

# Management Discussion and Analysis

## Market Overview

2003/04 was a challenging year for the telecommunications industry. The continued weak economic conditions in Hong Kong and fierce market competition resulted in downward price pressure. The situation was compounded by the outbreak of SARS in Hong Kong and the region.

Notwithstanding the weakness in the markets around the region, China continued to go from strength to strength, posting a GDP growth rate of 9.1%. Steady inflows of foreign direct investment, coupled with increases in domestic spending power, fuelled demand for IDD and mobile services. According to China's Ministry of Information Industry, total telecommunications industry revenue will reach US\$69 billion in 2004, up 12% from 2003.

With the deregulation of the telecommunications industry in China, the market will soon see the emergence of telecommunications operators offering services that ride on the telecommunications infrastructure developed by the four main network operators. Leveraging on our extensive experience in providing telecommunications services, China Motion is well positioned to cater to the increasingly sophisticated needs of consumers in China. The Group intends to capitalise on its solid relationships with the main network operators to negotiate an advantageous strategic partnership to enter the market.

The Closer Economic Partnership Arrangement (CEPA) between Hong Kong and the mainland has also fuelled demand for cross-border telecommunications services. The cross-border telecommunications service sector will grow in the years ahead. To ensure that the Group has the necessary capacity to meet the growing demand, in November 2003, China Motion entered into a co-operative agreement with China Telecommunications Corporation for the development of a cross-border telecommunications optic-fibre network.

Introduced in mid 2003, the "Individual Visit Scheme", which allows mainland residents to visit Hong Kong in their individual capacity, has brought myriad opportunities to Hong Kong's tourism and retail sectors. The strong spending power of visitors from cities in South China, the wide variety of telecom products and services available at our "CM Concept" stores as well as the widespread recognition of the "CM Concept" brand among these customers have all enabled China Motion to benefit from the scheme. The Group has formulated plans to strengthen the position of "CM Concept" and make it a preferred brand among mainland visitors.

In late 2003, a new chapter in Hong Kong's telecommunications industry commenced with the launch of the territory's first third generation (3G) telecommunications network. Other 3G network operators are expected to follow suit in late 2004. China Motion is the first company to have won a 3G dealership, a testament to the strength of its distribution network. The dealership has added to the already comprehensive range of products and services available at "CM Concept" shops, allowing it to keep pace with the latest market developments.

## Business Overview

During the year under review, the Group has successfully established itself as a multi-faceted telecommunications services provider with strong networks in key markets. We have a well-defined business model with three core businesses: international telecommunications services, mobile communications services and distribution and retail chain.

The Group has expanded its services in other major overseas markets with identified needs for telecommunications connections with China. The Group's overseas operations achieved 78% growth in turnover over last year.

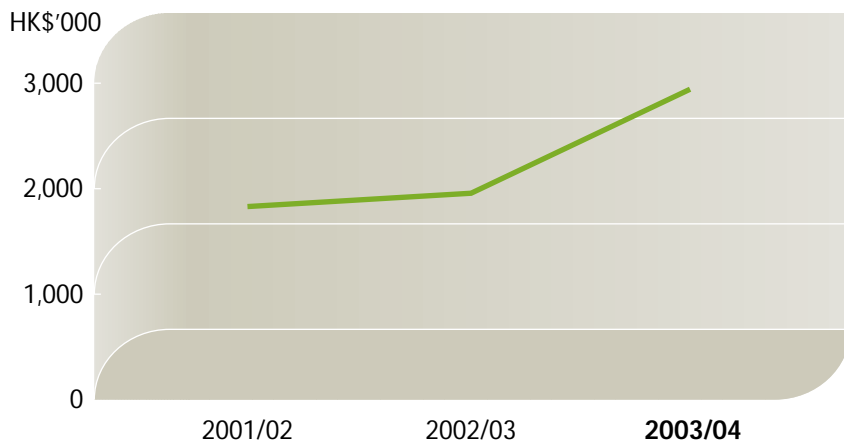
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The Group embarked on business streamlining initiatives with a view to improving its cost effectiveness. Back office functions have been centralised to provide support to different business units and functions, enhancing the flexibility of our operations and allowing us to respond speedily to market demands.

## International Telecommunications Services

Turnover of the Group's international telecommunications services business, mainly comprising wholesale and retail IDD services, increased by 14% over the previous year to HK\$501 million. Our wholesale IDD business contributed outstanding growth levels to the international telecommunications services business while the start-up retail IDD business showed promise.

## Staff Productivity (Annual turnover per staff)

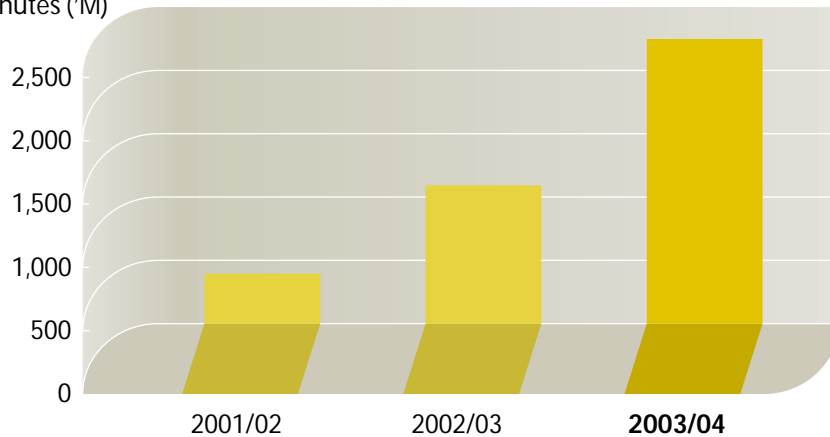






## IDD Voice Traffic

Minutes ('M)



In the financial year under review, the Group entered Vietnam, Japan and the United Kingdom, offering wholesale IDD services. The success of the overseas expansion strategy is evident in the significant contributions by the new overseas markets. The new overseas markets contributed towards the doubling of the Group's total IDD voice traffic to 2,400 million minutes for the financial year under review.

On the product front, the Group launched "ChinaOne 0050" in Hong Kong in May 2003. Subsequent to the launches, we also obtained retail licences in Singapore, Taiwan and ten states in the United States of America. As at the end of March 2004, the number of subscribers was approximately 120,000, and is expected to grow in the coming year. Responding to the "Individual Visit Scheme", we have also introduced a number of IDD calling cards for cross-border travellers.

### Mobile Communications Services

Turnover of the Group's mobile communications services business totalled HK\$172 million, up 38% when compared with last year. The increase was attributable to promising growth in the Mobile Virtual Network Operator (MVNO) business, which

outweighed the revenue loss resulting from the service contract expiry of 30,000 mobile subscribers in China in September 2003. The business relating to the Group's remaining 70,000 subscribers in China has expired at end of March 2004.

"CM Mobile" is the brand under which the Group offers MVNO services. It continued to enhance service quality and expand product offerings to satisfy various customers' needs. The coverage of the popular "Dual-Number Single SIM Mobile Service" was expanded beyond Guangdong province to include Shanghai. The Group launched prepaid stored value SIM cards targeting mainland visitors. "CM Mobile" also pioneered the introduction of "Dual-Network Mobile Service" in Hong Kong.

Leveraging on the Group's strengths in cross-border telecommunications, its extensive distribution and retail network and its experience in customer services, "CM Mobile" has been aggressively acquiring subscribers from among frequent cross-border travellers. The number of subscribers to the Group's mobile communications services business was 60,000 on 31 March 2004. The majority of "CM Mobile" services subscribers were acquired through "CM Concept" stores.

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The Group's mobile communications services business has begun to develop overseas markets. In April 2004, it was awarded a trial operating licence in Taiwan with commercial launch scheduled for later in the year. We are also actively looking for opportunities to introduce the "Dual-Number Single SIM Mobile Service" in Southeast Asian countries, key travel destinations for mainland travellers.

With efforts to expand market presence in Hong Kong and overseas markets, the Group believes the MVNO business will progress to break-even towards the end of the current financial year.

## **Distribution and Retail Chain**

Market sentiment in Hong Kong deteriorated during the financial year under review amid the outbreak of SARS and the economic downturn which affected the retail industry at large. "CM Concept" as a one-stop-shop of telecommunications and digital consumer electronics products was inevitably affected by the market situation. Turnover of the distribution and retail chain business decreased by 14% to HK\$129 million.

However, at the end of 2003, business and marketing plans were put in place to capture the opportunities arising from the introduction of the "Individual Visit Scheme". Responding to this huge business opportunity, the Group has set out to reposition "CM Concept". In addition to introducing new products and services, we have begun to strengthen our retail chain network by relocating the retail outlets to areas that are convenient to both local customers and mainland tourists. As at 31 March 2004, our chain consisted of 27 shops in strategically chosen

locations in Hong Kong. The new flagship store, which was opened in June 2004, will provide a comprehensive range of pre- and after-sales services to customers.

In the coming year, the dealership of Hutchison's 3G services in Hong Kong obtained in early 2004 and the expansion of the "Individual Visit Scheme" to the whole of Guangdong province and other provinces in China will be a positive driver of our distribution and retail chain business.

## **Voice Over Internet Protocol (VOIP) Related Business**

Stage one of the acquisition of 25% shareholding in China Motion Netcom Services Co., Ltd. which currently provides VOIP related services in China has been completed in line with schedule. The total purchase consideration for this stage amounted to HK\$129 million and the corresponding amortisation of goodwill has been included under the item "Share of (losses)/profits of associated companies" in the consolidated profit and loss account.

## **Prospects and Conclusion**

The Group anticipates improvements in the overall business environment in Hong Kong as the government's economic enhancement packages begin to take effect. Furthermore, economic recovery around the rest of the world will likely create a more favourable market environment. Against this backdrop, the Group will persist with its global development strategy.

The Group will continue to expand to overseas markets where there are attractive entry conditions, taking into consideration



the size of the market for China-bound traffic and the availability of appropriate local partners. In the current year, IDD traffic is anticipated to maintain steady growth, however the highly competitive conditions of last year will persist. Further, the Group is considering additional overseas markets such as Australia, and key European and Southeast Asian countries for expansion.

The Group will combine the strengths of its three core businesses for sales and marketing purposes. The international telecommunications and mobile communications services businesses, supported by the distribution and retail chain business, will work in tandem to identify and capture cross-selling opportunities. The directors expect positive developments in MVNO and distribution and retail chain operations. Nonetheless the current year will remain highly challenging.

The work we have done in the year under review has laid a solid foundation for growth in the future. The Group has reason to anticipate narrowing its losses in the current financial year.

#### Financial Position

As at 31 March 2004, the Group's cash and bank balances amounted to approximately HK\$53 million. Total bank borrowings were approximately HK\$126 million of which HK\$124 million is denominated in Hong Kong dollars and HK\$2 million is denominated in United States dollars. The Group's 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.

As at 31 March 2004, the Group had aggregated banking facilities of approximately HK\$91 million (excluding property mortgage loans), of which HK\$64 million was utilised. It is anticipated that the Group's cash and bank balances, 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.

#### Employee and Remuneration Policies

As at 31 March 2004, the Group had 352 full-time staff. Total staff costs (including directors' emoluments) incurred during the year amounted to HK\$122 million. The Group's remuneration policy is in line with prevailing market practice and its employees are remunerated based on performance and experience.

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





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## Corporate Experience

The people, and their expertise, are the fundamentals of a corporation's success. With our advantages of wide-ranging experience in operating telecommunications services, a committed, dynamic management team, and a team of enthusiastic staff, we are dedicated in our endeavours to revolutionise telecommunications services to meet customers' needs.