

## MANAGEMENT'S DISCUSSION AND ANALYSIS

## FINANCIAL REVIEW

## Results of Operation

Year ended 31 August	2002	2001
	HK\$'000	HK\$'000
<b>REVENUES</b>		
International telecom (IDD) services	<b>908,981</b>	861,338
Fixed telecom network services	<b>241,219</b>	154,262
Internet advertising services	-	1,034
	<b>1,150,200</b>	1,016,634
<b>Operating profit before interest</b>	<b>90,095</b>	28,082
Net interest income	<b>7,366</b>	30,896
<b>Profit before tax</b>	<b>97,461</b>	58,978
Tax	<b>(14,566)</b>	(18,775)
<b>Profit after tax</b>	<b>82,895</b>	40,203
Minority interests	<b>8,234</b>	13,724
<b>Profit attributable to shareholders</b>	<b>91,129</b>	53,927

This year, the Group turned in a stellar performance with a 69% growth in net profit to HK\$91 million, the highest record of the Group ever. This is a result of our sustained growth in revenue and significant reduction of costs of businesses, which directly contributed to strong gross profit and bottom line results.

During the year under review, the Group continued its growth in IDD services and at the same time recorded significant revenue increase in fixed telecom network services. A large reduction of total costs of services of 22% has boosted Group's gross margin to over 60% (or HK\$692 million) from 43% (or HK\$432 million) last year. Coupled with success in controlling operating expenses, this has translated into a strong bottom line profit.

The Group's turnover increased by 13% to HK\$1.15 billion compared to HK\$1.02 billion last year. IDD, our core business, accounted for HK\$909 million or 79% of total revenue. As a result of our cost-control efforts, operating expenses for IDD service dropped 8% to HK\$693 million and operating profit margin also increased to 24% from 14% last year. The IDD business contributed HK\$214 million in operating profit, compared to HK\$117 million last year, representing a robust growth of 82%.

The fixed telecom network business has shown a major turnover increase of 56% to reach HK\$241 million, as a result of our aggressive marketing plans to gain customers for broadband Internet access services. It has become an increasingly important revenue contributor, accounting for 21% of total revenue in this financial year 2002. Increased spending in acquisition and marketing expenses for broadband Internet access services has enlarged our subscriber base on the one hand, which will bring long term revenue growth, and increased operating expenses by 58% to HK\$368 million on the other. Depreciation expenses also increased in association with our investments in the fixed telecom network. Again, this network will allow us to cope with the fast growing business and reduce our reliance on leased network. For the year 2002, our fixed telecom network business incurred an operating loss of HK\$124 million. Despite this, we are delighted to report that the broadband Internet access services alone has started to reach break-even at EBITDA level in the second half of this financial year.

## BUSINESS REVIEW

### International Telecom Services

We are excited about the impressive growth of our IDD business in the year. Outgoing traffic volume surged by 58% to 916 million minutes from 580 million minutes last year. With our share of the outgoing IDD market growing from 20% in 2001 to 24% in August 2002, we are now the second largest provider and are closing the gap with the leading company to just a few percentage points. IDD revenue rose 6% to HK\$909 million from HK\$861 million last year. This single-digit growth was no small feat given that tariff rate has dropped 30% in average.

China remains to be our major long distance market contributing 63% of total traffic volume, followed by the U.S. and Canada. The China market volume jumped 87%, showing strong demands for international call services to and from China. We have started to make connection via the APCN2 cable to major China fixed telecom network operators. This gives us strong competitive advantages in costs. Upon China's entry to WTO, we expect that long distance call traffic will surge and we are well-positioned to provide best-valued services for this very important market.

### Fixed Telecom Network Services

Our fixed telecom network services are gathering momentum and have achieved success in extending geographical coverage and gaining new subscribers. As of 31 August 2002, our in-building block-wiring network covered more than 2,400 residential buildings with around 950,000 homepass, and 440 commercial buildings across the territory.

With a strategic focus on densely populated areas, our network has a high penetration rate in the New Territories, with 62% of our coverage, right in the heart of Hong Kong's fastest-growing populated area, followed by Kowloon with 25% and Hong Kong with 13%.

Our broadband Internet access services also grew significantly. As of the end of August 2002, we have 130,000 subscribers in residential and 6,000 in corporate sector. The growth helped increase revenue by 55% to HK\$239 million this year. While increased subscriber acquisition costs and depreciation costs have led to an operating loss of HK\$119 million, we are confident that our network investment and expanding customer base will begin to bring returns to the Group.

The creation of a sophisticated and far-reaching network enables us to provide a multitude of services, and fixed line services is but one of them. In April 2002, our fixed line services were inaugurated. In a short span of five months, we have connected approximately 21,000 subscribers, which have brought in HK\$2 million revenue this year. We are very pleased with the progress and we see high potential in this business.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### PROSPECTS

The Group's business has evolved into two clear and well-defined areas: IDD and fixed telecom network, each with its own unique business strategies. IDD will always be the mainstay of our services that provides the cash. Our strategy is to expand our market share and reinforce our strong position, in both prices and services.

Although the cut-throat price war has subsided, the market is still highly competitive, offering little room for tariff increase. Providers need to secure low-cost traffic and carefully monitor operating costs in order to return the margin while improving service quality to increase the share of market.

To this end, we have relocated our call center to Guangzhou in China. Other means of cost control will be explored and implemented. With a 24% market share, our market position is firmly secured and would not be easily challenged.

While satisfied with our position in the China route, the cost of connecting with China can be fluctuated subject to the termination rate, which is solely determined by our partners across the border, as we have seen in a recent case. Still, we are confident that with our large traffic volume and market share, we will continue to enjoy cost advantages over our competitors, and bring benefits to our customers.

At the same time as we reinforce our position in IDD business, we will devote energy to further develop the fixed telecom network business. Over the past years, heavy investments have been made in building our network, which serves as a well-founded service platform. This has mostly been completed and further huge investment is not foreseen in the near future. Now is the time to reap benefits. On the basis of such a sophisticated and efficient infrastructure, we are capable of launching a myriad of services in addition to broadband Internet access and fixed line services. We are confident that these services will meet the strong market demand for high quality service at competitive prices, and generate additional revenue and profit to the Group.

Looking ahead, the Group will study the possibility of providing other services to enlarge our revenue base and maximize the value of our infrastructure

In particular, our fixed line services have demonstrated strong growth potential, having quickly developed a large customer base. We regard this as a relatively less competitive market where our flexible marketing and pricing strategy will give us a definite niche.

Looking ahead, the Group will study the possibility of providing other services, such as pay-TV on the same fixed telecom network to enlarge our revenue base and maximize the value of our infrastructure.

As a further means of achieving cost-efficiency, we will consider migrating our existing wireless backbone to a wired platform starting 2003. However, a decision on such additional investment will only be made after carefully evaluating the business environment and assessing the potential returns.

#### EXCHANGE RATES

During the reporting year, the Group was not affected to any significant extent by fluctuations in exchange rates.

#### LIQUIDITY AND CAPITAL RESOURCES

As of 31 August 2002, the Group had cash and bank balances of approximately HK\$310 million and outstanding borrowing of HK\$45 million. Capital expenditure was HK\$579 million during the year, of which approximately HK\$440 million was invested in building the fixed telecom network in Hong Kong and HK\$120 million was for the development of international telecom facilities.

#### EMPLOYEE RELATIONS

As at the end of 31 August 2002, the Group had approximately 1,820 employees, of which 1,280 were located in Hong Kong, 500 were located in Guangzhou and the rest was for Canada and Japan. Total staff related cost was approximately HK\$196 million for the year under review. The Group provides remuneration package consisting of basic salary, bonus and other benefits. Bonus payment is discretionary and dependent on both the Group's and individual performances. The Group also provides comprehensive medical coverage, competitive retirement benefits schemes, and operates an Employee Share Option Scheme.

The Group is committed to improving its service quality and productivity. In this regard, the Group set up the Organization Development Department in April 2002 with an aim to improve organizational and individual performance through performance consulting and training services. Up to August 2002, over 13 different types of training programs, including managerial, supervisory, customer service, safety and computer network, were offered and the training man-days totaling 1,559.