Financial review

OVERALL PERFORMANCE

The Group recorded a profit attributable to shareholders of HK$555 million (2001: HK$563 million), a decline of only 1% despite the difficult conditions and the oversupply of transponder capacity that prevailed in certain segments of the market. These results were achieved after a provision of HK$12 million for bad and doubtful debts.

TURNOVER

Turnover for the year fell by 2% to HK$951 million (2001: HK$969 million). This was in line with expectations considering the soft market and a corresponding increase in pricing pressure.

COST OF SERVICES

Cost of services was HK$243 million (2001: HK$240 million), a slight increase of HK$3 million, or 1%.

ADMINISTRATIVE EXPENSES

Administrative expenses increased to HK$81 million (2001: HK$71 million), due to a provision of HK$12 million (2001: Nil) for bad and doubtful debts.

OTHER OPERATING INCOME

There was little other operating income in 2002. The amount of HK$9 million reported in 2001 was of a non-recurring nature arising from recognition of a system platform and services provided to an associate as the Group's contribution to its share capital.

BANK INTEREST INCOME

Interest of HK$6 million (2001: HK$7 million) was generated on short-term deposits that were earmarked to meet the payments of capital expenditure programmes.

SHARE OF RESULTS OF ASSOCIATES

The share of loss from an associate fell by 78% to HK$9 million (2001: HK$41 million), as a result of a smaller amount of amortisation in intangible assets and higher turnover in the associate. However, if the rental on the transponder capacity leased to the associate were to be taken into account, the net effect to the Group would be a profit of HK$6 million (2001: a loss of HK$25 million).

TAXATION

The effective tax rate was maintained at approximately at 11% (Standard rate in Hong Kong: 16%).

Financial review (continued)

FINANCIAL RESULTS ANALYSIS

The financial results are highlighted below:

		2002	2001	% Change
Turnover	HK$M	**951**	969	-2
Profit attributable to shareholders	HK$M	**555**	563	-1
Dividend (excluding special dividend)	HK$M	**98**	78	+25
Capital and reserves	HK$M	**3,347**	2,870	+17
Earnings per share	HK cents	**142**	144	-1
Dividend per share (excluding special dividend)	HK cents	**25**	20	+25
Dividend cover (excluding special dividend)	Times	**6**	7	-14
Special dividend per share	HK cents	**25**	—	n/a
Return on shareholders' funds	%	**17**	20	-15
Net assets per share - book value	HK cents	**858**	735	+17

Liquidity and financial resources

SOURCES OF FINANCING

The Group's principal use of capital during the year under review was the capital expenditure related to the construction of AsiaSat 4 and further investment in an associate. In addition, the Group also made progress payments of HK$51 million for the construction of telemetry, tracking and control ("TT&C") facilities at the Company's new Earth Station at Tai Po. These payments were financed through cash flow from operating activities.

On 24th November, 2000, the Company and its subsidiary, AsiaSat, entered into an agreement with a consortium of banks to provide a secured term loan credit facility of US$250 million (the "Loan Facility") with AsiaSat as the borrower and the Company as the guarantor. The loan is divided into two tranches, Tranche A for US$100 million, and Tranche B for US$150 million. The loan, together with cash flow from operating activities, is required to meet the capital expenditure of AsiaSat 4 and other projects. No drawdown of this facility was made during the year. As at 31st December, 2002, there were no outstanding bank loans.

Liquidity and financial resources (continued)

INTEREST AND REPAYMENTS

The Loan Facility provides that (i) borrowings will bear interest at a rate based on LIBOR (London Interbank Offered Rate) plus a margin between 1.00% to 1.25% per annum depending on the EBITDA (Earnings before interest, tax, depreciation and amortisation) ratios achieved, (ii) the Loan Facility will have a term of five years and will be repaid in five equal biannual instalments, starting from November 2003, and (iii) subject to certain conditions, the Company may, without premium or penalty, prepay all or part of its borrowings under the Loan Facility. The Loan Facility provides that the Group must use a certain percentage of any Excess Cash Flow (as defined in the Loan Facility) for the purpose of debt servicing under the Loan Facility, paying costs in connection with the construction, launch and insurance of AsiaSat 4 or any replacement satellite, if any, and fulfilling certain capital requirements.

SECURITY

The Loan Facility is secured by AsiaSat's assets, including its existing and future satellites, payments received in respect of transponder utilisation agreements on these satellites and assignments of construction and TT&C contracts relating to AsiaSat's satellites. The Loan Facility is also guaranteed by the Company.

COVENANTS

The Loan Facility includes covenants customary for agreements of this type, including restrictions on the Group's ability to incur indebtedness, certain restrictions on the Company's ability to pay dividends, restrictions on affiliated transactions, certain financial covenants, covenants with respect to compliance with laws, maintenance of licences and permits required for the Group's business and a requirement that all future transponder utilisation agreements be entered into on an arm's-length basis.

RESTRICTED DISTRIBUTIONS

The Loan Facility provides that the Company may make aggregate annual dividend payments in an amount not exceeding 20% of EBITDA for the relevant financial year or, if lower, 25% of the net profit for the relevant financial year. Consent from the lenders is required to be sought for any distribution that exceeds the above limits.

Capital structure

FUNDING AND TREASURY POLICY

The Group adopts conservative treasury policies and exercises tight control over its cash and risk management. Cash is generally placed in short-term deposits denominated in U.S. Dollars to meet its capital expenditure. The banking facilities of the Group are largely denominated in U.S. Dollars that can be met by its U.S. Dollar revenue. Thus, the Group does not have any significant currency exposure.

CURRENCIES IN BORROWINGS

Currently all the borrowings are denominated in U.S. Dollars.

INTEREST RATES

The interest rate on the Loan Facility is floating and based on LIBOR plus a margin between 1.00% to 1.25% per annum depending on the EBITDA ratios achieved.

FINANCIAL INSTRUMENTS FOR HEDGING

Since almost all the revenue of the Group is in U.S. Dollars there is no need to hedge its liabilities, which are also substantially denominated in U.S. Dollars.

FOREIGN CURRENCY INVESTMENT

The Group does not have any material investment in foreign currencies other than in U.S. or Hong Kong Dollars.

Order book

As at 31st December, 2002, the value of contracts on hand amounted to HK$4,029 million (2001: HK$4,552 million), the majority of which will be realised over the next few years. Almost all the contracts are denominated in U.S. Dollars.

Significant investments, their performance and future prospects

In April 2002, the Group increased its interest in SpeedCast Holdings Limited ("SpeedCast") from 36.5% to 45.3% for US$4 million, of which US$2.5 million was in cash and US$1.5 million in transponder capacity, making a total equivalent to HK$31 million. Based on the net asset value of SpeedCast, the amount was split into HK$18 million as investment and HK$13 million as goodwill. The goodwill is to be amortised evenly over a period of 24 months.

SpeedCast provides three major services: high-speed Internet connectivity, multimedia content delivery, and corporate broadcast services. In September, SpeedCast expanded its product line by launching its two-way networking and Internet connectivity services.

Significant investments, their performance and future prospects (continued)

For the year 2002, SpeedCast increased its turnover to HK$12 million (2001: HK$4 million), an increase of 200%. However, the company still incurred a loss of HK$49 million (2001: HK$119 million), but this was a reduction of 59%.

At 31st December, 2002, the book value of the investment in SpeedCast, including goodwill, stood at HK$18 million. In a worst case scenario, this is the maximum exposure that the Group would have to bear.

The participation in SpeedCast is a strategic, long-term investment and, as originally contemplated, the Group does not expect a return from the joint venture in the near term. However, over the longer term, the prospects for SpeedCast remain promising.

Material acquisitions and disposals of subsidiaries and associated companies

During the year, there were neither material acquisitions nor disposals of subsidiaries and associated companies save for the additional capital contribution to SpeedCast amounting to US$4 million by way of cash and transponder capacity of US$2.5 million and US$1.5 million respectively. After this investment, SpeedCast has become a 45.3% associate of the Group.

Segment information

The turnover of the Group, analysed by location of customers, is disclosed in note 4 to the financial statements.

Employees and remuneration policies

As at 31st December, 2002, the Group had 83 permanent staff (2001: 80).

The Group considers its human resources as one of its most valuable assets. The talent pool that the Group draws from overlaps with the telecommunications, information technology and some high-tech equipment vendor industries.

The Group has established a performance based appraisal system. The present remuneration package consists of salaries, housing benefits (applicable to certain grades of employees), discretionary bonuses, share options (again applicable to certain grades of employees) and fringe benefits that are compatible with the market.

Pursuant to the Company's new share option scheme adopted on 25th January, 2002 (the "Share Option Scheme"), the Board of Directors of the Company may grant options to any employees (including officers and directors) of the Company or any of its subsidiaries to subscribe for shares in the Company. The subscription price shall be such a price as the Board of Directors of the Company may in its absolute discretion determine at the time of grant but the subscription price shall not be less than whichever is the higher of (i) the closing price of the shares as stated

Employees and remuneration policies (continued)

in The Hong Kong Stock Exchange Limited's (the "Stock Exchange") daily quotations sheet on the date of grant; (ii) the average closing price of the shares as stated in the Stock Exchange's daily quotation sheets for the five business days immediately preceding the date of the grant; or (iii) the nominal value of a share.

The Group does not operate an in-house regular training programme. However, the Group does provide ad hoc training on new developments/facilities and sponsors employees to attend external vocational training that is relevant to their jobs and their career progression.

Charges on group assets

AsiaSat entered into the Loan Facility to finance the construction of AsiaSat 4 and AsiaSat 5. The Loan Facility is secured by an assignment of all rights, title, benefits and interest in the insurance and transponder receipts of AsiaSat's satellites, and a fixed and floating charge over the assets of AsiaSat, including its existing and future satellites. In addition, the loan agreement contains certain financial covenants that, among other things, require AsiaSat to maintain a certain level of net assets, and restrict AsiaSat's amount of borrowings and liabilities.

Capital commitments

Details of the capital commitments of the Group are set out in note 25 to the financial statements.

As at 31st December, 2002, the Group had total capital commitments of HK$286 million (2001: HK$1,060 million), of which HK$219 million (2001: HK$216 million) was contracted for but not provided in the financial statements and the remaining HK$67 million (2001: HK$844 million) was authorised by the Board but not contracted for.

Gearing ratio

As at 31st December, 2002, the Company had no debt. Had the Loan Facility been fully drawn down as at the balance sheet date, the debt to equity ratio would have become 37:63.

Exchange rates and any related hedges

During the year, almost all of the Group's revenues, premiums for satellite insurance coverage and debt service, and substantially all capital expenditure were denominated in U.S. Dollars. The Group's remaining expenses were primarily denominated in Hong Kong Dollars. As at 31st December, 2002, almost all the Group's transponder utilisation agreements, transponder purchase agreements, borrowings, obligations to construct and launch satellites, and to purchase telemetry, tracking and control equipment were denominated in U.S. Dollars. Hence, the Group does not have any significant currency exposure and does not need to hedge.

Contingent liabilities

At 31st December, 2002, the Group had significant contingencies as follows:

(a) Pursuant to a change effective from 1st April, 2001 in Indian tax regulations, the Group may be subject to Indian income tax on revenues received by the Group in respect of income from provision of satellite transponder capacity to the Group's customers for purposes of those customers carrying on business in India or earning income from any source in India.

The Indian tax authorities had previously made assessments against the Group (including interest as of 21st March, 2001) totalling approximately HK$21 million (INR131 million) for the assessment year 1997-1998 and approximately HK$23 million (INR141 million) for the assessment year 1998-1999. No assessment has yet been made for the 1999-2000, 2000-2001, 2001-2002 or 2002-2003 assessment years.

The Indian tax authorities have initiated tax recovery measures against the Group. The Group had filed appeals for each of the assessment years 1997-1998 and 1998-1999. In order to expedite the legal proceeding in India and obtain a stay of the recovery measures, the Group made a tax payment totalling approximately HK$19 million (INR120 million) to the Government of India.

In relation to the appeal filed for assessment year 1997-1998, the Income-tax Appellate Tribunal (the "Tribunal") has held that the Group is subject to Indian income tax even prior to 1st April, 2001 in respect of income from the provision of satellite transponder capacity to the Group's customers for the purposes of those customers carrying on business in India or earning income from any source in India. The Tribunal has directed Indian tax authorities to make a fresh computation of taxable income. No revised assessment has been received by the Group to date. The Group does not believe that it is liable for Indian income tax as held by the Tribunal and is planning to file an appeal against the Tribunal's decision.

In addition, based on the general principles set forth by the Tribunal, the amount of income taxable in India depends on the payments made by the Group's customers to the Group for the purposes of those customers carrying on business in India or earning income from any source in India. As such information is proprietary in nature and has not been provided by the Group's customers, the Group cannot reasonably estimate the taxable income, if the decision by Tribunal becomes final. Accordingly, no provision has been recognised for Indian income tax in these financial statements.

(b) Pursuant to the telemetry, tracking, control and monitoring licence granted in Hong Kong by the Chief Executive in Council under the Telecommunication Ordinance (Chapter 106), the Group was granted a broadcasting satellite service ("BSS") licence (the "Licence") on 27th June, 2000 to maintain and operate a payload of four BSS channels onboard AsiaSat 4. AsiaSat, as the Licencee, has provided a performance bond of HK$5 million in favour of The Government of The Hong Kong Special Administrative Region as a condition of the grant of the Licence.

Critical accounting policies

REVENUE RECOGNITION

To confirm with the U.S. and Hong Kong GAAP requirements, revenue from transponder utilisation agreements is recognised on a straight-line basis over the period of the agreements. The excess of lease rental revenue recognised on a straight-line basis over lease rentals received and receivable from customers in accordance with the contract terms is shown as unbilled lease rental receivable.

Revenue from the sale of transponder capacity under transponder purchase agreements is recognised on a straight-line basis from the date of delivery of the transponder capacity until the end of the design life of the satellite.

Should any customers terminate their transponder utilisation agreements before the end of the term of the agreements, the Company will have to record a bad debt as a consequence of having had to recognise the income in advance of the contractual payment being due.