HK$500 million (2015: HK$1,331 million), a decrease of 62%, giving a basic and diluted earnings per share from continuing and discontinued operations of HK$1.14 (2015: HK$3.04).

SEGMENT RESULTS

Revenue under Hong Kong TV broadcasting which comprised advertising revenue from the Group's free TV channels and the pay TV channels declined from HK$3,105 million to HK$2,707 million, a decrease of 13%, due to the sluggish advertising market. The above decrease in revenue of HK$398 million and the additional costs for the broadcast of the Rio 2016 Olympic Games and extended broadcast of drama on Jade into the weekends mainly explained the change from the segment profit before non-recurring items of HK$551 million to a segment loss of HK$71 million.

Revenue from Hong Kong digital new media which comprised subscription income from myTV SUPER and advertising revenue from mobile devices, website portals and OTT platform, increased from HK$170 million to HK$230 million, an increase of 35%, due to the launch of myTV SUPER in April. This segment changed from a segment profit of HK$41 million to a segment loss of HK$29 million because of the net start-up costs of myTV SUPER.

Revenue from programme licensing and distribution which comprised licensing income from distribution of our programmes through telecast, video and new media licensing, increased from HK$951 million to HK$1,019 million, an increase of 7%. The increase in revenue was mainly attributable to the recoupment of licensing income of HK$126 million after settlement of the dispute with a major online operator in Mainland China which was partly offset by the lower licence fee receivable from MEASAT in Malaysia, the depreciation of the Malaysian Ringgit against Hong Kong dollars, and the lower telecast licensing income in Mainland China. The licensing income from Singapore remained relatively steady. Higher programme costs were incurred during the year. As a result, this segment recorded a profit of HK$444 million (2015: HK$410 million), an increase of 8%.

Revenue from overseas pay TV operations which comprised revenue from our pay TV platforms in North America (USA), Australia and Europe, and TVB Anywhere introduced in September 2016, decreased from HK$186 million to HK$169 million, a decrease of 9%. The decrease in revenue was mainly due to the adverse impact on subscription revenue caused by the proliferation of pirated TV contents overseas. Start-up costs for the OTT platform were incurred, but such unfavourable variances were partly offset by some savings in programme costs. As a result, this segment recorded a loss of HK$40 million (2015: a loss of HK$31 million).

Revenue from channel operations which comprised revenue from TVB8 and Xing He, the Group's satellite TV channel operations, decreased from HK$105 million to HK$90 million, a decrease of 14%. The segmental profit decreased from HK$17 million to HK$2 million, a decrease of 87%, which was mainly caused by lower advertising revenue from Malaysia market resulting from the stagnant economy.

Revenue from other activities which comprised revenue from magazine publishing, production of musical works and movie recorded an increase from HK$129 million to HK$191 million, an increase of 48%. This segment recorded a profit before a non-recuring item of HK$28 million (2015: HK$11 million).

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

The Group continued to maintain a strong financial position as at 31 December 2016. Total equity stood at HK$7,230 million (2015: HK$7,836 million), a decrease of 8%. There has been no change in the share capital of the Company, namely 438,000,000 shares in issue.

During the year, the Group had fully repaid its bank loans. In October 2016, the Group issued US$500 million 3.625% five-year notes due 2021 ("Notes") which are guaranteed by the Company. The Notes are listed on the Stock Exchange. The Note proceeds will be deployed to fund the expansion of digital new media business and other capital expenditures, to make strategic investments and for general corporate purposes. At 31 December 2016, the gearing ratio, expressed as a ratio of gross debts to total equity, was 53.1% (2015: 3.0%).

At 31 December 2016, the Group had unpledged bank and cash balances of HK$6,198 million (2015: HK$2,817 million), an increase of 120%, and certificates of deposit (as held-to-maturity financial assets under Current Assets) amounting to HK$775 million (2015: Nil). The increases were mainly due to the funds received from the issuance of the Notes and the receipt of sale proceeds from disposals of 47% interest in Liann Yee Group and the property in Neihu, Taipei. Out of the unpledged bank and cash balances, 11% were in Hong Kong dollars, 65% in US dollars, 19% in New Taiwan dollars and 5% in Renminbi. About 29% of the unpledged bank and cash balances (approximately HK$1,818 million) were maintained in overseas subsidiaries for their daily operations. Cash not immediately required for operations was placed as time deposits and certificates of deposit.

As at 31 December 2016, the Group had held-to-maturity financial assets (under Non-current Assets amounting to HK$524 million (2015: Nil) which comprises a portfolio of 18 fixed income securities issued by a number of issuers which are listed or unlisted in Hong Kong or overseas carrying fixed coupon rates ranging from 3.55% to 6.375% per annum and maturity dates ranging from 18 January 2018 to 19 February 2027. This portfolio has been set up for treasury management purpose with the view to enhance the overall yield of the Company's cash reserves, under an established treasury policy endorsed by the Executive Committee of the Board. The certificates of deposit ("CDs") amounting to HK$775 million as noted above comprised CDs issued by major banks with a coupon rate of 1.13% per annum. These CDs had matured on 23 January 2017.

During the year, the Group had invested in an associate holding a 29.94% interest in Shaw Brothers Holdings Limited, a Hong Kong listed company engaging in movie and entertainment related business.

Trade receivables from third parties amounted to HK$1,279 million (2015: HK$1,381 million) decreased by 7% over the last year end due to the decrease in advertising income from Hong Kong. Special provision has been made, where appropriate, to cover any potential bad and doubtful debts. Due to the purchases of OTT set-top boxes for myTV SUPER service near the year end date, prepayments relating to such capital expenditure as at 31 December 2016 increased when compared with 31 December 2015.

Trade and other payables and accruals increased from HK$686 million to HK$921 million mainly due to the accrual of interest of Notes and provision for taxes in relation to the disposals of equity interest in Liann Yee Group and the Neihu property.

At 31 December 2016, the Group's net current assets amounted to HK$8,533 million (2015: HK$5,622 million), an increase of 52%. At 31 December 2016, the current ratio, expressed as the ratio of current assets to current liabilities, was 10.1 (2015: 8.8).

At 31 December 2016, bank deposits of HK$6 million (2015: HK$2 million) were pledged to secure banking facilities granted to certain subsidiaries of the Group.

At the year end, the Group had capital commitments totalling HK$300 million (2015: HK$166 million), an increase of 81% mainly to cater for the business needs of myTV SUPER and Hong Kong TV broadcasting business.

The Company announced that on 24 January 2017 an offer would be made to buy-back, subject to conditions, up to 138,000,000 shares, representing approximately 31.51% of the share capital of the Company, at the price of HK$30.50 per share. The offer, if accepted in full, will result in the Company paying approximately HK$4,209 million to the accepting shareholders. Subsequently, on 13 February 2017, the Company announced a revised offer that the maximum number of shares to be bought back under the offer will be reduced from 138,000,000 to 120,000,000, representing 27.40% of the share capital of the Company so that at least 25% of the shares will be held by the public at all times upon the close of the revised offer. The offer price was increased from HK$30.50 to HK$35.075 per share to maintain the same aggregate consideration for the offer as the Company originally proposed. As at the date of this report, the Offer has not yet closed.

FINANCIAL GUARANTEE

At 31 December 2016, there was guarantee given to a bank amounting to HK$8 million (2015: HK$7 million) for banking facilities granted to an investee company.

EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES AND RELATED HEDGES

The Group's foreign exchange exposures comprise trading and non-trading foreign currency translation exposures. Foreign exchange trading exposures mainly arise from trade receipts from overseas customers.

The Group is also exposed to currency fluctuation on translation of the accounts of overseas subsidiaries, on the repatriation of earnings and loans, and the Notes. In order to mitigate the potential impact of currency movement, the Group closely monitors its foreign exchange exposures and uses suitable hedging arrangements against significant foreign currency exposures, where necessary. No forward exchange or hedging contract was entered into by the Group during the year.

HUMAN RESOURCES

At the year end, the Group employed, including contract artistes and staff in overseas subsidiaries but excluding Directors and freelance workers, a total of 4,249 (2015: 4,221) full-time employees.

For employees in Hong Kong, different pay schemes apply to contract artistes, sales and non-sales personnel. Contract artistes are paid either on a per-show basis or by a package of shows basis. Sales personnel are remunerated on commission based schemes. Non-sales personnel are remunerated on a monthly salaries basis. About 3% of the Group's manpower was employed in overseas subsidiaries, and was paid on scales and systems relevant to the respective localities and legislations.

For Hong Kong employees, discretionary bonuses may be awarded as incentive for better performance. For the year, all qualified personnel received discretionary bonuses averaging one month's basic salaries. The Group did not operate any employee share option scheme in 2016.

From time to time, the Group organises, either in-house or with vocational institutions, seminars, courses and workshops on subjects of technical interest, such as industrial safety, management skills and other related studies, apart from sponsorship of training programmes that employees may enrol on their own initiatives.

To sustain the long term steady supply of human resources for production, the Group has implemented a number of new initiatives during the year targeting training and development of internal staff for TV production in the areas of design and construction of settings for production, make-up and costume design, with a view to ensure that the necessary skills sets are appropriately retained and developed within our business.

TREASURY MANAGEMENT

Under a set of guidelines laid down by the Executive Committee, the Company maintains a portfolio of fixed income securities which are held to maturity for overall enhancement of the interest yield from the Company's fund. Such fixed income securities are selected from bonds issued by listed companies or state-owned companies, with or without credit ratings, taking into account the business sector; the coupon rate and the yield-to-maturity; the currency; and the maturity dates. The Executive Committee reviews the portfolio at each meeting to ensure that the guidelines are adhered to, and the investment objectives are fulfilled.