

# Management Discussion and Analysis

## Market Overview

In the past year, the global telecommunications market is still in the course of self-adjustment. Amidst the weak market sentiment while keen competition remains, it requires more creativity for telecommunications operators to explore new markets, to expand the customer base and to ensure business growth. Implementation of new technologies and innovative services is the only way to overcome the adverse situation. In view of this, the upsurge of telecommunications value-added services in the markets continues to stimulate customers' needs for new services. On the other hand, there has been an increasing tendency for telecommunications operators to establish strategic alliances to improve their capabilities and to reduce expenditure on fixed costs.

As for the telecommunications industry in Hong Kong, the full opening of the fixed line market and the increasingly competitive mobile market have forced voice communication further lower its rates ever. Together with the comprehensive telecommunications infrastructure and the pro-competition regulations stipulated by the government after the opening up of the market, a more favorable market environment targeting the mass market is provided for emerging operators. In the 2G mobile services market, service providers are prompted to develop more value-added services to maintain their competitiveness, as the market is close to saturation. These new services include data, multi-media short message services and information services.

With China's accession into the WTO, its telecommunications market is more ready for open competition. Further economic development in China has prompted more international business partners to enter into China's market which encourages more economic activities and foreign investments and this will create an enormous increase in demand for cross-border telecommunications services in and out of China. As a key gateway into China for the rest of the world, Hong Kong enjoys an unrivalled geographical advantage in the development of cross-border telecommunications.

As an experienced value-added telecommunications service provider, China Motion has established a cross-border distribution network and an experienced sales team. This has placed China Motion in a unique advantageous position as it possesses more in-depth experiences in the PRC market than other foreign players while it has accumulated more international business exposure than PRC enterprises. These are valuable advantages in order to secure further business opportunities in the cross-border and value-added telecommunications arena. China Motion targets to capture the vast business opportunities in world-wide the Chinese communities and following the successful restructuring of its cross-border and value-added business, the Group will continue to explore opportunities in all these fields to become one of the market leaders.

## Business Overview

During the year under review, despite the turbulence in the global economy and the challenges faced by the overall telecommunications industry, the Group carved for itself a unique market positioning, providing cross-border telecommunications services between the PRC, Hong Kong and other major business hubs around the world. During the year, China Motion continued to provide comprehensive telecommunications value-added services. With consolidated resources and a strong business development roadmap, the Group achieved a turnaround in its business performance with profitable financial results. Mindful of the rapid developments within the telecommunications industry, the Group divested its paging business in June 2002 to focus on the development of its cross-border, value-added telecommunications services. With its successful bid for a license to provide fixed line services in Hong Kong at the beginning of 2003, China Motion evolved into three core businesses, namely telecommunications networks, mobile related services and distribution and retail chain.

During the year under review, while the disposal of the paging business had minimal impact on the Group's turnover, the Group saw substantial growth from the telecommunications networks business, which contributed to the improved results. Turnover was HK\$735,573,000,



representing a growth of 2% over the previous year, out of which turnover from telecommunications networks segment, when compared with the previous year, recorded an 80% increase to HK\$456,400,000. Turnover from telecommunications networks business contributed 62% of the total turnover and became the major revenue generator of the Group. The IDD operations of the business performed exceptionally well and became one of the significant players in the market.

In mobile related services, the Group officially launched its MVNO business in August 2002 with a series of services with cross-border capabilities, including the "2-WAY" Stored Value SIM Card and the "Dual SIM Mobile Services". This made China Motion one of the first tier MVNO players to launch services after acquiring the MVNO license. During the year under review, the MVNO business contributed HK\$20,578,000 to the Group's turnover.

By the second half of the year under review, the retail chain business achieved a turnaround and recorded a profit, as a result of stringent cost controls and closure of redundant retail stores. With the continuous launch of new products in the market, the distribution and retail chain serves as the ideal distribution channel for the Group's proprietary services and products.

During the year under review, the Group successfully divested its paging services unit, streamlining its businesses and sharpening its focus. The Group continues its commitments to developing its core businesses to generate higher profit margins, increasing revenue sources and developing business in accordance with the intended plans.

## Performance of Core Businesses

### Telecommunications Networks

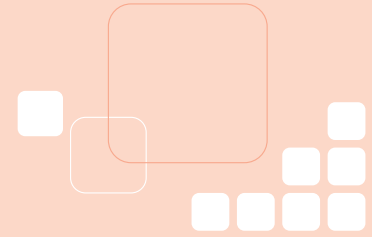
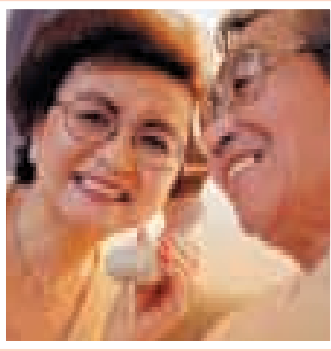
Amidst the global economic downturn, China outperformed the world economy with robust economic development, impressive growth in export and direct foreign investments. All these positive developments have promised great prospects for the IDD market of China. During the year under review, telecommunications networks business, with focus on restructuring business strategies for its core IDD operations, performed exceptionally well and witnessed a rapid growth.

**IDD traffic grew dramatically** During the year under review, due to the increase in voice traffic, the IDD operations achieved a turnover of HK\$439,096,000, representing a 91% increase from the previous year. During the year, IDD voice traffic exceeded 1,200 million minutes, or approximately averaging 100 million minutes per month, representing a remarkable growth of 150% over the previous year.

**IDD voice traffic between China and Hong Kong surged** Due to changes in market conditions, the Group focused on developing China-related IDD services to expand its revenue base. Currently 90% of the Group's IDD voice traffic is attributable to usage related to China, totaling 140 million minutes – an increase of 133% over the last year.

### Acquisition of licenses from around the world

Leveraging growth in China, with its robust exports and foreign investments, the Group continued to strengthen IDD services between Hong Kong, China and North America, by expanding into new markets and acquiring overseas licenses. China Motion Netcom, the subsidiary of the Group to operate its IDD business, has obtained licenses and set up representative offices in Singapore, Taiwan, New York, Vancouver, and Toronto. A few months from operation commencement, the Singapore and Taiwan offices have already recorded 47 million and 30 million minutes of voice traffic respectively at the end of March this year. China Motion Netcom has also signed a MOU with a major telecommunications player in Vietnam, further cementing the foundation for future business development.



### **IP Transit, a stepping stone to new market**

**opportunities** IP transit is one of the critical stepping stones for the Group in expanding its geographical reach. During the year under review, connection points were set up in various parts of the world, including Hong Kong, Los Angeles, New York, Singapore, Taiwan and Japan. By connecting Hong Kong and Los Angeles through these connection points, the IP transit segment is poised to become one of the major growth drivers for the Group.

**Develop broadband for connection with IDD service providers** China Motion Netcom developed new international broadband services with capacity exceeding 1,000M. It has also developed a number of specialised international broadband services in connection with various first-tier IDD service providers in different parts of the world.

**Strong business growth led to further expansion in switching capacity** In order to satisfy growing demands in voice traffic and to provide quality services to customers, the Group upgraded its equipment several times during the year under review. For the year under review, capacity for both inter and intra switching equipment around the world was approximately 50,000 ports. New switching equipment has also been installed in Los Angeles, Singapore and Taiwan. The constructions of overseas connection points contributed to the growth of VOIP traffic volume overseas, leading to an overall expansion to over 1,500 ports.

**Launch of local fixed line services to penetrate the retail market** At the beginning of 2003, the Group successfully obtained a license to provide fixed line services in Hong Kong, and launched its first local service under the brand "ChinaOne" in February 2003. After acquiring the license, the Group launched "ChinaOne 0050", a retail IDD service for commercial and household customers with enormous needs for communication between China and Hong Kong. At the same time, the Group also launched its ChinaOne prepaid calling cards in North America and achieved encouraging performance from the markets.

### **Mobile Related Services**

During the year under review, mobile related services recorded a turnover of HK\$109,841,000, representing a decrease of 16% compared to the previous year. The drop was attributed to the fall in ARPU (Average Revenue Per User) in China. Following the recent introduction of new mobile related products and services, the business recorded a significant improvement during the second half of the year.

**Launch of MVNO services maintains strong business growth** The Group launched its mobile related services under the brand name "CM Mobile" in Hong Kong in August 2002. Since then, the MVNO business has contributed a turnover of HK\$20,578,000. The management is confident that the business will continue to grow and become one of the major revenue streams for the Group.

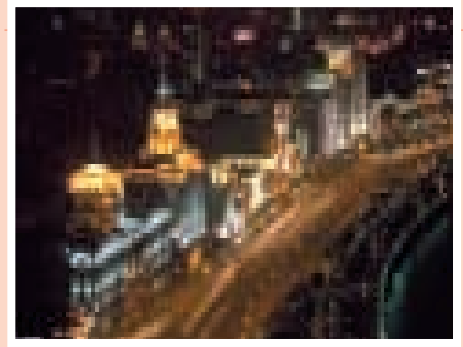
**"CM Mobile" achieves growing reputation and popularity** Leveraging on its strengths in cross-border communications and extensive retail chain network, and to cater for the communications needs of frequent travelers between China and Hong Kong, the Group released a series of products under the brand "CM Mobile". Products provided include prepaid cards, postpaid services and "Dual SIM Mobile Services", all of which have received favorable market responses.

**"Dual SIM Mobile Services" attract high-end users** Since development starting from the end of 2002, "Dual SIM Mobile Service" provides one single SIM card and

**CM Mobile**



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comes with a combination of other value added services including voice mail, SMS and secretarial services. The product has appealed to frequent cross-border travelers and attracted a high ARPU customer segment for the Group. Leveraging its existing market base, the Group will continue to customise more value-added services and capture more high ARPU users.

### Distribution and Retail Chain

Because of very high penetration rate and competition amongst mobile operators, the mobile phone market in Hong Kong remained weak, during the year under review, the business maintained a turnover of HK\$146,140,000, a drop of 21% when compared with last year. However, due to stringent and effective cost control measures, the business achieved a turnaround in the second half of the year and a profitability of HK\$5,554,000.

**Successful turnaround in the fourth quarter** Amidst competitive and aggressive marketing campaigns from various mobile service players in 2003, the Group's distribution and retail chain business continued its growth momentum and witnessed a return to profitability. Thanks to the steady growth in mobile service subscribers and revenue generated from products under the CM Mobile brandname, the business witnessed an increase in turnover by the second half of the year.

**Stringent cost control in operations** The Group adopted a series of cost control measures under the challenging local retail market. The number of retail chain stores was reduced from 33 at the beginning of the year to 26 at the end of the year. The cost control measures proved successful by the second half of the year, when the business saw a turnaround, despite unfavorable business and economic sentiment in the first half.

**Synergies between branded products and retail chain create higher value** In the past year, China Motion continued to diversify the product range and broaden geographical coverage for its mobile related business. The management believes that cost effective measures and

strategic locations of the distribution network will add to the successful appeal of the Group's mobile related products and services, strengthening the synergy between the two. In the long run, this synergy will continue to bring better performance for the Group.

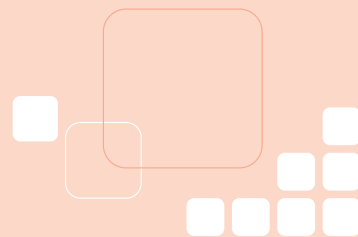
### Global mobile phone market resumes growth

According to a research by Gartner in the US, mobile phone manufacturers have increasingly been launching new generation mobile phones. In the first quarter of 2003, 110 million mobile phones were already sold around the world, representing an increase of 18% as compared to last year. The 3G mobile phone was launched in Europe and stimulated sales of mobile phones. The Group's distribution and retail chain business is poised to benefit from such new business opportunities.

### Long-Term Investments

On 30 January 2003, the Group signed a conditional agreement with China Motion Telecom Holdings Limited to acquire a total of 50% (by two stages of 25% each) of the registered capital of one of its subsidiaries, China Motion Netcom Services Co Ltd ("CM Netcom") – to develop VOIP-related business in China. CM Netcom currently provides VOIP-related services in Beijing and Shanghai. Completion of the acquisition agreement is conditional upon, inter alia, the conditions precedent to be fulfilled on or before 31 October 2003 with completion of the acquisition to take place by 31 December 2003 and 2004 for the stages one and two respectively. As of the date of this report, the relevant parties to the acquisition are still in the process of fulfilling the relevant conditions precedent.

The total consideration for this acquisition is HK\$258,000,000, of which HK\$46,729,000 has been paid as deposit, and the capital expenditure funding of HK\$80,159,000 paid last year will be applied as part of the consideration of the acquisition. The Group will leverage its expertise in IDD services and work with business partners in China to capture the huge market opportunities there and maximise value for shareholders.



## Prospects

As China continues to experience robust economic growth, increase in foreign investments and high domestic consumption power and the holding of upcoming world, the Group is confident that the communication needs between China and Hong Kong, and China with the rest of the world, will continue to grow. The cross-border telecommunications market holds immense opportunities for further development and China Motion is poised to become one of the biggest beneficiary in this.

The Group will continue to leverage its competitiveness to achieve the following targets:

- Further expand its wholesale IDD business to other countries such as the United Kingdom and Australia where there is huge demand for communications services to China
- Expand the newly launched retail IDD services
- Enhance the communications systems and platforms to fully develop proprietary products, such as ChinaOne and CM Mobile, for individuals and SMEs
- Expand the retail market for brands and products developed by the Group
- Partnership with other major telecommunications operators to further develop the mobile services business

With streamlined businesses and sharpened focus, the Group has been able to apply stringent cost control measures and successfully turn its operations around to record profit. With such a strong base to work from, the management expects that China Motion will continue to see growth and will strive to improve profitability for the Group.

## Financial Position

The Group has always maintained a prudent and stable financial strategy. As at 31 March 2003, the Group's cash and bank balances amounted to approximately HK\$86,013,000. Total bank borrowings were approximately HK\$135,419,000 of which HK\$132,362,000 is denominated in Hong Kong dollars and HK\$3,057,000 is

denominated in US dollars. The bank loans are repayable monthly and the last monthly installment will be in August 2013. The current total borrowings as a percentage of shareholders' funds were maintained at a healthy gearing ratio of 18%, which is similar to last year's level.

During the year, the Group financed its operations through internally generated funds, banking facilities and the proceeds of funds raised in the financial year ended 31 March 2001. Total net proceeds then raised amounted to HK\$303,000,000 and have been utilised in the current and previous years as proposed.

As at 31 March 2003, the Group had aggregate banking facilities of approximately HK\$73,520,000, of which HK\$45,313,000 was utilised. It is anticipated that the Group's cash and bank balance, as at the balance sheet date, together with the unused banking facilities, will be sufficient to discharge its debts and to fund its operations.

## Exposures to Fluctuations in Exchange Rates

The Group is exposed to fluctuations in Renminbi and United States dollars as certain expenses payable and trade receivables from customers are settled in these currencies respectively.

## Staff and Remuneration Policies

As at 31 March 2003, the Group employed a workforce of approximately 523. Total staff costs excluding directors' emoluments incurred during the year amounted to HK\$119,455,000. The Group's remuneration policy has been in line with prevailing market practice and has remunerated its employees based on their performance and experience.

The Group also offers a staff benefits package to its employees, which includes training allowance, provident fund and medical insurance. In addition, the Group grants share options to certain directors of the Company and certain employees of the Group.

# STRENGTH IN CHINA

Leveraging the expertise, capabilities and strong business relations with telecommunications service providers from Hong Kong and China, China Motion has provided high quality cross-border value-added telecommunications services, and expanded its global business network, to bring unlimited telecommunications services to its customers.

