Overview

SmarTone's strong financial performance in the 2002/03 financial year continued into the first half of the current financial year. The Group achieved a profit attributable to shareholders in the period of $235 million (second half of 2002/03: $155 million). Group profit increased during the period compared to the previous six months as the business recovered following the ending of the SARS epidemic. The ISP business was closed in the second half of 2002/03 and therefore had no effect on the Group's result for the six months ended 31 December 2003. There were also no charges made for impairment of assets in the period.

The Group has adopted the revised Hong Kong Statement of Standard Accounting Practice 12, "Income taxes" in the period. This resulted in the Group incurring a charge in the period of $39 million in respect of deferred taxation. Comparative figures for the previous financial year have been restated accordingly, and resulted in a profit attributable to shareholders of $223 million for the first half of 2002/03.

Operating performance

The business achieved earnings before interest, tax, depreciation and amortisation ("EBITDA") for the period of $448 million (second half of 2002/03: $359 million).

Turnover increased in the period by $171 million to $1,549 million (second half of 2002/03: $1,378 million) due to both higher mobile services revenue and handsets sales:

- Mobile services revenue in the period increased by 12 per cent. to $1,217 million (second half of 2002/03: $1,083 million). Hong Kong mobile postpaid revenue increased due to higher ARPU and subscribers. Hong Kong prepaid revenue and Macau mobile revenue also increased in the period compared to the second half of 2002/03.

  Hong Kong blended ARPU for the period was $188 per month (second half of 2002/03: $178 per month). This increase was mainly due to the recovery in roaming revenue following the ending of the SARS epidemic and an increase in data revenue. Postpaid ARPU for the period, registered a 2 per cent. increase to $207 (second half of 2002/03: $203).

- Handsets and accessories sales in the period were $332 million (second half of 2002/03: $295 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, integrated cameras and Java engine. GX22, the best GSM CameraPhone in the market, was launched in September 2003 with strong response from customers. Sales remained strong in the first months of 2004.

Cost of goods sold and services provided increased to $523 million (second half of 2002/03: $435 million) arising from higher costs of handsets sold and higher IDD and roaming partner charges. Such higher costs reflected the corresponding increases in handset sales and roaming revenues.

Other operating expenses (excluding depreciation and loss on disposal of fixed assets) decreased to $578 million (second half of 2002/03: $584 million). This was mainly due to a decrease in sales and marketing expenses in the period.

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 2003.

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. There were no charges for impairment in the six months to 31 December 2003 and 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 2003.

Capital structure, liquidity and financial resources

The Group's capital structure changed during the period with the payment of the special and final dividends. Prior to the dividend payments, the Group was financed entirely by share capital and internally generated funds and had no external borrowings. With increased investment in debt securities and the distribution of the special cash dividend, several short term Hong Kong dollar floating interest rate, revolving credit facilities were arranged. The Group also cancelled the share premium account in the period and transferred the balance to the contributed surplus account.

The cash resources of the Group remain strong with cash and bank balances and investments in held-to-maturity debt securities, net of external borrowings, at 31 December 2003 of $1,910 million.

The Group had a net cash inflow from operating activities during the period of $353 million. Net interest received during the period was $34 million compared to $48 million in the previous six months due to an increasing percentage of its surplus funds invested in higher yielding fixed income securities. The Group's other major outflows of funds in the period were payment of the special and final dividends, purchases of held-to-maturity debt securities and purchases of fixed assets. The Group also had an inflow of $420 million being the proceeds from committed borrowing facilities totaling $600 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 2004 from existing cash resources and its committed borrowing facilities.

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 arranged several committed 1-year Hong Kong dollar denominated revolving credit facilities from various banks during the period totaling $600 million. Of this facility, $420 million was utilised at 31 December 2003.

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 2003 was $335 million (30 June 2003: $392 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 Stated dollar denominated bank deposits and investments in debt securities. 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 2003 under these performance bonds was $152 million (30 June 2003: $202 million). All performance bonds were fully cash collaterialised using surplus cash deposits.

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 had 1,260 full-time employees as at 31 December 2003, 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.

The Group has a share option scheme, under which the Company may grant options to the participants, including directors and employees, to subscribe for shares of the Company. During the period, employees exercised 2,066,500 share options at prices of $9.29 and $9.20 and at 31 December 2003, 3,133,500 share options were outstanding.