Management Discussion and Analysis

Mobile

The Mobile business achieved an EBITDA profit of HK$208 million for the period compared to HK$146 million for the second half of the last financial year. This arose due to lower costs of sales and operating costs.

Turnover in the period was HK$1,110 million, a decrease of HK$26 million from HK$1,136 million in the second half of 2000/2001. This arose principally due to lower Mobile postpaid service revenue which decreased by 3.7% to HK$927 million. Mobile prepaid revenue also decreased during the period due to lower average prepaid subscribers in the period compared to the previous six months.

Handset and other accessory sales were HK$69 million in the period compared to HK$71 million in the second half of the previous financial year mainly due to a lower number of handsets sold.

The Mobile period end monthly churn rate was 4.0% compared to 5.5% at the end of the previous financial year. This improvement was due to additional retention programs put in place in the period.

Cost of goods sold and services provided decreased to HK$263 million (HK$341 million – second half of 2000/2001). This mainly resulted from the lower handset sales and decrease in IDD carrier costs and roaming partners' charges.

Other operating expenses (excluding depreciation) decreased to HK$639 million (HK$649 million – second half of 2000/2001). The only category showing an increase was sales and marketing costs which rose by HK$27 million due to an increase in sales commission.

The Group's Mobile subsidiary in Macau commenced commercial operations during the period. The operation is in a start-up phase until it achieves a critical mass.

LMDS

During the period, the restructuring of the Group's LMDS business was substantially completed. Headcount was reduced and the LMDS operation was absorbed into the Mobile operation to achieve greater operational efficiencies. The restructuring resulted in a much reduced operating loss for the period of HK$11 million compared to HK$69 million (both amounts prior to write down for impairment for fixed assets) for the second half of the financial year 2000/2001.

A write down of HK$68 million was made at 31 December 2001 against the carrying value of LMDS fixed assets to reflect the uncertainty of future cash flows that can be generated from this business. The Group expects there will be no further write off related to the business in the future.

Subsequent to 31 December 2001, the Telecommunications Authority of Hong Kong ("TA") waived certain milestone obligations of the performance bond relating to the LMDS business licence. These totalled HK$45 million in respect of the milestones to be met in 2003. The TA is also currently reviewing the other milestone obligations due in 2002.

Subsidiaries, associates and other investments

One significant wholly-owned subsidiary, SmarTone 3G Limited, was established during the period to acquire the Group's 3G licence in Hong Kong.

The Group has invested in three telecom and technology venture capital funds. During the period ended 31 December 2001, a provision was made of HK$12 million against these funds to reflect the current valuation. The carrying value of these investments in the Group's balance sheet at 31 December 2001 was HK$63 million. The Directors are of the opinion these investments are now conservatively valued.

There were no disposals of subsidiaries, associates or other investments during the six months ended 31 December 2001.

Capital structure, liquidity and financial resources

The Group is financed entirely by share capital and internally generated funds and has no external borrowings. The cash reserves of the Group remain strong with cash and bank balances and fixed income investments of HK$3,408 million at 31 December 2001. During the period, the Group invested HK$313 million in held-to-maturity debt securities to generate a better rate of return on its surplus cash resources than that offered by bank deposits.

The Group had a net inflow from operating activities during the period of HK$29 million. Interest received during the period was HK$48 million compared to HK$85 million in the second half of the 2000/2001 financial year. The Group's average cash balances (including held-to-maturity debt securities) declined by 4.5% in the period compared to the second half of the previous financial year. In addition to the purchase of held-to-maturity debt securities, the Group's other major outflow of funds was purchase of fixed assets of HK$120 million during the period.

In the six months ended 31 December 2001, 3,165,000 of the Company's own shares were repurchased for HK$27 million.

The Directors of the Group are of the opinion that the Group can fund its capital expenditure for the current financial year ending 30 June 2002 from existing cash resources.

Treasury policy

The Group invests its surplus funds in accordance with a treasury policy approved from time to time by the Board of Directors. Surplus funds are placed on deposit with banks in Hong Kong or invested in debt securities. Bank deposits in Hong Kong are maintained materially in Hong Kong dollars. Deposits are currently only placed with banks with a Moody credit rating of Baa or better.

The Group's investments in debt securities comprise investment grade corporate bonds and floating rates notes. The investments are denominated in either Hong Kong or United States dollars and have maturity dates in 2004 and 2005. The Group's policy is to hold its investments in debt securities until their maturity date.

The Group is required to arrange for banks to issue performance bonds and letters of credit on its behalf. At 31 December 2001, the Group had cash collateralised performance bonds and letters of credit totalling HK$356 million, a net increase of HK$222 million since 30 June 2001. This net increase is represented by a HK$250 million performance bond relating to the 3G licence and a release of a HK$28 million outstanding performance bond obligation from the TA relating to the LMDS licence. No other assets of the Group were subject to any charge.

Functional currency and foreign exchange exposure

The functional currency of the Group is the Hong Kong dollar and all material revenues, expenses, assets and liabilities are denominated in Hong Kong dollars. The Group does not therefore have any significant exposure to gains or losses arising from the movement of foreign exchange rates against the Hong Kong dollar. It does not currently undertake any foreign exchange hedging activity.

Contingent liabilities

Certain banks, on the Group's behalf, have issued performance bonds to the telecommunications authorities of Hong Kong and Macau in respect of obligations under licences issued by those authorities. The total amount outstanding at 31 December 2001 under these performance bonds was HK$356 million compared to HK$134 million at 30 June 2001. All material performance bonds were fully cash collateralised using surplus cash deposits. The increase arose due to the HK$250 million performance bond issued to the TA in respect of its 3G licence acquired during the period offset by fulfilment of certain milestone obligations in respect of its LMDS business licence.

A bank, on the Group's behalf, has also issued a letter of credit to guarantee its obligations under a lease out lease back arrangement entered into during the year ended 30 June 1999. The Directors are of the opinion that the risk of the Group being required to make payment under this guarantee is remote. The Group has no other material contingent liabilities.

Since 31 December 2001, the TA has released certain performance bond obligations of the Group's LMDS business licence and is reviewing the remainder, as discussed under "LMDS" above.