FINANCIAL REVIEW

Since 2015, the Group has been undergoing transformation from a conventional TV station to one incorporating multiple digital platforms, and enhancing production quality of drama programmes. To achieve these objectives, the Group had increased headcount under new businesses, including myTV SUPER, Big Big Channel, Big Big Shop and the revamped TVB Finance & Information Channel (Channel 85) which created some pressure on operating costs. To re-align with business direction, we examined the operations of certain areas of operation during the year, which included broadcasting; international licensing; and publications, and as a result, rationalised headcount and operating costs.

For the year ended 31 December 2018, revenue of the Group increased from HK$4,336 million to HK$4,477 million, an increase of 3%. Cost of sales increased from HK$2,320 million to HK$2,336 million, an increase of 1%. As a result, gross profit amounted to HK$2,141 million (2017: HK$2,016 million), an increase of 6%, and the gross profit percentage was 48% (2017: 47%).

Cost of sales increased from HK$2,320 million to HK$2,336 million, an increase of 1%. Included in cost of sales were the cost of programmes and film rights which amounted to HK$1,810 million (2017: HK$1,748 million). Higher costs of self-produced dramas (partly to support the production costs of the three co-production drama titles), increased content costs for myTV SUPER and a full year of operation of the Big Big Channel business resulted in increase in costs during the year. Such additional costs was partially offset by costs reduction after operations streamlining.

Selling, distribution and transmission costs for the year amounted to HK$758 million (2017: HK$724 million), an increase of 5%. This increase was mainly attributed to business expansion of myTV SUPER service and Big Big Channel platform, the launch of e-commerce business, Big Big Shop, and movements in some cost provisions.

General and administrative expenses for the year amounted to HK$967 million (2017: HK$903 million), an increase of 7%, which was mainly attributable to the business development of the new digital platforms.

An impairment loss provision for trade receivables of HK$26 million was made during the year according to the Group's past history, existing market conditions as well as forward looking estimates at year end.

During the year, impairment charges and fair value loss in a total amount of HK$526 million was recognised against bonds issued by SMI Holdings Group Limited ("SMI" or "SMI Group") and China Energy Reserve and Chemicals Group ("CERC") in the aggregate nominal amounts of HK$924 million.

Gain on disposal of investment properties in 2018 was relating to the sale of two floors of an investment property in Taipei which were considered as non-core assets. After this disposal in 2018, the Group is retaining the remaining two floors in the same block for operation of Big Big Channel in Taiwan and for property investment.

Interest income is generated from financial assets of the Group which comprised (i) an investment portfolio for treasury management purposes[14] totalling HK$3,113 million (2017: HK$775 million), and (ii) a promissory note to a joint venture company, Imagine Tiger Television LLC ("ITT"), in the amount of US$66.7 million (2017: US$66.7 million) at the interest rate of 12% per annum ("Promissory Note"). During the year, the Group recorded an increase in interest income from HK$118 million to HK$255 million, an increase of 116%, which was driven by the increase in the size of the investment portfolio since the beginning of 2018 and the full year interest effect of the Promissory Note. The interest income from the investment portfolio was HK$140 million (2017: HK$40 million) and the interest from the Promissory Note was HK$66 million (2017: HK$27 million).

[14] classified as financial assets at amortised cost and financial assets at fair value through profit or loss in the Consolidated Statement of Financial Position at 31 December 2018

The Group suffered net exchange losses of HK$25 million during the year (2017: net exchange gain of HK$19 million). These exchange losses 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 losses in the Consolidated Income Statement. In addition, the Group incurred losses on movie and drama investments totalling HK$28 million during the year.

On 23 January 2018, the Company announced that it will not proceed with the share buy-back offer which was previously announced on 24 January 2017. As a result of this decision to abort the transaction, professional fees in relation to the offer totalling HK$29 million were written off in the Consolidated Income Statement in 2017.

Finance costs for the year amounted to HK$128 million (2017: HK$152 million) which were mainly attributed to the net interest costs of the US$500 million 3.625% notes due 2021 ("TVB Notes"). The presentation of finance costs on a net basis was made to mirror the netting off of the amount of TVB Notes issued less the amount held by the Company as a single item on the Consolidated Statement of Financial Position.

The Group absorbed losses of the joint venture, ITT, of HK$115 million during the year (2017: HK$32 million, since the commencement of operation in July 2017). During the initial years of development, ITT was at the preparatory stage for production of its TV slate for US networks, and as a result, reported losses of HK$115 million for the year. These losses of ITT included interest expenses of HK$66 million on the Promissory Note (US$66.7 million at 12% per annum) paid to the Group during the year. This interest income earned by the Group was booked under interest income in the Consolidated Income Statement for the year.

Loss before income tax for the year amounted to HK$124 million (2017: profit before income tax of HK$358 million), which was mainly due to the impairment charge and fair value loss of SMI bonds of HK$500 million during the year.

The Group's taxation charge amounted to HK$53 million (2017: HK$94 million), a decrease of 44%, which arose from an over-provision of income tax expense from Hong Kong TV broadcasting relating to prior year after confirming the tax deductibility of certain finance costs. 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 30%.

Adjusted EBITDA[15] (excluding non-recurring items) decreased from HK$821 million in 2017 to HK$809 million in 2018, a decline of 2%.

[15] Adjusted EBITDA means profit/loss for the year before finance costs, income tax expense, depreciation and amortisation, share of results of joint ventures/associates, interest income, impairment loss/reversal of impairment loss on bond securities at amortised cost and trade receivables, fair value adjustments on financial assets at fair value through profit or loss, gain on disposal of investment properties and professional fees incurred for the aborted share buy-back offer. Adjusted EBITDA is not presented as a measure of operating performance in accordance with the Hong Kong Financial Reporting Standards. The computation of the Adjusted EBITDA may not be comparable to similarly titled measures of other companies.

FINANCIAL REVIEW

(LOSS)/EARNINGS PER SHARE

Overall, the Group's loss attributable to equity holders for the year totalled HK$199 million (2017: profit of HK$243 million), giving a basic and diluted loss per share of HK$0.45 (2017: earnings per share of HK$0.56).

SEGMENT RESULTS

Segment	Hong Kong TV broadcasting	myTV SUPER	Big Big Channel business	Programme licensing and distribution	Overseas pay TV and TVB Anywhere	Other activities
Nature of revenue	Advertising revenue and production income from co-production drama serials	Subscription and advertising revenue	Advertising revenue; sales commission; fees for event management; music royalties and licensing income	Licensing income from telecast, video and new media distribution	Subscription and advertising revenue	Revenue from magazine publication and movie investments

Segment revenue from Hong Kong TV broadcasting's external customers increased from HK$2,818 million to HK$2,923 million, an increase of 4%, which was fuelled by the increase in production income relating to the three co-production drama serials from HK$185 million to HK$299 million. However, advertising income from terrestrial TV channels in Hong Kong alone reported a slight decrease from HK$2,459 million to HK$2,440 million, a decrease of 1%. Overall, this segment reported a gain before non-recurring impairment charge/fair value loss of HK$173 million (2017: HK$165 million).

Segment revenue from myTV SUPER's external customers increased from HK$280 million to HK$402 million, an increase of 43%, due to the increase in advertising revenue through the growth in consumption of content on this platform. This segment reported a gain of HK$16 million which turnaround from a loss of HK$85 million last year.

Segment revenue from Big Big Channel business's external customers increased from HK$44 million to HK$87 million, an increase of 98%. More advertising income was generated from the online social media platform, Big Big Channel during the year. However, owing to upfront costs required for the development of Big Big Channel and the launch of Big Big Shop, this segment recorded a net loss of HK$19 million (2017: a net loss of HK$11 million).

Segment revenue from programme licensing and distribution's external customers decreased from HK$955 million to HK$870 million, a decrease of 9%. The decrease in revenue was mainly attributable to the lower license fee from Singapore and Vietnam in the amount of HK$147 million, as a result of changes in the terms of the new supply contracts, which partially offset the growth of new media licensing revenue from Mainland China of HK$107 million. The licensing income from Malaysia remained relatively steady during the year. As a result, the segment profit decreased from HK$504 million to HK$414 million, a decrease of 18%.

Segment revenue from overseas pay TV and TVB Anywhere's external customers decreased from HK$151 million to HK$140 million, a decrease of 7%. As the transition from the old pay TV model to OTT is in progress and impact of piracy is still on-going, revenue for this segment was under pressure. In adopting this OTT model, the business structure was changed such that the main operation of the overseas OTT service is now performed in Hong Kong as opposed to overseas under the pay TV model. The cost base has been lowered. As a result, the segment loss narrowed from HK$53 million to HK$16 million during the year, a decrease of 71%.

External revenue from other activities recorded a decrease from HK$88 million to HK$54 million, a decrease of 38%, due to the cessation of circulation of TVB Weekly in October 2018. As a result, this segment recorded a loss before non-recurring income of HK$17 million (2017: profit of HK$6 million).

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

The Group continued to maintain a strong financial position as at 31 December 2018. Total equity stood at HK$6,307 million (2017: HK$7,157 million). There has been no change in the share capital of the Company, i.e. 438,000,000 ordinary shares were in issue at the year end.

CASH AND TREASURY MANAGEMENT

At 31 December 2018, the Group had restricted cash of HK$1 million (2017: HK$4,307 million). Following the decision to abort the share buy-back offer in January 2018, the cash previously earmarked for the transaction was released.

At 31 December 2018, the Group had unrestricted bank and cash balances of HK$1,269 million (2017: HK$893 million). Out of total bank deposits and cash balances held by the Group, 39% were in US dollars, 17% in Hong Kong dollars, 24% in Renminbi and 16% in New Taiwan dollars. About 58% of the unrestricted bank and cash balances (approximately HK$730 million) were maintained in overseas subsidiaries for their daily operations. Cash not immediately required for operations was placed as time deposits.

Under an approved Investment Guidelines, the Company maintains a portfolio of fixed income securities which are held-to-maturity for yield enhancement. Such fixed income securities are selected from bonds issued by listed companies or PRC state-owned companies, taking into account business sector; coupon rate and yield-to-maturity; currency; and maturity dates. This investment portfolio is monitored by the Investment Committee of the Board on a continuous basis which can make recommendation for changes, if and considered necessary, to the Executive Committee. The Investment Committee would ensure that the investment objectives as laid down are fulfilled.

As at 31 December 2018, the Company's portfolio of fixed income securities which were held to maturity amounting to HK$2,463 million (2017: HK$775 million). These fixed income securities (classified under "Financial assets at amortised cost") were issued by issuers which are listed or unlisted in Hong Kong or overseas, and in aggregate, carry a weighted average yield-to-maturity of 5.67% per annum (2017: 6.03%) and have maturity dates ranging from 28 July 2019 to 1 October 2027. The investment portfolio is made up by a total of 45 (2017: 18) issuers of fixed income securities. The largest investment in fixed income securities within the portfolio represented approximately 2.7% (2017: 1.7%) of the total assets of the Group as at 31 December 2018. The interest received during the year from the financial assets at amortised cost amounted to HK$109 million (2017: HK$40 million).

As set out in Note 13 to the consolidated financial statements, CERC had defaulted the payment of the principal of a bond ("2018 CERC Bond") due in May 2018 and as a result, this triggered a cross default for another bond held by the Group ("2019 CERC Bond") due in January 2019. The aggregated nominal amount of the 2018 CERC Bond and the 2019 CERC Bond amounted to US$12 million. CERC is a state-owned oil and gas trading, logistics and distribution and supply services provider in China. During the year, the coupon payment was received from CERC accruing up to 20 December 2018. Based on the review report of the financial condition prepared by FTI Consulting (Hong Kong) Limited, the financial advisor appointed by CERC, management believes that CERC has both the intention and ability to settle the outstanding balances. However, as the repayment schedule of CERC Bond would be extended in accordance with the debt restructuring plan of CERC, an impairment loss of HK$26 million was made to reflect the delayed repayment of 2018 and 2019 Bonds' principals.

SMI BONDS

The Group had entered into subscription agreements for US$23 million 9.5% unsecured redeemable fixed coupon bonds due 2020 (extendable to 2021) ("Fixed Coupon Bonds") and US$83 million 7.5% secured redeemable convertible coupon bonds due 2020 (extendable to 2021) ("Convertible Bonds" and together with the Fixed Coupon Bonds, the "SMI Bonds"), both issued by SMI, a company listed in Hong Kong. The Fixed Coupon Bonds and the Convertible Bonds were classified under "Financial assets at amortised cost" and "Financial assets at fair value through profit or loss" respectively as at 31 December 2018.

The Convertible Bonds are collateralised on a share charge over the entire issued share capital of SMI International which holds 41.34% of the registered capital of Chengdu Runyun Culture Broadcasting Limited, a sino-foreign equity joint venture established in the PRC with limited liability ("Chengdu Runyun"). Chengdu Runyun is principally engaged in the operation and the management of movie theatre business of SMI in the PRC.

Trading in the shares of SMI has been suspended on The Stock Exchange of Hong Kong Limited ("Stock Exchange") since 3 September 2018 upon the request of SMI. As result of this trading suspension, the SMI Bonds have defaulted. Pursuant to SMI's announcement dated 12 March 2019, it has commenced a debt restructuring process, including prospective conversion of outstanding debts into equity, and raising of capital by prospective subscription of new shares of SMI.

In view of the default of the SMI bonds, the Company performed an impairment assessment of the Fixed Coupon Bonds using a lifetime expected credit loss model, which estimated the eventual shortfall of cash recoverable from the Fixed Coupon Bonds. Based on an impairment assessment over the recoverability of the amount of the Fixed Coupon Bonds, the Group recognised a full impairment charge of HK$180 million against the Fixed Coupon Bonds for the year ended 31 December 2018. The impairment assessment used key inputs based on financial information extracted from the 2017 audited financial statements and 2018 interim financial information of SMI Group and other forward looking factors in view of SMI's published announcements.

In addition, the Company performed a fair value assessment of the Convertible Bonds in respect of the debt and equity conversion features, together with the collateral pledged against the Convertible Bonds. As a result of the assessment performed on the Fixed Coupon Bonds as described in Note 13(b) and the suspension of the trading of SMI's shares, the Company considered that the debt and equity conversion features of the Convertible Bonds would have a minimal value. Therefore, the Company has determined to perform a fair value assessment on the collateral. The Company has engaged an independent external valuer to perform a valuation of the Chengdu Runyun group using the discounted cash flow model under the income approach, which is further described in Note 14. The fair value assessment has adopted certain key operating assumptions provided by SMI, including number of cinemas, cinema attendance rates, ticket price, market discount rate and terminal growth rates. Based on the fair value assessment, the Group recognised a fair value loss of HK$320 million against the Convertible Bonds for the year ended 31 December 2018.

In aggregate, a total impairment charge/fair value loss has been made in the amount of HK$500 million in relation to the SMI Bonds.

The Company considered that the information used in the above assessment represented the best available estimates despite the lack of latest financial and other information of the SMI Group and Chengdu Runyun group. The Company expects the SMI Bonds are to be realised more than 12 months after 31 December 2018.

TVB FINANCE LIMITED

As at 31 December 2018, the Company held US$112 million in nominal value of US$500 million 3.625% Notes due 2021 issued by TVB Finance Limited. This holding in TVB Notes was presented and netted off against the liabilities of TVB Notes under "Non-current borrowings" on the Consolidated Statement of Financial Position.

OTHER ITEMS IN THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Trade receivables from third parties amounted to HK$1,895 million (2017: HK$1,588 million), an increase of 19% over the last year end. Receivables from new media licensing revenue from Mainland China and subscription revenue from myTV SUPER business contributed to the increase. Impairment loss provisions are calculated based on the Group's past history, existing market conditions and forward looking estimates at 31 December 2018.

Other receivables, prepayments and deposits amounted to HK$572 million (2017: HK$483 million). The increase was mainly due to increase in advance payments made for drama production and accrued interests from the investment portfolio.

Trade and other payables and accruals decreased from HK$872 million to HK$740 million, which was mainly due to decrease in advance payments from co-producers of drama.

At 31 December 2018, the Group's net current assets amounted to HK$3,855 million (2017: HK$7,265 million), a decrease of 47%. The decrease in net current assets was due to the decrease in cash as a result of the purchase of securities for the investment portfolio, mainly classified under non-current assets. The current ratio, expressed as the ratio of current assets to current liabilities, was 5.9 at 31 December 2018 (2017: 9.2).

Borrowings at 31 December 2018 totalled HK$3,044 million (2017: HK$3,814 million) which were made up mainly by the TVB Notes and a small bank overdraft. During the year, the Company purchased US$104 million nominal amount of the TVB Notes at a price of US$103 million through open market to form part of its investment portfolio. At 31 December 2018, the gearing ratio, expressed as a ratio of net debt to total equity, was 29.1% (2017: 41.7%).

TVB Notes, issued by TVB Finance Limited, are guaranteed by the Company and are listed in Hong Kong. The proceeds from TVB Notes had been deployed to fund the development of the digital new media business and other capital expenditures, and to invest in ITT and for general corporate purposes.

At 31 December 2018, the Group had capital commitments totalling HK$171 million (2017: HK$227 million), a decrease of 25%.

FINANCIAL GUARANTEES

At 31 December 2018, there were guarantees given to banks amounting to HK$7 million (2017: 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 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 SCHEMES

The Company and a wholly-owned subsidiary, Big Big Channel Holdings Limited ("Big Big Channel Holdings"), adopted the Share Option Scheme and the Subsidiary Share Option Scheme on 29 June 2017 respectively. These share option schemes will be valid and effective for a period of ten years from the date of adoption. 17,000,000 share options were granted by the Company under the Share Option Scheme during the year. No share options had been granted by Big Big Channel Holdings under the Subsidiary Share Option Scheme during the year.

HUMAN RESOURCES

At the year end, the Group employed a total of 4,041 full-time employees (2017: 4,436), 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, while non-sales personnel receive monthly salaries. Discretionary bonuses may be awarded as an incentive for better performance. About 2% of the Group's manpower was employed in overseas subsidiaries and paid on scales and systems relevant to the respective localities and legislations.

Under the Share Option Schemes of the Group, options may be granted to directors and employees of the Group to subscribe for shares in the Company and in Big Big Channel Holdings.

From time to time, the Group organises, 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.

SHARE BUY-BACK

On 23 January 2018, the Securities and Futures Commission granted its consent for the Company not to proceed with the share buy-back offer, as the timeline for the conclusion of the Communications Authority ("CA")'s assessment relating to the Company's previous shareholding change applications in 2015 and 2016 (the "Assessment") could not be ascertained. Since then, the Company has responded to questions from the CA and provided information requested by the CA.

The Company will continue to assist the CA with its Assessment with the view to bringing the matter to a conclusion.