

# Focused Direction



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# MANAGEMENT DISCUSSION AND ANALYSIS

## Market Overview

After a year of rapid expansion, there emerged a certain level of consolidation in the global telecom business. At the same time, while facing new challenges, the China telecom industry is benefiting from the economic developments of the country and its gradual opening policies. It outperformed other industries and attracted the attention of the world. In 2000, the China telecom market continued to record rapid growth with telecom income reaching RMB307.4 billion, a 26.4% increase over 1999. As plenty of opportunities emerged in the market, fixed line users increased by 36.28 million to reach 145.122 million; mobile phone subscribers increased to 85.26 million and Internet users broke the 10 million mark, reaching 16.017 million.

With China's imminent entry into WTO, the telecom market will unveil a new era after its admission. Telecom enterprises are developing their business to cater for the new environment. In order to meet the entrance requirements, the Chinese government has to speed up the pace of opening up its telecom market which, on the other hand, has impelled domestic telecom enterprises to further enhance their competitiveness. As a result, the local demand for telecom infrastructure, products, technologies and services will continue to grow, providing an ideal environment for the Group to develop itself as "one of the first nationwide virtual network operators and value-added service provider in China".



A dedicated call center for market research, customer relations and telemarketing services

## Business Structure

### Telecommunications Networks

- Telecom network
- E-commerce solution
- Trunked radio and network engineering

### Distribution and Retail Chain

- "CM Concept" retail store chain
- *chinamotion.com*

### Unified Messaging

- Paging and messaging services
- Telecare service





## Business Review

To cope with the development trend of the telecom industry, the Group put forth a business restructuring plan in 1999 to expand its businesses into high growth and high value-added network communication and Internet businesses. The overall restructuring has been completed, along with the establishment of three core businesses that complement each other and enable the Group to improve its overall operation efficiency. Some of the new businesses are already making profit.

In the first half of Year 2000, the Group implemented a series of measures to prepare itself for new business opportunities. Internally, the Group carried out a thorough write-off on obsolescent equipment and the impairment of assets and goodwill incurred by the business restructuring. Externally, the Group has developed the domestic markets for its telecom products and services and continued to invest in telecom networks and short message based unified messaging services. This has set a good foundation for new sources of income. Although operating condition of the Group has improved in the second half of the year, however, the business was still affected by the weak consumption market of Hong Kong and the stagnant growth of customer. Thus, turnover for the year recorded a negative growth rate, a drop of 13.8%, to HK\$768,433,000. Loss attributable to shareholders for the year was HK\$212,203,000.



The trunk radio service center attends to every customer's need

recruiting new talent appropriate for future tasks.

Riding on its reputation in the China telecom market and its close tie with strategic partner CMTH, the Group participated in telecom activities permitted by China's telecom ordinance. The results so far have been satisfactory. Apart from having a strong business foundation, the Group is also actively

## Performance of Core Businesses

### Telecommunications Networks

Telecommunications Networks is one of the development focuses of the Group. During the period under review, it has achieved encouraging performance.

VoIP and IP transport services have shown remarkable results. Although IDD tariff in both Mainland China and Hong Kong were reduced one after another, it has led to a tremendous increase in usage volume. Turnover from IDD operations reached HK\$98,196,000 for the year, representing a five-fold growth from a low base in the previous year. During the year, the VoIP and IP transport services have undergone business consolidation and development. In addition to the Group's active measures to reduce operating costs, this business has already achieved economies of scale and thus, a satisfactory profit before interest and tax of HK\$20,350,000 was recorded, representing an increase of 45 times over the previous year. Presently, the Group's backbone network connecting Mainland China, Hong Kong and North America has already reached a massive scale, providing voice, data communication and broadband resale services to customers. The Group's international voice traffic has now reached 45 million minutes per month.



The transport industry of Mainland China and Hong Kong is inconvenienced by our cross-border trunking service

# MANAGEMENT DISCUSSION AND ANALYSIS

During the period under review, the Group has entered strategic alliances in VoIP and IP related businesses with both domestic and foreign network operators. They include:

- Edge2Net: both parties agree to utilize each other's equipment. Edge2Net also brings expertise in IP deployment, engineering knowledge, and capital investment to the partnership.
- China Netcom: cooperation in network interconnection and in operating the International Private Leased Circuit ("IPLC") and the development of telecom services upon IPLC in China and North America.
- AboveNet: provision of reliable, high-capacity Internet connectivity by AboveNet to the Group.



The data storage center in Shenzhen



Our repair center provides comprehensive after-sale services

These cooperative agreements have enabled the Group to pursue for the development of multi-facet telecom services in China and international markets. They have further expanded the Group's private IP network coverage and international VoIP market share. As at 31 March 2001, the Group, together with CMTH, has signed 45 corporate accounts for its virtual private network and over 100,000 roaming ISP users.

Turnover of mobile-related services operation recorded a steady growth of 4.7% to HK\$184,261,000 for the year. Profit before interest and tax reached HK\$139,657,000.

In the wireless networking services, the sluggishness of the current trunking and leasing markets attributed to a sales of HK\$49,984,000, a decrease of 16.5% over the previous year. Loss before interest and tax amounted to HK\$120,132,000. During the period under review, the trunking business has obtained a series of engineering contracts from companies of both Mainland China and Hong Kong. The Group is currently upgrading its existing equipment to the next digital generation. While consolidating the existing customer base, the Group will introduce value-added services, such as data transmission service, to customers. The Group is confident that the potential of wireless trunked radio and related business in the China market remains promising.

## Distribution and Retail Chain

Results of the "CM Concept" telecom products and services retail chain were against expectation. This was mainly due to various external factors including the saturated penetration rate of Hong Kong mobile phone users and fierce competitions among suppliers of both mobile phone and service plan, altogether contributing to a continuous drop in market demand, price and profit margin. The turnover for the retail chain business, as a result, has experienced a vast decline. Although the situation was relieved and there were signs of recovery in the second half of the year, the retail chain operation still suffered a negative growth of 38.8% to HK\$147,354,000, and loss before interest and tax was HK\$23,955,000. Nevertheless, "CM Concept" retail chain remained as one of the top dealers in terms of sales to the mobile network operators in Hong Kong.



The trendy design of "CM Concept" retail shop reflects its high-tech telecom product line

During the period under review, the Group has successfully extended the "CM Concept" mode of operation into Eastern and Southern China by investing 25% equity interest in two joint ventures with CMTH, as an effort to tap into the vast consumer market for telecom products and services in Mainland China. Other than the 40 retail chain stores in Hong Kong, the Group now operates about 800 stores in Eastern and



Southern China. Performance of these stores have been satisfactory and they are aiming to bring the retail chain business back to profitability. While exercising stringent control on operating costs, the Group also aims to enhance the selling capability of "CM Concept" by closely monitoring new telecom products and their demand in the market, as well as making proper adjustments in product structure.

The decline in the turnover of the repair services operation was attributable to the decrease in sales of mobile telephones and telecom products. Revenue for the year was HK\$46,141,000, a decrease of 17.7%. However, through effective cost and management control, the profitability of this business was satisfactory in comparison to the profit before interest and tax that amounted to HK\$25,282,000.

The Group's online value-added distribution platform for telecom products traded under the Internet, *chinamotion.com* and e-commerce recorded a turnover of HK\$27,848,000 as a start-up. Although tighter cost control in operation and capital investment have been implemented in the second half of the year, loss before interest and tax for the year reached HK\$53,050,000. To minimize further loss, the operation has now been largely scaled down.



The Operation and Management Center – the backbone of our network

## Unified Messaging

Paging services have been the principal income source of the Group. However, the on-going market consolidation and stagnant growth in users and prices contributed to the unsatisfactory performance of this business. During the period, a turnover of HK\$190,383,000 was recorded, a decrease of 27.6% from the previous

year. Loss before interest and tax was HK\$104,930,000, which included the provision for fixed assets and goodwill written-off of HK\$103,400,000. The implemented measures on operating efficiency and cost control have boosted the operation back to profitability in the second half of the year. Augmented by the written-off of certain excessive paging facilities, integration of frequencies and the reduction of operating costs, the Group anticipates a return of profitability for this business. On the service side, the Group will continue to expand the short messages services utilizing its unified messaging platform. It will continue to provide corporate clients with tailor-made messaging services to meet their specific needs.



Our call center operates around-the-clock – a guarantee of timely paging service

# MANAGEMENT DISCUSSION AND ANALYSIS

The Telecare services envisioned a high growth rate with a turnover of HK\$12,782,000, a seven-fold increase over previous year. Nevertheless, the gross profit margin for this business was affected as a result of capital investment in call center facilities during the period and the increasing operation costs. Loss before interest and tax amounted to HK\$6,712,000. The Group provides market research, customer care and telemarketing services to its corporate clients who are mainly from the government, banking and financial sectors.

## Financial Position

The Group adopts stringent and cautious financial strategies. The management endeavors to allocate resources efficiently to enhance the utilization of funding. As at 31 March 2001, the Group's cash and bank balance amounted approximately to HK\$208,800,000 and total borrowings were approximately HK\$144,600,000. Currently, the balance sheet of the Group remains healthy with the assets/liabilities ratio dropping from 32.6% last year to 16.6% this year.

The Group generally finances its operation with internally generated cash flows, banking facilities and the two corporate finance activities. Net proceeds of HK\$303,000,000, raised from placement on 11 April 2000 and from rights issue on 1 February 2001, were applied as follows:

- HK\$55,000,000 for the expansion of sales and distribution network of the retail operation;
- HK\$55,000,000 for the development of long distance call business;
- HK\$25,000,000 for the furtherance of Internet service provider business;
- HK\$15,000,000 for the acquisition of equipment for operator assisted call centers;
- HK\$40,000,000 for development of VoIP and IP networks;
- HK\$40,000,000 for upgrade of network digital equipment; and the remaining balance is retained as general working capital.

As at 31 March 2001, the Group had aggregate banking facilities of approximately HK\$123,000,000 of which HK\$13,000,000 was utilized. The Group's cash and bank balance at that date amounted to approximately HK\$208,800,000. This, together with the unutilized banking facilities, enabled the Group to discharge its debts and to fund its operation expenditures.

## Exposures to Fluctuations in Exchange Rates

The Group has exposure to the fluctuations of Renminbi and United States dollars as certain expenses payables and sales receivables from customers are settled in these currencies, respectively.

## Staff and Remuneration Policies

As at 31 March 2001, the Group employed a workforce of approximately 980 people. Total staff costs incurred during the year amounted to HK\$192,300,000. The Group offers comprehensive remuneration and benefit package to its employees with remuneration policies reviewed by the management on a regular basis. The Group sets up a defined contribution retirement scheme for its employees. In addition, the Group also adopts share option schemes which structure to take into account the comparable remuneration level of the market.

## Other Information

Apart from the above, other areas which are required to be disclosed under the requirements of paragraph 32 of Appendix 16 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") are considered not significant to the Group's operations, and hence no additional disclosure has been made.