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DISCIPLINED COST CONTROL

This will always remain to be the Group's business strategy
to reduce expenses and enhance operating efficiency

CHAIRMAN'S STATEMENT

It's been ten years since City Telecom was first started in Hong Kong. The past decade can be described as significant and eventful. Thanks to the perseverance and dedication of everyone from management to staff, our business has broken new grounds time after time. This year, in particular, the Group has achieved its best ever results in its ten year's history in all aspects including earnings growth, number of customers, IDD traffic volume and development of fixed telecom network infrastructure.

The incredible performance of our IDD business deserves a special mention. The number of our registered subscribers grew three folds from 348,000 in 1997 to 1,148,000 this year. Outgoing traffic volume surged by 600% within a span of five years. Operating profit margin increased to 24% this year compared with 14% in the previous year. As a result of the great leap in outgoing traffic growth, as of the end of August 2002, **the Group captured 24% of the outgoing IDD market, having risen from just 20% a year before.**

Despite the impeccable performance, IDD as a business is faced with uncertainties and subject to external changes. As we have seen in a recent case, termination rate for mainland-bound calls can be raised by our PRC partners, and telecom service providers will have no choice but to bear higher costs of traffic. Our position as a leading player with a substantial share of outgoing traffic gives us benefits **of low transmission costs than our competitors**. In fact, we are handling around 30% of the China traffic. Assuming the top player still owns 30% market share, we believe our China-Hong Kong traffic should have exceeded the total traffic of the other three providers combined.

Asia Pacific Cable Network 2 (APCN2), the submarine cable that we participate for investment, has been launched into service, connecting us to major fixed telecom network operators in Asia. With the inauguration of this submarine cable, we connect directly with the three major fixed network services providers in China, namely China Telecom, China Netcom and China Unicom. Such direct linkage ensures that we have the good voice quality while keeping transmission cost at a lower level. As a result, the Group enjoys definite advantages over our competitors in the IDD business, and has a larger buffer to minimize the impact of unexpected changes.

As I pointed out in our last interim report, to us the IDD business is still at a "sunrise" stage, and there is still a lot of room for growth and bring substantial returns to the Group.

Turning to fixed telecom network business. In our opinion, this market is much more predictable and the competition is not as keen. Therefore, it has been earmarked as our next targeted business area besides IDD. Unlike other new fixed network providers, we have adopted state-of-the-art Metro Ethernet IP technology when building our own network. It enables in-house wire connectivity which supports the transmission of voice, Internet data and TV signal through a single network made of optical fibre or Cat5E copper wire. It also frees us from having to rely on Type II interconnection by leasing network from the dominant provider. By steadfastly developing our long-term infrastructure complimented with disciplined cost control, our network is built at a speed that some other service providers who may have been awarded the licence for seven years cannot even match. At the same time, we have a much more competitive cost structure that helps improve our earnings capability.

The fixed telecom network service has recorded outstanding performance. The Group has completed its first stage of investment. According to the figures globally released by Cisco Systems in June 2002, **our Metro Ethernet IP network is the world's largest**. Currently, our network spans 3,000 buildings with around 1.1 million residential homepass and 500 commercial buildings on a single network platform, providing broadband Internet access and fixed line services.

Our investment in fixed telecom network is in its first harvest period. Currently, we have gained 150,000 broadband and 40,000 fixed line residential subscribers, fuelled by our aggressive marketing strategies to maintain high subscriber growth rate. **I believe the Group has created one of the best records of Hong Kong ever in terms of fixed telecom network development and rate of returns**.

Stringent cost controls will always remain the Group's business strategy. For this purpose, we have relocated our call center to Guangzhou in China and recruited mainland staff to provide customer services and other back-end service supports. This measure significantly reduces our expenses in after-sales services and enhances the Group's operating efficiency.

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investment

As one of the Group's major shareholder and Chairman, I fully understand the concerns of other shareholders that the Group may deploy massive resources and invest excessively. **The management is therefore cautious when it comes to investment**. In the past, our investments were mostly funded by IDD income and internal reserves. This cannot be continued. Therefore, in the coming six months, we will carefully monitor our investments in the fixed telecom network services, assessing the returns and prospects of each investment and from there decide the investment strategy in the second phase of development of the fixed telecom network business.

Telecommunications industry is a long and winding road. We go down this road with conviction and determination, undaunted by challenges. Looking ahead, we shall devote our energy to further develop the fixed telecom network business, seeking new breakthroughs and move towards the land of victory.
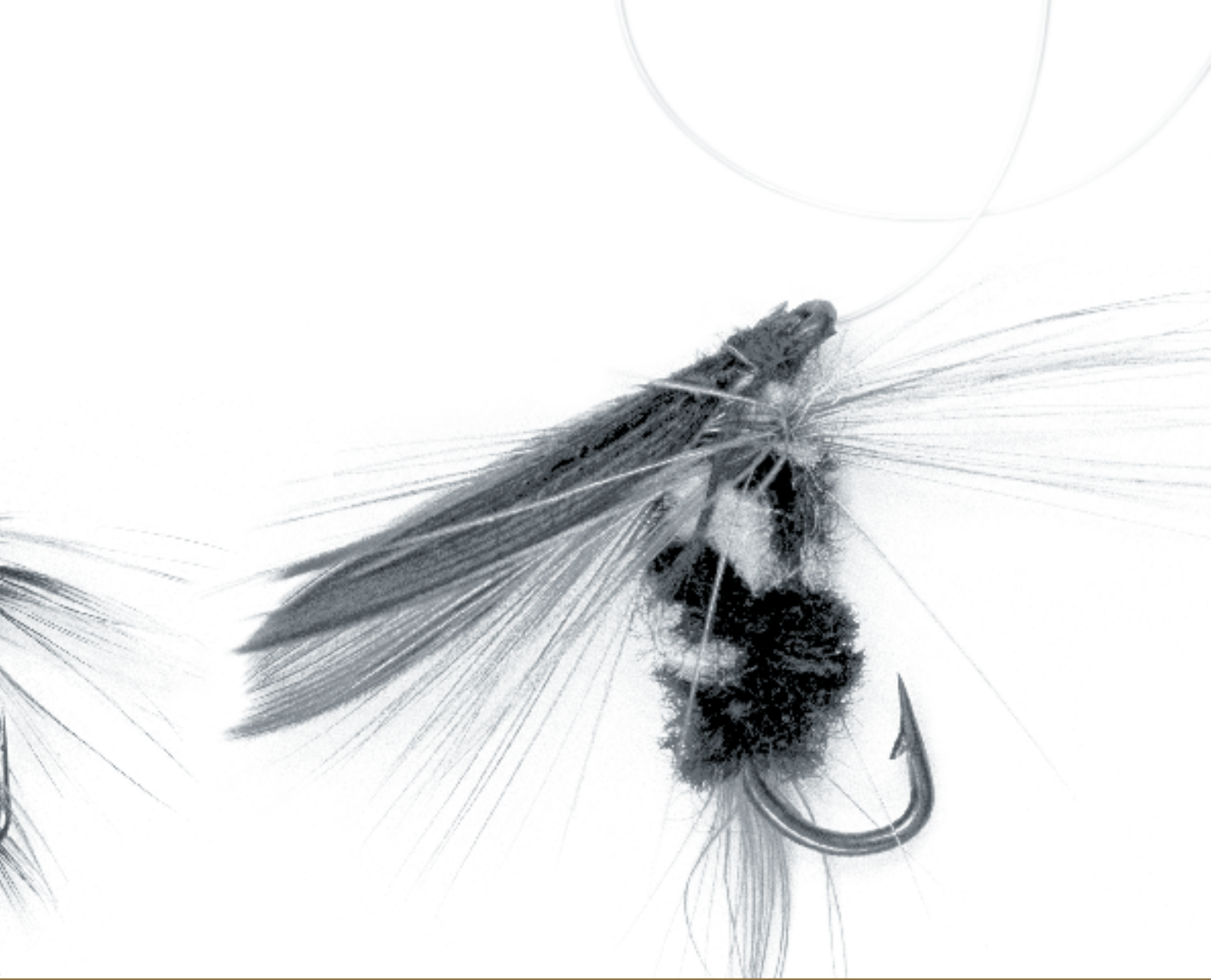
Wong Wai Kay, Ricky
Chairman
Hong Kong, 20th November, 2002

INVESTMENT PRIORITIZATION

Investment decisions would be made upon consideration of degree of exigency and necessity for better allocation of resources