FINANCIAL REVIEW

Continuing operations

For the year ended 31 December 2017, the Group's continuing operations comprised Hong Kong TV broadcasting, Hong Kong digital new media, Big Big Channel business, programme licensing and distribution, overseas pay TV operations, channel operations and other activities, including publications and movie production.

Business expansion and new businesses gave rise to inevitable increases in costs during the year. These included (i) myTV SUPER service (introduced in April 2016 and fully operational during the year); (ii) co-production of drama serials with iQiyi and Tencent; and (iii) Big Big Channel (introduced in July 2017).

The Group recorded revenue under continuing operations of HK$4,336 million (2016: HK$4,210 million), an increase of 3%. Cost of sales increased from HK$2,299 million to HK$2,319 million, an increase of 1%. As a result, gross profit amounted to HK$2,017 million (2016: HK$1,911 million), an increase of 6%. Gross profit percentage stood at 47% (2016: 45%).

During the year, revenue from Hong Kong TV broadcasting increased by 6%, which was mainly contributed by new production income from co-produced drama of HK$185 million. Licensing revenue from Singapore remained steady but revenue from Malaysia and Mainland China dropped due to unfavourable market conditions. More revenue was earned by Hong Kong digital new media business reflecting a full year's operation of myTV SUPER.

Cost of sales increased from HK$2,299 million to HK$2,319 million, an increase of 1%. Included in cost of sales were the cost of programmes and film rights which amounted to HK$1,748 million (2016: HK$1,759 million). Production costs associated with the three co-produced drama serials and full year of operation of myTV SUPER services, in particular expenditure relating to the strengthening of its programme offerings, resulted in increase in costs during the year. Such additional costs was offset by the absence of costs relating Rio 2016 Olympic Games, which was non-recurring.

Selling, distribution and transmission costs for the year amounted to HK$724 million (2016: HK$639 million), an increase of 13%. This increase was mainly attributed to business expansion of myTV SUPER service and the launch of Big Big Channel platform from July 2017.

General and administrative expenses for the year amounted to HK$900 million (2016: HK$949 million), a decrease of 5%. Despite increases of costs relating to business operations in 2017, a lesser provision for impairment losses on trade receivables was required when compared with 2016.

The Group had a net exchange gain of HK$19 million during the year (2016: net exchange losses of HK$26 million). Such exchange gains were related to the re-translation of various foreign currencies such as Malaysian Ringgit and Renminbi into Hong Kong Dollars and were recorded as other gains. Last year, other losses comprised a HK$70 million settlement loss on acquisition of a further 9.99% interest in a company and a write-off of a movie investment of HK$30 million.

Gain on disposal of investment properties arose from the sale of a property on Bade Road, Taipei, during the year. Last year, the Group realised a disposal gain of HK$280 million for disposal of the property in Neihu, Taipei.

On 23 January 2018, the Company announced that it will not proceed with a share buy-back offer announced on 24 January 2017. As a result, professional fees in relation to the offer of HK$29 million were written off during the year.

Finance costs for the year amounted to HK$152 million (2016: HK$34 million) which were mainly attributed to the full year impact of interest costs of TVB Notes.

During the year, the Group shared losses of joint ventures of HK$32 million in total. This mainly comprised the share of the loss of Imagine Tiger Television LLC ("ITT"), which was formed as a joint venture in July 2017. Such loss was mainly attributed to the start-up costs and the interest expense amounting to HK$27 million on a promissory note payable to the Group which was recorded under other revenues.

FINANCIAL REVIEW

Profit before income tax for the year amounted to HK$358 million (2016: HK$553 million), a decrease of 35% over 2016.

The Group's income tax expense amounted to HK$94 million (2016: HK$105 million), a decrease of 10%. Whilst the profits tax rate for Hong Kong remains at 16.5%, the Group's major subsidiaries operate in overseas countries whose effective rates vary from 0% to 40%.

Discontinued operations

Last year, the Group disposed of its remaining 47% equity interest in a joint venture, Liann Yee Production Co., Ltd and its subsidiaries ("Liann Yee Group"), and generated a net gain on disposal of HK$71 million. Such a gain did not recur in the year.

Earnings per share

Overall, the Group's profit attributable to equity holders for continuing and discontinued operations for the year totalled HK$244 million (2016: HK$500 million), a decrease of 51%, giving a basic and diluted earnings per share from continuing and discontinued operations of HK$0.56 (2016: HK$1.14).

SEGMENT RESULTS

Revenue under Hong Kong TV broadcasting which mainly comprised income from advertisers from the Group's free TV channels and the production income from co-produced drama serials increased from HK$2,707 million to HK$2,870 million, an increase of 6%. The above increase in revenue of HK$163 million and the absence of non-recurring costs relating to Rio 2016 Olympic Games were the key reasons for the change from the segment loss before non-recurring items of HK$71 million to a segment gain of HK$165 million.

Revenue from Hong Kong digital new media which comprised subscription and advertising income increased from HK$230 million to HK$306 million, an increase of 33% due to the full year of operation of myTV SUPER. Increase in content costs due to the better programme offering, resulted in a segment loss of HK$85 million (2016: a loss of HK$29 million).

Revenue from Big Big Channel business which comprised advertising income from online social media platform, Big Big Channel, and music entertainment income. The online social media business is undertaken by Big Big Channel Limited, which became a subsidiary in November 2016 and was previously engaged in Hong Kong pay TV business prior to the surrender of the pay TV licence in June 2017. As a result of the start-up overhead costs incurred for the launch of Big Big Channel in the second half of the year, this segment recorded a loss of HK$11 million (2016: a gain of HK$0.6 million).

Revenue from programme licensing and distribution which comprised licensing income from distribution of our programmes through telecast, video and new media licensing, decreased from HK$1,019 million to HK$982 million, a decrease of 4%. The decrease in revenue was mainly attributable to the lower telecast licensing income in Mainland China and lower license fee from MEASAT in Malaysia. The licensing income from Singapore remained relatively steady. Lower programme costs and bad debt provision were incurred. In addition, a net gain in exchange arising from stronger Renminbi and Malaysian Ringgits was also booked during the year. As a result, this segment recorded a profit of HK$493 million (2016: HK$444 million), an increase of 11%.

Revenue from overseas pay TV operations which comprised revenue from our pay TV platforms in North America (USA), Australia and TVB Anywhere business, decreased from HK$169 million to HK$151 million, a decrease of 10%. The increase in loss was mainly due to the adverse impact on subscription revenue caused by the proliferation of pirated TV contents overseas and higher costs incurred for the TVB Anywhere platform upgrade during the year which were partially offset by lower programme costs. As a result, this segment recorded a loss of HK$53 million (2016: a loss of HK$40 million).

Revenue from channel operations which comprised revenue from TVB8 and Xing He, the Group's satellite TV channel operations, decreased from HK$90 million to HK$85 million, a decrease of 6%, which was due to lower advertising income in Malaysia. More cost savings resulting from the completion of satellite migration for TVB8 and Xing He channels and a higher exchange gain arising from stronger Malaysian Ringgits were recorded during the year. The segmental profit increased from HK$2 million to HK$11 million, an increase of 383%.

Revenue from other activities which mainly comprised revenue from magazine publishing and movie production recorded a decrease from HK$156 million to HK$93 million, a decrease of 40%. Decrease in revenue was mainly due to box office income from a movie was taken up last year. This segment recorded a profit before non-recurring income of HK$33 million (2016: HK$27 million).

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

The Group continued to maintain a strong financial position as at 31 December 2017. Total equity stood at HK$7,157 million (2016: HK$7,230 million), a decrease of 1%. 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 invested in a joint venture of ITT by capital contribution for 50% of its equity interest of US$33 million and provision of a Promissory Note of US$67 million. The purpose of ITT is to finance the development and production of a slate of television projects.

At 31 December 2017, the Group had restricted cash of HK$4,307 million (31 December 2016: HK$6 million). Increase was mainly due to setting aside cash for the share buy-back offer of HK$4,209 million. Subsequently, the amount of HK$4,209 million has been released from restricted cash after the Board announcement dated 23 January 2018 on the decision not to proceed with the share buy-back offer. At 31 December 2017, the Group had unrestricted bank and cash balances of HK$893 million (2016: HK$6,198 million). The decrease of 86% was mainly due to the restricted cash for the share buy-back offer and US$100 million investment in ITT. Out of total bank deposits and cash balances held by the Group, 56% in US dollars, 34% were in Hong Kong dollars, 7% in Renminbi and 3% in New Taiwan dollars. About 14% of the total bank deposits and cash balances (approximately HK$709 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.

The certificates of deposit amounting to HK$775 million held at 31 December 2016 (as held-to-maturity financial assets under current assets) had matured on 23 January 2017. As at 31 December 2017, the Group had held-to-maturity bond securities amounting to HK$775 million (2016: HK$524 million) which comprises a portfolio of fixed income securities issued by a number of issuers which are listed or unlisted in Hong Kong or overseas carrying a weighted average yield-to-maturity of 6.03% per annum (2016: 4.79%) and with 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.

Trade receivables from third parties amounted to HK$1,588 million (2016: HK$1,279 million) increased by 24% over the last year end. Balances from one major licensee, MEASAT Broadcast Network Systems Sdn Bhd, which ceased to be a related party during the year was re-classified as trade receivables from third parties as at the end of the year. Receivables from co-production of drama and advertising and subscription receivables resulted from the growth of myTV SUPER business also contributed to the increase. Special provision had been made to cover any potential bad and doubtful debts.

Subsequent to the year end, the Group executed a sales and purchase agreement to sell certain remaining property assets in Taiwan, with a carrying value amounting to HK$43 million, which was presented as "Non-current asset held for sale" in the consolidated statement of financial position at the end of the year.

Trade and other payables and accruals decreased from HK$921 million to HK$872 million mainly due to the settlement of the provision for taxes in relation to the disposals of equity interest in the Liann Yee Group and the Neihu property, which was offset by advanced payments from co-producers of drama.

FINANCIAL REVIEW

In 2016, the Group issued TVB Notes which are guaranteed by the Company and listed on The Stock Exchange of Hong Kong Limited. The TVB Notes proceeds has been 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 2017, the gearing ratio, expressed as a ratio of gross debts to total equity, was 53.3% (2016: 53.1%).

At 31 December 2017, the Group's net current assets amounted to HK$7,265 million (2016: HK$8,533 million), a decrease of 15%. The current ratio, expressed as the ratio of current assets to current liabilities, was 9.2 at 31 December 2017 (2016: 10.1).

At the year end, the Group had capital commitments totalling HK$227 million (2016: HK$300 million), a decrease of 24%.

FINANCIAL GUARANTEES

At 31 December 2017, there were guarantees given to banks amounting to HK$8 million (2016: HK$8 million) for banking facilities granted to an investee company.

EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES AND RELATED HEDGES

The Group's foreign currency 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 and also on the repatriation of earnings and loans, and the TVB 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.

SHARE OPTION SCHEME

The Company and a non wholly-owned subsidiary, Big Big Channel Holdings Limited ("Big Big Channel Holdings") adopted the Share Option Scheme and the Subsidiary Share Option Scheme respectively on 29 June 2017. These share option schemes will be valid and effective for a period of ten years from the date of adoption. No share options were granted by the Company and Big Big Channel Holdings under the Share Option Scheme and the Subsidiary Share Option Scheme during the year.

Details of the share option schemes were set out in the Company's circular dated 29 May 2017.

HUMAN RESOURCES

At the year end, the Group employed a total of 4,436 full-time employees (2016: 4,249), including contract artistes and staff in overseas subsidiaries. This figure excluded directors and freelance workers.

For employees in Hong Kong, different pay schemes apply to contract artistes, sales, and non-sales personnel. Contract artistes are paid either per show or per package of shows. 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 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. Under the share option schemes of the Group, options may be granted to certain directors and employees of the Group to subscribe for shares in the Company or Big Big Channel Holdings.

From time to time, the Group organizes, either in-house or with other vocational institutions, seminars, courses, and workshops on subjects of technical interests, 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 of the Company's fund. Such fixed income securities are selected from bonds issued by listed companies or stated-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.