Overview

SmarTone's strong recovery in financial performance during the 2001/02 financial year continued for the six months ended 31 December 2002. The Group achieved a profit attributable to shareholders in the period of $238 million (second half of 2001/02 - $155 million). Profit recorded by the Group's mobile business increased during the period compared to the previous six months and no charges were made for impairment of assets. The ISP business achieved break-even during the period.

Mobile

The mobile business achieved earnings before interest, tax, depreciation and amortisation ("EBITDA") for the period of $392 million (second half of 2001/02 - $365 million).

Turnover increased in the period by $203 million to $1,442 million (second half of 2001/02 - $1,239 million) due to higher mobile services revenue and handsets sales:

- Mobile services revenue in the period increased by 5 per cent. to $1,181 million (second half of 2001/02 - $1,130 million). Hong Kong mobile postpaid revenue increased due to higher average ARPU partially offset by lower average subscribers. Hong Kong prepaid revenue and Macau mobile revenue also increased in the period compared to the second half of 2001/02.

  Hong Kong average postpaid ARPU for the period was $222 per month (second half of 2001/02 - $210 per month). With the growing convergence of postpaid and prepaid services in Hong Kong, and to be consistent with international practice, SmarTone now also calculates ARPU on a blended basis. Blended ARPU for the period, calculated as Hong Kong mobile services revenue divided by the total number of postpaid and prepaid customers, registered a 7 per cent. increase to $189 (second half of 2001/02 - $176).

- Handsets and accessories sales in the period were $261 million (second half of 2001/02 - $109 million). There was a substantial increase in handsets sold due to the launch in the period of new handset models with advanced features such as colour screens and GPRS.

Total customers of the Hong Kong mobile business was 952,000 as at 31 December 2002. Monthly churn rate in December 2002 was 2.5 per cent. compared to 3.0 per cent. in June 2002. This improvement was due to various retention programmes in place during the period. In addition, along with other operators in Hong Kong, SmarTone imposed a one-time fee throughout the period for port-in customers.

Cost of goods sold and services provided increased to $436 million (second half of 2001/02 - $304 million) due to higher costs of handsets sold due to increased handsets sales volume.

Other operating expenses (excluding depreciation) increased to $613 million (second half of 2001/02 - $571 million). This was mainly due to an increase in sales and marketing expenses in the period, including major advertising campaigns for the Re-centering campaign and the launches of various new products and services such as SmarTone iN and picture**mail**.

The financial performance of the Group's mobile business in Macau continued to improve and it was profitable in the six months to 31 December 2002.

ISP Business

During the period, the ISP business achieved break-even. The obligations of the outstanding performance bonds of $56 million were satisfied during the period and the bonds released.

Subsidiaries, associates and other investments

There have been no significant subsidiary companies acquired or established during the period.

The Group has invested in three telecom and technology venture capital funds, one of which is held via an investment in an associated company. The Directors are of the opinion these investments are conservatively valued.

There were no disposals of subsidiaries, associates or other investments during the six months ended 31 December 2002.

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 $3,803 million at 31 December 2002, an increase of $216 million during the six months. During the period, the Group further invested $386 million in held-to-maturity investment grade fixed income securities to generate a better rate of return on its surplus cash.

The Group had a net cash inflow from operating activities during the period of $450 million. Interest received during the period was $42 million compared to $27 million in the previous six months due to higher average cash balances in the period and an increasing percentage of its surplus funds invested in higher yielding fixed income securities. In addition to the purchase of fixed income investments, the Group's other major outflows of funds during the period were purchase of fixed assets, shares repurchases and payment of the 2001/02 final dividend.

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 2003 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 investment grade debt securities. Bank deposits in Hong Kong are maintained in Hong Kong or United States dollars.

The Group's investments in debt securities are denominated in either Hong Kong or United States dollars with a maximum maturity of 3 years. The Group's policy is to hold its investments in debt securities until maturity.

The Group is required to arrange for banks to issue performance bonds and letters of credit on its behalf. In certain circumstances, the Group will partially or fully collaterise such instruments by cash deposits to lower their issuance cost. Total amount of pledged deposits at 31 December 2002 was $419 million (30 June 2002 - $525 million).

Functional currency and foreign exchange exposure

The functional currency of the Group is the Hong Kong dollar. All material revenues, expenses, assets and liabilities, except its United States dollar fixed income investments and bank deposits, are denominated in Hong Kong dollars. The Group does not therefore have any significant exposure to foreign currency gains and losses other than those arising due to its United States dollar denominated bank deposits and fixed income investments. The Group does not currently undertake any foreign exchange hedging.

Contingent liabilities

Performance bonds

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 2002 under these performance bonds was $202 million (30 June 2002 - $308 million). All performance bonds were fully cash collaterialised using surplus cash deposits. The decrease during the period arose as follows:

- The remaining performance bond obligations totalling $56 million relating to the Group's LMDS licence were released as discussed under ISP business above.
- The performance bond in respect of the Group's licence for 3G services was reduced by $50 million to $200 million in accordance with a one-year waiver granted by the Telecommunications Authority of Hong Kong.

Lease out, lease back arrangement

A bank, on the Group's behalf, had issued a letter of credit to guarantee the Group's obligations under a lease out lease back arrangement entered into during the period ended 30 June 1999. This letter of credit is fully cash collaterialised using surplus funds to lower its issuance costs. The Directors are of the opinion that the risk of the Group being required to make payment under this guarantee is remote.

Other than the above, the Group has no other material contingent liabilities.

Employees and share option scheme

The Group employed approximately 1,270 full-time employees as at 31 December 2002, with the majority in Hong Kong. Staff receive a remuneration package consisting of basic salary, bonus and other benefits. Bonus payments are discretionary and depend, inter-alia, on both the Group's performance and the performance of the individual employee. Benefits include a mandatory provident fund scheme and medical and dental care insurance. Staff members are provided with both internal and external training appropriate to each individual's requirements.

During the period, the Company resolved to terminate its existing employee share option scheme and adopt a new scheme. At 31 December 2002, options to subscribe for 7,661,250 shares were outstanding under the old scheme and no options had been issued under the new scheme. The options outstanding under the old scheme either lapsed, or were acquired for a nominal amount pursuant to the mandatory general offer by Cellular 8 Holdings Limited for the Company's shares completed in January 2003.