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SmarTone iN™

MANAGEMENT DISCUSSION AND ANALYSIS

(Financial figures are expressed in Hong Kong dollars)

Review of financial results

SmarTone continued to deliver improved financial performance in 2003/04. The Group achieved a profit attributable to shareholders of $466 million for 2003/04 compared to $378 million for 2002/03. Group's profit increased during the year as contribution from Hong Kong mobile business, Macau operations and the handset business all showed improvements.

The results for 2003/04 incorporated the financial effect from the adoption of Statement of Standard Accounting Practice 12 (revised) "Income taxes" by the Group with effect from 1 July 2003. This has been applied retrospectively with comparative figures presented being restated to conform to the new policy.

Turnover increased by $535 million to $3,367 million (2002/03: $2,832 million) due to both higher mobile services revenue and handsets sales.

- Mobile services revenue increased by $226 million to $2,489 million (2002/03: $2,263 million). Higher revenues from roaming, multimedia services, prepaid and the Macau operations were partially offset by lower local voice revenue.

  Hong Kong blended ARPU for 2003/04 was $188 (2002/03: $183). This increase reflected the improvement in customer quality. Postpaid ARPU dropped by a modest 1% to $211 (2002/03: $213). Lower postpaid airtime revenue resulting from a general market downtrend of local tariffs was largely offset by the recovery of roaming revenue from the SARS epidemic and the continuous growth of multimedia services revenue. However, this year on year comparison masked a rebound in postpaid ARPU to $216 in the second half from $207 in the first half.

- Handsets and accessories sales increased by $322 million to $878 million (2002/03: $556 million). There was a substantial increase in handsets sold due to the launch of more new handset models with advanced features such as high resolution colour screen; high pixel integrated camera with digital zoom and flash; enhanced video recording, audio and multimedia messaging capabilities; and increased internal dynamic memory with support for expandable storage. GX22 was launched in September 2003 and GX32, the best GSM CameraPhone in the market, was launched in March 2004. Both models received overwhelming response from customers.

Cost of goods sold and services provided increased by $385 million to $1,259 million (2002/03: $874 million) due to higher costs of handsets sold and higher interconnection and IDD costs. This reflected the corresponding increases in handset sales, voice traffic and multimedia services revenues.

Other operating expenses (excluding depreciation and loss on disposal of fixed assets) dropped by $17 million to $1,188 million (2002/03: $1,205 million). Nearly all categories of expenses were lower due to improvements in operational efficiency through process rationalisation and productivity enhancement. The decline in operating expenses was achieved notwithstanding the Group's commitments in bringing the best service quality, network performance and customer experience to the market.

The business achieved earnings before interest, tax, depreciation and amortisation ("EBITDA") for 2003/04 of $919 million (2002/03: $753 million). EBITDA for the second half of 2003/04 was $471 million compared to $448 million for the first half. EBITDA includes all customer acquisition costs and handset subsidy amortisation.

Net finance income dropped by $13 million to $59 million (2002/03: $72 million) due to lower average net cash and debt securities balances and lower deposit interest rates.

The financial performance of the Group's mobile business in Macau continued to improve and it was profitable throughout 2003/04.

Capital structure, liquidity and financial resources

The Group's capital structure changed during the year 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

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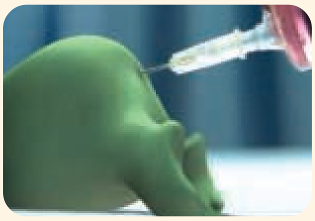
the special cash dividend, several short term Hong Kong dollar floating rate revolving credit facilities totalling $600 million were arranged. Of these facilities, $150 million was utilised at 30 June 2004.

The Group had a net cash inflow from operating activities of $801 million in 2003/04 as compared to $844 million in 2002/03. This drop was mainly caused by higher working capital requirements for trade receivables and handset inventories at 30 June 2004 compared to 30 June 2003. Requirements for these working capitals fell at 30 June 2003 due to the adverse business impact caused by the SARS epidemic in the second half of 2002/03. Cash resources of the Group, however, remain strong with cash and bank balances and investments in held-to-maturity debt securities, net of external borrowings, of $2,073 million as at 30 June 2004.

Capital expenditure of the Group amounted to $680 million in 2003/04 as compared to $366 million in 2002/03. Majority of the capital expenditure was for 3G network rollout, 2G network upgrade and expansion to further improve network quality and coverage, and purchases of hardware and software for multimedia services provisioning. These items are expected to continue to be the major areas of the Group's capital expenditure in 2004/05.



The directors are of the opinion that the Group can fund its capital expenditure and working capital requirements for 2004/05 with internal cash resources and committed borrowing facilities. The directors do not anticipate any difficulties in securing renewals of these committed borrowing facilities upon their expiry in November 2004.

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 as 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 totalling $600 million during the year.

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 collateralise such instruments by cash deposits to lower their issuance costs. Total amount of pledged deposits at 30 June 2004 was $326 million (30 June 2003: $392 million).

Functional currency and foreign exchange exposure

The functional currency of the Group is Hong Kong dollar. All material revenue, expenses, assets and liabilities, except its United States dollar bank deposits and debt securities, 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 bank deposits and investments in debt securities. The Group does not undertake any foreign currency hedge.

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 30 June 2004 under these performance bonds was $152 million (30 June 2003: $202 million). All performance bonds were fully cash collateralised using surplus cash deposits.

Lease out, lease back arrangement

A bank, on the Group's behalf, has issued a letter of credit to guarantee the Group's obligations under a lease out lease back arrangement entered into during 1998/99. This letter of credit is fully cash collateralised using surplus cash deposits. The directors are of the opinion that the risk of the Group being required to make payment under this guarantee is remote.

Employees and share option scheme

The Group had a total of 1,351 full-time employees at 30 June 2004, majority of which are in Hong Kong. Total staff costs were $359 million in 2003/04 as compared to $360 million in 2002/03.

Employees 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 retirement schemes and medical and dental care insurance. Employees 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 year, the Company issued a total of 9,457,000 share options which are exercisable at an exercise price of $9.00 per share from 5 February 2005 to 4 February 2014.

Through a focused set of initiatives in the areas of human resources development and reward programmes, the Group is striving to build a strong, committed and engaged workforce. The prevailing pay-for-performance culture is able to incentivise and reward employee with outstanding performance, which can lead to a long-term enhancement of the overall calibre of the employees of the Group.