# Management Discussion and Analysis

## Overview

*The following discussion should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in the annual report. Our consolidated financial statements have been prepared in accordance with Hong Kong GAAP, which differs in some material respects from US GAAP. For a discussion of these differences and a reconciliation of net (loss) profit attributable to shareholders and shareholders' (deficits) equity to US GAAP, see "Information for US Investors" section.*

We had total turnover of HK$14,960 million in 2004, representing an increase of 48.1% from total turnover of HK$10,104 million in 2003. The increase was mainly due to strong growth in turnover from our India and Thailand mobile operations resulting from strong growth in our customer base together with consolidation for the first time of the results of Vanda Systems & Communications Holdings Limited ("Vanda") (since renamed Hutchison Global Communications Holdings Limited ("HGCH")), in which we acquired a majority interest in March 2004. In particular, turnover from our India operations increased by 57.7% from HK$4,497 million in 2003 to HK$7,093 million in 2004.

Our total operating profit increased by 113.9% to HK$1,859 million in 2004 from HK$869 million in 2003. This increase was primarily attributable to a one-time gain of HK$1,300 million generated from the placement of shares in HGCH, as described below. Excluding the one-time gain, our operating profit declined by 35.7% to HK$559 million because operating expenses increased by 54.2% as described below. These increased operating expenses were offset in part by increases in operating profit from our India operations and Partner Communications Company Ltd ("Partner"), our mobile telecommunications operator in Israel in which we hold an approximately 43% interest, and a reduced operating loss from our Thailand operations. Our operating profit margin, excluding associated companies, increased from 2.8% in 2003 to 7.4% in 2004.

Our operating expenses increased by 54.2% from HK$9,826 million in 2003 to HK$15,154 million in 2004. The increase was primarily attributable to expenditures associated with higher levels of activity in our business, as well as the consolidation of Vanda's operating expenses into our consolidated results for the first time, charges in relation to certain restructuring activities and impairments that took place in 2004, the inclusion of several start up operations in 2004, increased depreciation and amortisation due to the commercial launch of 3G operations in Hong Kong and a full year's depreciation from Thailand operations which we launched in February 2003. Excluding charges relating to restructuring activities and impairments, operating expenses grew approximately in line with the increase in turnover that we experienced during the same period.

## Basis of Preparation of Financial Statements

We were formed in March 2004 in preparation for a restructuring by Hutchison Whampoa during the third quarter of 2004. In connection with the restructuring, Hutchison Whampoa and a number of its affiliates transferred to us their holdings in certain mobile and fixed-line telecommunications businesses. We also issued additional ordinary shares as a part of the restructuring to capitalise substantially all of the outstanding loans from the Hutchison Whampoa group, net of receivables from such companies, in the aggregate amount of HK$20,869 million.

The restructuring has been accounted for as a reorganisation of businesses under common control, in a manner similar to a pooling of interests. Our consolidated financial statements have been prepared as if our Company and the structure of our ownership of our subsidiaries had been in existence at all dates and during all years presented, and include the accounts of the direct and indirect subsidiaries and the interests and investments in associated companies and jointly controlled entities contributed to us by the Hutchison Whampoa group in connection with the restructuring. The results of operations of subsidiaries, associated companies and jointly controlled entities acquired or disposed of during a year are included in our consolidated financial statements commencing from the effective dates of their acquisition or up to the effective dates of their disposal, as the case may be. See Note 2 to our accounts.

We group our subsidiaries into the following five business segments for financial reporting purposes, based on their geographic area of operation and principal business line:

- Hong Kong mobile;
- Hong Kong fixed-line;
- India;
- Thailand; and
- Others.

The results of operations of our Macau mobile business are aggregated with our Hong Kong mobile business because our Macau mobile operating company is a subsidiary of our Hong Kong mobile operating company, shares the same management and is significantly smaller, in terms of financial results and customer numbers.

In March 2004, Vanda acquired 100% of our fixed-line and data centre businesses, and was renamed HGCH. Our stake in HGCH increased to 78.9% of the enlarged share capital of HGCH. As of March 2004, HGCH was accounted for as our consolidated subsidiary. Previously, we held only a 37.1% interest in Vanda and accounted for its results using the equity accounting method. Subsequently, following a placement of our shares in HGCH, our stake in HGCH decreased to 52.5% and we recognised a one-time gain of HK$1,300 million.

Others comprise Sri Lanka, Paraguay, Ghana and Corporate Office.

Partner is currently accounted for as an associated company using the equity accounting method. In February 2005, Partner accepted an offer from some of its founding Israeli shareholders to buy back a minimum of approximately 17.2% of its total outstanding ordinary shares. If the offer is approved by Partner's shareholders and all other conditions satisfied, our interest in Partner would increase to in excess of 50%. If the purchase is completed in 2005, then by virtue of our majority ownership we would thereafter consolidate Partner as a subsidiary, which would change the presentation of our financial results for 2005 and thereafter.

In 2004, the Group made the decision to early adopt Hong Kong Financial Reporting Standards 3, Hong Kong Accounting Standards 36 and 38 in respect of business combinations, impairment of assets and intangible assets, which makes our financial statements more in line with International Financial Reporting Standards. In our interpretation of these standards there is an impact on our 2004 results, which is explained further in our Critical Accounting Policies and Note 3 to the accounts.

The following table presents, for the years indicated, the amounts and percentages of turnover of the major line items in our consolidated profit and loss account:

| | Year ended 31 December | | | |
|---|---|---|---|---|
| | 2003 | | **2004** | |
| | (HK$ millions, except percentages) | | | |
| Turnover | $10,104 | 100.0% | **$14,960** | **100.0 %** |
| Operating expenses | | | | |
| Cost of inventories sold | 547 | 5.4% | **1,400** | **9.4 %** |
| Staff costs | 1,081 | 10.7% | **1,597** | **10.7 %** |
| Depreciation and amortisation | 2,262 | 22.4% | **3,059** | **20.4 %** |
| Other operating expenses | 5,936 | 58.7% | **9,098** | **60.8 %** |
| Profit on partial disposal of a subsidiary company | – | – | **1,300** | **8.7 %** |
| Operating profit of the Company and subsidiary companies | 278 | 2.8% | **1,106** | **7.4 %** |
| Share of profits less losses of associated companies | 591 | 5.8% | **753** | **5.0 %** |
| Operating profit | 869 | 8.6% | **1,859** | **12.4 %** |
| Interest and other finance costs, including share of associated companies, net | 970 | 9.6% | **1,054** | **7.0 %** |
| (Loss) profit before taxation | (101) | (1.0)% | **805** | **5.4 %** |
| Current taxation charge | 22 | 0.2% | **105** | **0.7 %** |
| Deferred taxation (credit) charge | (195) | (1.9)% | **384** | **2.6 %** |
| Profit after taxation | 72 | 0.7% | **316** | **2.1 %** |
| Minority interests | 286 | 2.8% | **244** | **1.6 %** |
| Net (loss) profit attributable to shareholders | $(214) | (2.1)% | **$72** | **0.5 %** |

## Group results

***Turnover***

Our turnover increased by 48.1% from HK$10,104 million in 2003 to HK$14,960 million in 2004. The increase was mainly due to strong growth in our mobile customer base, which increased from approximately 8.5 million as of 31 December 2003 to approximately 12.6 million as of 31 December 2004. All of our operating companies reported an increase in turnover in 2004 with particularly strong growth in India. Our India operations accounted for 47.4% of our total turnover in 2004, compared to 44.5% in 2003. As our Thai operations moved into their first full year of operations, the percentage of our total turnover derived from them rose from 3.5% in 2003 to 8.1% in 2004. Our Hong Kong fixed-line operations, after the consolidation of Vanda's results for the first time, accounted for 18.1% of our turnover in 2004, compared to 16.1% in 2003. Turnover from our Hong Kong mobile operations declined as a percentage of our total turnover from 34.5% in 2003 to 24.8% in 2004.

Turnover from mobile services accounted for 79.3% of total turnover while turnover from fixed line and other services accounted for 18.1%. Telecommunication products, which are principally handsets and accessory sales, represented 2.6% of total turnover.

### *Operating profit*

Our operating profit increased from HK$869 million in 2003 to HK$1,859 million in 2004. The increase was due primarily to a one-time gain of HK$1,300 million. Excluding the one-time gain, our operating profit declined by 35.7% from HK$869 million in 2003 to HK$559 million in 2004 because operating expenses increased by 54.2% due to a combination of activity related increases, the impact of start up operations and restructuring and impairment charges and offset by the lower amortisation expenses resulting from the net effect of early adoption of HKFRS 3 and HKAS 38 from 1 January 2004 as described below. These increased operating expenses were offset in part by increases in operating profit from our India operations and Partner, and a reduction in operating loss from our Thailand operations. Our operating profit margin, excluding associated companies, increased from 2.8% in 2003 to 7.4% in 2004.

The following table presents, for the years indicated, a breakdown of operating expenses and percentage change from year to year:

| | Year ended 31 December | | |
|---|---|---|---|
| | 2003 | **2004** | % Change |
| | (HK$ millions) | | |
| Cost of inventories sold | $547 | **$1,400** | 155.9% |
| Staff costs | 1,081 | **1,597** | 47.7 |
| Depreciation and amortisation | 2,262 | **3,059** | 35.2 |
| Other operating expenses | 5,936 | **9,098** | 53.3 |
| Operating expenses | $9,826 | **$15,154** | 54.2% |

The rise in operating expenses was primarily attributable to expenditures associated with higher levels of activity in our business. Excluding charges relating to restructuring activities and impairments, operating expenses grew approximately in line with the increase in turnover that we experienced during the same period.

Cost of inventories sold increased by 155.9% from HK$547 million in 2003 to HK$1,400 million in 2004, mainly due to the consolidation of Vanda into our Hong Kong fixed-line and other operations for the first time. Vanda had cost of inventories of HK$597 million for 2004, whereas our Hong Kong fixed-line and other operations had no cost of inventories sold in 2003. Excluding Vanda, cost of inventories sold increased by 46.8%, reflecting the launch of 3G operations in Hong Kong and the ramp up in operations in Thailand and stayed constant at 5.4% of total turnover in 2003 and 2004.

Staff costs increased by 47.7% from HK$1,081 million in 2003 to HK$1,597 million in 2004, mainly due to increased staff costs resulting from expansion of our business, restructuring costs, as well as the increase related to our initial consolidation of Vanda. As a percentage of total turnover, staff costs remained stable at 10.7% in both 2003 and 2004, reflecting growth in staff in line with growth in total turnover.

Depreciation and amortisation expenses increased by 35.2% from HK$2,262 million in 2003 to HK$3,059 million in 2004. This increase was mainly attributable to the increase in our fixed assets as a result of the network build-out in all of our operations. In addition, the launch of 3G services in Hong Kong in January 2004 resulted in the commencement of depreciation charges and amortisation of customer acquisition costs in 2004. However, because of the early adoption of HKFRS 3 and HKAS 38 from 1 January 2004, goodwill amortisation expenses decreased by HK$540 million in 2004 whereas the amortisation of telecommunication customer acquisition costs increased by HK$260 million in 2004, resulting in a net decrease of HK$280 million in amortisation expenses . Primarily as a result of this decrease, depreciation and amortisation expenses decreased from representing 22.4% of our total turnover in 2003 to 20.4% in 2004.

The following table presents, for the years indicated, a breakdown of other operating expenses:

| | Year ended 31 December | |
|---|---|---|
| | 2003 | **2004** |
| | (HK$ millions) | |
| Costs of services provided | $ 4,195 | **$6,389** |
| General administration and distribution costs | 1,706 | **1,949** |
| Impairment loss on fixed assets | – | **142** |
| Write-off of telecommunications customer acquisition costs | 234 | **150** |
| Costs directly related to construction of network capitalised as fixed assets | (333) | **(531)** |
| Others | 134 | **999** |
| Other operating expenses | $5,936 | **$9,098** |

Other operating expenses increased by 53.3% from HK$5,936 million in 2003 to HK$9,098 million in 2004. The main component of other operating expenses was costs of services provided, comprised of network costs and associated network operating costs, which increased by 52.3% from HK$4,195 million in 2003 to HK$6,389 million in 2004. The increase in costs of services provided was mainly attributable to continued growth in our customer base, which resulted in significant increases in interconnection, roaming and IDD charges. Other contributing factors were the continued build-out of networks, which resulted in increased rental fees for cell sites and leased lines, as well as the consolidation of Aircel Digilink India Limited, which we acquired in August 2003, and the consolidation of Vanda. The increase in other operating expenses was also partly due to the increase in general, administration and distribution costs by 14.2% from HK$1,706 million in 2003 to HK$1,949 million in 2004. Another factor contributing to the increase in other operating expenses was certain costs in respect of restructuring that took place in 2004, including a charge of HK$142 million in respect of an impairment loss on telecommunication and network equipment. The write-off of telecommunications customer acquisition costs arises as a consequence of our policy of capitalising customer acquisition costs for postpaid customers joining our 3G network in Hong Kong and our CDMA2000 1X network in Thailand. The customer acquisition cost capitalised is amortised over the contract life under HKAS 38. Where a customer leaves the network before the end of the contract life, the unamortised balance of that customer acquisition costs is immediately expensed. In 2004 there was a charge of HK$150 million in respect of such charges (2003 - HK$234 million).

### *Share of profits less losses of associated companies*

This item reflects our share, under the equity method of accounting, of the profits net of losses of our associated companies, being principally Partner. In 2004, our share of profits less losses of associated companies increased by 27.4% to HK$753 million from HK$591 million in 2003. This increase principally reflected an increase in the operating profit of Partner, which was primarily due to customer growth in Partner's operations in Israel.

***Interest and other finance costs, including share of associated companies, net***

Interest and other finance costs, net, principally consists of interest and other finance costs relating to our debt, net of interest income received from bank deposits, as well as our share of the interest and other finance costs of our associated companies, including Partner. Interest and other finance costs, net, increased by 8.7% from HK$970 million in 2003 to HK$1,054 million in 2004, primarily due to higher levels of debt used to finance the expansion of our operations. HK$178 million related to interest paid on loans from the Hutchison Whampoa group, which were subsequently capitalised as part of the restructuring.

***(Loss) profit before taxation***

We recorded a profit before taxation of HK$805 million in 2004, compared to a loss before taxation of HK$101 million in 2003. Profit before taxation in 2004 included a one-time gain of HK$1,300 million. Excluding this one-time gain, we would have recorded a loss before taxation in 2004 of HK$495 million.

***Current and deferred taxation charges (credits)***

We recorded a net taxation charge of HK$489 million in 2004, compared to a net taxation credit of HK$173 million in 2003. Of these amounts, HK$105 million and HK$22 million were attributable to current taxation for 2004 and 2003, respectively. The current taxation charges for both years were due principally to the application of tax loss carry-forward rules in India.

We recorded a net deferred taxation charge of HK$384 million in 2004, compared to a net deferred taxation credit of HK$195 million in 2003. The net deferred taxation charge related to each of our India and Hong Kong mobile operations as well as Partner, where we had historical losses and applied our carry-forward losses to our tax positions as offsets.

***Net (loss) profit attributable to shareholders***

As a result of the foregoing, we recorded a profit after taxation of HK$316 million in 2004, compared to a profit after taxation of HK$72 million in 2003.

We recorded a profit attributable to shareholders of HK$72 million in 2004, compared to a loss attributable to shareholders of HK$214 million in 2003. Excluding the one-time gain of HK$1,300 million, we would have recorded a net loss attributable to shareholders of HK$1,228 million in 2004.

## Results of our operating companies

***Turnover***

The following table presents, for the years indicated, a breakdown of turnover by our five business segments and the percentage of total turnover accounted for by each segment:

| | Year ended 31 December | | | |
|---|---|---|---|---|
| | 2003 | | **2004** | |
| | (HK$ millions, except percentages) | | | |
| Hong Kong mobile | $3,485 | 34.5% | $3,714 | 24.8% |
| Hong Kong fixed-line | 1,628 | 16.1 | 2,701 | 18.1 |
| India | 4,497 | 44.5 | 7,093 | 47.4 |
| Thailand | 355 | 3.5 | 1,219 | 8.1 |
| Others | 139 | 1.4 | 233 | 1.6 |
| Turnover | $10,104 | 100.0% | $14,960 | 100.0% |

- ***Hong Kong mobile operations.*** Our Hong Kong mobile operations accounted for 24.8% of our total turnover in 2004, compared to 34.5% in 2003. Turnover increased by 6.6% from HK$3,485 million in 2003 to HK$3,714 million in 2004. Our customer base grew 12.2% from approximately 2.0 million as of 31 December 2003 to approximately 2.2 million as of 31 December 2004, but the increase in customers resulted largely from 3G customers who joined the network towards the end of 2004. The addition of the new 3G customers and the higher tariff associated with 3G services helped to partly offset reductions that we made to tariffs for 2G service in response to the ongoing pressure of discounts offered by our competitors throughout the year. In addition, turnover was lower in 2003 as our business suffered from the effects of the outbreak in Hong Kong of severe acute respiratory syndrome (SARS), which led to temporarily lower roaming turnover as visits to and outside Hong Kong by business and leisure travelers decreased during that period.

- ***Hong Kong fixed-line operations.*** Our Hong Kong fixed-line operations accounted for 18.1% of our total turnover in 2004, compared to 16.1% in 2003. Turnover from our Hong Kong fixed-line operations increased by 65.9% from HK$1,628 million in 2003 to HK$2,701 million in 2004. This increase was primarily due to the first time consolidation of the results of Vanda, in which we acquired a majority interest in March 2004. In addition, we achieved increased turnover from our international and local bandwidth, local and international voice and residential broadband services.

- ***India operations.*** Our India operations accounted for 47.4% of our total turnover in 2004, compared to 44.5% in 2003. Turnover from our India operations increased by 57.7% from HK$4,497 million in 2003 to HK$7,093 million in 2004, primarily due to an increase in the total number of customers from approximately 4.1 million in 2003 to approximately 7.2 million in 2004. Turnover growth was also supported by an increase in the percentage of postpaid customers from 22.1% of total customers in India at the end of 2003 to 29.8% at the end of 2004. Average revenue per user for postpaid subscribers is significantly higher than for prepaid customers.

- ***Thailand operations.*** Our Thailand operations accounted for 8.1% of our turnover in 2004, compared to 3.5% in 2003. Turnover from our Thailand operations increased by 243.4% from HK$355 million in 2003 to HK$1,219 million in 2004, which was attributable to a significant increase in our customer base and to receiving turnover for 12 months in 2004 compared to only 10 months in 2003. We began marketing *Hutch* brand mobile telecommunications services in Thailand in February 2003. As of 31 December 2004, the *Hutch* brand service had approximately 615,000 subscribers, compared to approximately 224,000 as of 31 December 2003, representing an increase of 174.6%.

- ***Other operations.*** Turnover from other operations consisted of turnover from our mobile telecommunications operators in Sri Lanka, Paraguay and Ghana. These operations collectively accounted for 1.6% of our turnover in 2004, compared to 1.4% in 2003. Turnover from other operations increased by 67.6% from HK$139 million in 2003 to HK$233 million in 2004. This increase was primarily due to an increase in the number of customers in Sri Lanka and Paraguay.

## *Operating profit*

The following table presents, for the years indicated, a breakdown of operating profit by our five business segments, as well as profit on partial disposal of a subsidiary company and share of profits less losses of associated companies, and the percentage of total operating profit accounted for by each segment or line item:

| | Year ended 31 December | | | |
|---|---|---|---|---|
| | 2003 | | **2004** | |
| | (HK$ millions, except percentages) | | | |
| Hong Kong mobile | $606 | 69.7% | **$(534)** | **(28.7)%** |
| Hong Kong fixed-line | 230 | 26.5 | **218** | **11.7** |
| India | 670 | 77.1 | **1,344** | **72.3** |
| Thailand | (1,113) | (128.1) | **(1,071)** | **(57.6)** |
| Others | (115) | (13.2) | **(151)** | **(8.1)** |
| Profit on partial disposal of a subsidiary company | – | – | **1,300** | **69.9** |
| Subtotal | 278 | 32.0 | **1,106** | **59.5** |
| Share of profits less losses of associated companies | 591 | 68.0 | **753** | **40.5** |
| Operating profit | $869 | 100.0% | **$1,859** | **100.0%** |

The following table presents, for the years indicated, a breakdown of operating expenses by our five business segments and the percentage of operating expenses accounted for by each segment:

| | Year ended 31 December | | | |
|---|---|---|---|---|
| | 2003 | | **2004** | |
| | (HK$ millions, except percentages) | | | |
| Hong Kong mobile | $2,879 | 29.3% | **$4,248** | **28.0%** |
| Hong Kong fixed-line | 1,398 | 14.2 | **2,483** | **16.4** |
| India | 3,827 | 39.0 | **5,749** | **38.0** |
| Thailand | 1,468 | 14.9 | **2,290** | **15.1** |
| Others | 254 | 2.6 | **384** | **2.5** |
| Operating expenses | $9,826 | 100.0% | **$15,154** | **100.0%** |

- ***Hong Kong mobile operations.*** Our Hong Kong mobile operations recorded an operating profit of HK$606 million in 2003, which declined to an operating loss of HK$534 million in 2004. The operating profit margin of our Hong Kong mobile operations decreased from a positive margin of 17.4% in 2003 to a negative margin of 14.4% in 2004. These declines were mainly the result of a 47.6% increase in operating expenses, from HK$2,879 million in 2003 to HK$4,248 million in 2004. The increase in operating expense was primarily attributable to the launch of our 3G business in 2004. Hong Kong staff costs increased by 64.5% as a result of the launch of 3G services and the continued growth in 2G services, as well as costs associated with restructuring. Further, in 2004, the Office of the Telecommunications Authority Hong Kong ("OFTA") announced a 3 years moratorium upon expiry of our CDMA licence in 2005, in order for us to migrate our CDMA customers to 2G or 3G networks. In addition, as part of our cost saving initiatives, certain network and information technology services and maintenance were outsourced. As a result of the foregoing, we recorded an impairment loss on telecommunications and network equipment of HK$142 million for the year ended 31 December 2004.

- ***Hong Kong fixed-line operations.*** Our Hong Kong fixed-line operations recorded an operating profit of HK$218 million in 2004 compared to an operating profit of HK$230 million in 2003. The operating profit margin was 8.1% in 2004 compared to 14.1% in 2003. The decline in operating profit and margin was the result of an increase in our operating expenses. Our operating expenses increased by 77.6% from HK$1,398 million in 2003 to HK$2,483 million in 2004. The increase in operating expenses was attributable to increased costs of inventories sold, mainly due to the consolidation of Vanda, which had cost of inventories sold of HK$597 million for 2004, compared to no cost of inventories sold for our fixed-line operations in 2003. Hong Kong fixed-line continued to expand its footprint in 2004, which increased its depreciation and amortisation expenses by 11.2% from HK$437 million in 2003 to HK$486 million in 2004.

- ***India operations.*** Operating profit from our India operations increased by 100.6% from HK$670 million in 2003 to HK$1,344 million in 2004 and the operating profit margin increased from 14.9% in 2003 to 18.9% in 2004. The increases mainly reflected the business growth in our India operations, strong operating performance and lower depreciation and amortisation expenses resulting from a change in accounting policies on goodwill. Operating expenses from our India operations increased by 50.2% from HK$3,827 million in 2003 to HK$5,749 million in 2004. The increase in operating expenses was attributable to the continued growth of our business in India, and therefore increased network and other associated network operating costs and offset by the decrease in amortisation expenses resulting from the early adoption of HKFRS 3 from 1 January 2004. Further, our operating costs increased as a result of our acquisition of Aircel Digilink India Limited in August 2003 and the continued build-out of networks in Chennai, Karnataka, Andhra Pradesh, Rajasthan, Haryana, Uttar Pradesh (East), Punjab, Uttar Pradesh (West) and West Bengal.

- ***Thailand operations.*** Operating loss from our Thailand operations decreased from HK$1,113 million in 2003 to HK$1,071 million in 2004 as the customer base continued to grow, which resulted in an increase in turnover and improvement in operating results. Operating expenses from our Thailand operations increased by 56.0% from HK$1,468 million in 2003 to HK$2,290 million in 2004. The increase in operating expenses was attributable to increased staff costs and depreciation and amortisation expenses, which was in part attributable to incurring full year operating expenses in 2004 compared to 10 months start-up costs in 2003. Our depreciation and amortisation expenses increased by 159.3% from HK$305 million to HK$791 million mainly due to the early adoption of HKAS 38 from 1 January 2004.

- ***Other operations.*** Operating loss from our other operations increased to HK$151 million in 2004 from HK$115 million in 2003 and consisted of operating profit from our operation in Ghana and operating losses from our operations in Sri Lanka and Paraguay as well as operating expenses of our Corporate Office. Operating expenses from our other operations increased by 51.2% from HK$254 million in 2003 to HK$384 million in 2004. Of this amount, other operating expenses increased by 89.9% in 2004, due mainly to the inclusion of our Corporate Office expenses, which was established in March 2004.

## Share of profits less losses of associated companies

Our share of profits less losses of associated companies increased by 27.4% from HK$591 million in 2003 to HK$753 million in 2004. This increase principally reflected an increase in the operating profit of Partner. We own approximately 43% of Partner.

Partner's operating profit for 2004 was NIS1,019 million (equivalent to HK$1,844 million), an increase of 19.2% from NIS855 million (equivalent to HK$1,458 million) in 2003. Partner's turnover increased by 15.1% from NIS4,468 million (equivalent to HK$7,622 million) in 2003 to NIS5,141 million (equivalent to HK$9,305 million) in 2004. This increase was primarily due to increased revenue from services (including data and content) and equipment.

Partner's operating costs increased by 14.1% to NIS4,121 million (equivalent to HK$7,459 million) from NIS3,613 million (equivalent to HK$6,164 million) in 2003. The increase in 2004 as compared to 2003 resulted primarily from the increase in service revenues, as the higher level of service revenues, driven by increased minutes of use, resulted in higher variable costs including inter-carrier termination fees and transmission, and the increased depreciation and amortisation which were recorded since Partner commercially launched its 3G services on 1 December 2004, higher distribution and advertising costs in response to increasing competition and the introduction of Partner's 3G network and a larger provision for doubtful accounts resulting from the increased volume of handset sales, compensation costs under the new stock option plan, and costs incurred in Partner's attempt to purchase a controlling interest in Matav and a write-off of legal and accounting fees incurred in 2001 in preparing Partner's shelf registration with the United States Securities and Exchange Commission.

## Liquidity and Capital Resources

### Capital Requirements

Our liquidity and capital requirements relate principally to the following:

- capital expenditures for the continuing build-out and expansion of our networks in the markets where we operate, including purchases of fixed assets and licences and acquisitions of interests in existing third-party telecommunications companies as well as companies engaged in complementary or related businesses;

- costs and expenses relating to the operation of our businesses, including ongoing costs related to network operations, sales and distribution expenses and customer service; and

- payments of the principal of, and interest on, our debts.

### Capital Expenditure

The following table sets forth our capital expenditure by business segment for the years indicated:

| | **Year ended 31 December** | |
|---|---|---|
| | 2003 | **2004** |
| | (HK$ millions) | |
| Hong Kong mobile | $1,280 | **$557** |
| Hong Kong fixed-line | 1,257 | **717** |
| India | 1,617 | **2,463** |
| Thailand | 1,344 | **876** |
| Others | 48 | **64** |
| Total | $5,546 | **$4,677** |

Capital expenditure in 2004 was 15.7% lower than the 2003 level due to the decrease in capital expenditure of our Hong Kong mobile, Hong Kong fixed-line and Thailand operations, which was partially offset by the increase in capital expenditure of our India operations. The decrease in capital expenditure of our Hong Kong mobile operations mainly reflected the completion of our initial investment in building the basic infrastructure of a territory-wide 3G network. The decrease in capital expenditure in our Hong Kong fixed-line operations was due to the completion of the major infrastructure build-out and lower prices. The decrease in capital expenditure of our Thailand operations was mainly due to the completion of the principal network coverage. On the other hand, the increase in capital expenditure of India operations was driven mainly by our continued investment in extending its operations. During 2004, we launched three new licence areas in Punjab, West Bengal and Uttar Pradesh (West).

Our capital expenditure is expected to be at similar levels in 2005 assuming no significant new licences or operating areas. We expect that our principal capital expenditure requirements for 2005 will include the following:

- continued build-out of the 2G mobile telecommunications network in India, accounting for approximately 60% of our estimated capital expenditures in 2005;

- maintenance and capacity expansion for CDMA2000 1X mobile telecommunications network in Thailand, accounting for approximately 5% of our estimated capital expenditures in 2005;

- maintenance and capacity expansion for 3G mobile telecommunications network in Hong Kong, accounting for approximately 5% to 10% of our estimated capital expenditures in 2005; and

- continued build-out of our fixed-line business for capacity and access connections, accounting for approximately 10% to 15% of our estimated capital expenditures in 2005.

## Outstanding Debt

The following table presents our outstanding bank loans and other interest-bearing borrowings and debentures as of 31 December 2003 and 2004:

| | **Total debt** As of 31 December (HK$ millions) 2003 | **2004** |
|---|---|---|
| Bank loans-current portion | $3,723 | **$12,281** |
| Other loans-current portion | 1,556 | **1,316** |
| Debentures-current portion | 204 | **247** |
| Long-term loans | 7,485 | **3,582** |
| Total debt [(1) (2)] | $12,968 | **$17,426** |

(1) Excluding the net long-term amount due to related companies of HK$22,360 million as at 31 December 2003. In connection with our recent restructuring, we issued shares to capitalise outstanding loans from Hutchison Whampoa group companies in the net aggregate amount of HK$20,869 million in September 2004.

(2) Excluding the HK$4 million interest-bearing loan from minority shareholders of one of our operating companies as at 31 December 2003 and 2004. The loan does not have fixed repayment terms and is payable on demand.

## Management Discussion and Analysis

We have financed our network build-out and operating costs mainly through loans from commercial banks. As of 31 December 2003 and 2004, the ratio of our total debt to total assets was approximately 36% and 44%, respectively.

| | Fixed / Floating Interest Rate | Maturity Date | Currency | Committed Facility | Current Portion | Long-term Portion | Total |
|---|---|---|---|---|---|---|---|
| | | | | HK$ millions | HK$ millions | HK$ millions | HK$ millions |
| Hong Kong Mobile | Floating | Dec 05 | HKD | $6,000 | $4,110 | $ – | $4,110 |
| Hong Kong Fixed-line | Fixed | Apr 05 – Dec 06 | RMB | $16 | $16 | $ – | $16 |
| | Fixed | Dec 05 | SGD | 88 | 27 | – | 27 |
| | Fixed | Dec 05 | MR | 60 | 11 | – | 11 |
| | Fixed | Continuing Limit | PHP | 13 | – | – | – |
| | Fixed | Nov 07 – Jan 14 | HKD | 17 | 1 | 13 | 14 |
| | Floating | Mar 05 – Apr 05 | USD | 128 | 49 | – | 49 |
| | Floating | Dec 05 – Mar 09 | HKD | 100 | 54 | 17 | 71 |
| India | Fixed | Feb 05 – Aug 06 | INR | $320 | $318 | $2 | $320 |
| | Floating | Mar 05 – Oct 06 | INR | 6,236 | 4,075 | 650 | 4,725 |
| Thailand | Fixed | Jul 05 | THB | $439 | $439 | $ – | $439 |
| | Floating | Jan 05 – Jan 07 | THB | 3,410 | 800 | 1,291 | 2,091 |
| | Floating | Oct 05 – Jan 07 | JPY | 5,079 | 2,903 | 1,423 | 4,326 |
| | Floating | Mar 10 | USD | 273 | 41 | 186 | 227 |
| Corporate | Floating | Nov 05 | HKD | $8,000 | $1,000 | $ – | $1,000 |
| Total | | | | $30,179 | $13,844 | $3,582 | $17,426 |

The increase in borrowings of our Hong Kong mobile operations in 2004 was mainly due to network expansion and customer acquisition costs of the 3G network.

The increase in borrowings of our Hong Kong fixed-line operations in 2004 was mainly for fixed assets acquisition and working capital funding.

The additional borrowings of our India operations in 2004 were mainly to finance the new service areas and expansion of their networks.

Increased borrowings of our Thailand operations in 2004 were to finance the initial operating stage of the business.

The following table presents our outstanding bank loans and other interest-bearing third-party borrowings and debentures as of 31 December 2004 by business segment, as well as information regarding maturities and interest and other finance costs in 2004 in respect of such debt:

| | Maturity | | | Year ended 31 December 2004 |
|---|---|---|---|---|
| | **Short-term** | **Long-term** | **Total debt** | **Interest and other finance costs** |
| | | (HK$ millions) | | |
| Hong Kong mobile | $4,110 | $ – | $4,110 | $64 |
| Hong Kong fixed-line | 158 | 30 | 188 | 5 |
| India | 4,393 | 652 | 5,045 | 325 |
| Thailand | 4,183 | 2,900 | 7,083 | 175 |
| Corporate | 1,000 | – | 1,000 | 14 |
| Total | $13,844 | $3,582 | $17,426 | $583 |

As of 31 December 2004, bank loans and other interest-bearing third-party borrowings by our subsidiaries amounted to HK$17,426 million, excluding our minority shareholder loan of HK$4 million. Of the total borrowings as of such date, 79.4% was repayable within one year, 17.5% was repayable between one to two years, 2.9% was repayable between two to five years and 0.2% was repayable after five years. In 2004, the weighted average interest rate of our borrowings was 1.1% for our Hong Kong mobile operations, 3.1% for our Hong Kong fixed-line operations, 6.9% for our India operations and 3.1% for our Thailand operations.

As of 31 December 2004, fixed assets and current assets of our subsidiary companies amounting to HK$5,236 million and HK$95 million, respectively, were used as collateral for certain of the borrowings. The current portion of our bank and other loans and debentures is secured to the extent of HK$3,830 million. The long-term portion of our bank and other loans and debentures is secured to the extent of HK$1 million.

In May 2004, HTIL's Corporate Office entered into a HK$8,000 million secured revolving credit facility with ABN AMRO Bank N.V.. This facility was amended in August 2004 and is secured by way of a fixed and floating debenture over our shares in, and guarantees from, various intermediate holding companies of our Group's operations and charges over the entire issued share capital of those guarantors and a charge over at least 52.6% of the issued share capital of HGCH. The facility, which is intended to provide funds for working capital purposes, if needed, will mature on 15 November 2005, the date that is 13 months after the effective date of our listing on the Hong Kong Stock Exchange.

Our Company, our subsidiaries and Partner are subject to various financial and operating covenants under their loan agreements and debt instruments. Among other things, these covenants restrict the ability to pledge their assets, to effect a merger or sale of all or substantially all of their assets, and to pay dividends under certain circumstances. A number of the loan agreements and/or debt instruments are subject to either acceleration or repurchase at the holder's option upon a change of control of the relevant entity.

As of 31 December 2004, HK$11,224 million of our outstanding debt was guaranteed by Hutchison Whampoa group companies. Under the terms of a credit support agreement with Hutchison Whampoa, we will pay guarantee fees charged at normal commercial rates and will provide counter-indemnities in favour of the Hutchison Whampoa group in respect of guarantees, indemnities and security provided by Hutchison Whampoa and its group companies for so long as there remains a guarantee liability. In 2004, we paid a guarantee fee of HK$152 million, compared to HK$126 million in 2003.

None of such guarantees were prematurely released upon listing of our Company's shares on the Hong Kong Stock Exchange and New York Stock Exchange in October 2004. Except as described below, if guarantees, indemnities and security are required to be given in support of debts of subsidiaries or associated companies, we expect that we, rather than Hutchison Whampoa or its group companies, will provide those guarantees, indemnities and security. Although our funding costs may increase as a result of the future replacement of such guarantees, indemnities and security, we do not believe that the increase in our funding costs will be significant.

## Contractual Obligations

The following table sets forth selected information regarding our contractual obligations to make future payments as of 31 December 2004:

| Contractual obligations | Total | Payments due within 1 year | 1 - 5 years | After 5 years |
|---|---|---|---|---|
| | | (HK$ millions) | | |
| Purchase obligations | $2,259 | $2,203 | $56 | $– |
| Operating lease obligations | 1,713 | 544 | 571 | 598 |
| Loans[1] | 17,426 | 13,844 | 3,554 | 28 |
| Payment for the right to use spectrum | 1,157 | 50 | 261 | 846 |
| Total contractual obligations | $22,555 | $16,641 | $4,442 | $1,472 |

(1) Including bank loans and other interest-bearing third-party borrowings. Excluding the HK$4 million interest-bearing loan from minority shareholders of one of our operating companies.

## Capital Resources

We have traditionally met our working capital and other capital requirements principally from cash flow from our operating activities, borrowings by our subsidiaries from banks based on guarantees and/or pledges provided by Hutchison Whampoa and its affiliates.

As of 31 December 2004, we had net current liabilities of HK$14,266 million comprising a current portion of bank loans and other loans equal to HK$13,844 million and other net current liabilities of HK$422 million. As of 31 December 2003, we had net current liabilities of HK$6,250 million, comprising a current portion of bank loans and other loans equal to HK$5,483 million and other net current liabilities of HK$767 million. The increase in net current liabilities in 2004 compared to 2003 was attributable to an increase in short-term borrowings of HK$8,361 million, mainly due to the shortening of the maturity of a number of bank loans together with an increase in short-term borrowings by our Company and our Hong Kong mobile, India and Thailand operations, which was offset slightly by a decrease of HK$345 million in other net current liabilities. The increase in our short-term borrowings of HK$1,000 million was due to the draw down under a bank facility maturing in 2005 to finance our subsidiaries' operations. See Note 19 to our accounts.

Our net cash inflows from operating activities in 2004 amounted to HK$2,244 million, compared to HK$1,004 million in 2003. The increase in net cash inflows from operating activities was mainly due to a working capital outflow of HK$1,055 million in 2003, compared to a working capital inflow of HK$35 million in 2004. The working capital inflow in 2004 consisted primarily of an increase in trade and other payables of HK$1,063 million, a decrease in inventories, consisting mainly of handsets, of HK$143 million, which was offset by a corresponding increase in debtors and prepayments of HK$1,081 million, mainly reflecting the increase in receivables from our increased customer base. In comparison, the working capital outflow in 2003 consisted primarily of an increase in amounts due from debtors and prepayments of HK$755 million and an increase in inventories, consisting mainly of handsets, of HK$570 million. Our trade receivables increased from HK$895 million in 2003 to HK$1,719 million as of 31 December 2004. The increase was primarily due to increases in turnover resulting from growth in our customer base. The average collection time for our trade receivables was 42 days in 2004, compared to 32 days in 2003. The increase in the average collection time in 2004 was mainly due to the consolidation of Vanda into our Hong Kong fixed-line and other operations, which typically has a longer collection period than our mobile operations.

Our net cash outflows from investing activities amounted to HK$4,420 million in 2004, compared to HK$6,482 million in 2003. In 2004, we had a profit on disposal of partial interest related to the placement of HGCH, which accounted for HK$1,578 million inflow of our cash flows from investing activities. The net cash outflows from investing activities consisted mainly of capital expenditures on 2G, 3G and fixed-line network build-out. The decrease was partially due to a decrease in purchase of fixed assets from HK$5,573 million in 2003 to HK$5,138 million in 2004.

Our net cash inflows from financing activities amounted to HK$2,285 million and HK$4,612 million in 2004 and 2003, respectively. These amounts mainly reflected a net increase in loans in the amount of HK$3,802 million and HK$4,026 million in 2004 and 2003, respectively, primarily to fund network build-out and operations by our operating companies.

## Off-Balance Sheet Arrangements

In addition to the contractual obligations discussed above, we have commitments that could require us to make material payments in the future. These commitments are not included in our consolidated balance sheet as of 31 December 2003 and 31 December 2004.

As of 31 December 2004, we had total contingent liabilities and commitments of HK$5,850 million including HK$2,259 million in respect of purchase obligations, HK$1,713 million in respect of operating lease obligations, HK$564 million in respect of performance guarantees, HK$157 million in respect of claims made against us relating to certain sales taxes and HK$1,157 million in respect of payment for the right to use spectrum. See Notes 26 and 27 to our accounts.

In addition, under the current shareholder arrangements with respect to the India entities through which we hold our business interests in India, we have put/call options in place, which, if exercised by the relevant counter party, could require us to make material payments to purchase additional interests in these India entities. Pursuant to the relevant shareholders' arrangements, the exercise prices of these options will be at fair market value as determined by agreements between us and the India shareholders of the relevant holding entity or, failing such agreements, by an investment bank.

Similarly, under the current shareholders' agreements with respect to the entities through which we hold our business interests in our operating companies in Thailand, we have put/call options in place, which, if exercised by the relevant counter party, could require us to purchase additional interests in these holding entities. Pursuant to the relevant shareholders' agreements, the exercise prices of these options are the historical costs of acquisition of the shares subject to such options.

We are required under the relevant shareholders' agreements relating to our interests in the Thai operating companies to provide funding for operating expenses and capital expenditures of the operating companies or the intermediary holding companies through which we hold our interests in these operating companies. To date, we have met these funding obligations primarily through procuring guarantees for third-party loans to these companies, but we may in the future fund these operating expenses and capital expenditures directly.

## Market Risk Hedging and Derivatives

We are exposed to market risk from changes in interest rates and currency exchange rates. Interest rate risk exists principally with respect to our net financial liabilities bearing interest at floating rates. Interest rate risk also exists with respect to the fair value of fixed-rate financial assets and liabilities. Exchange rate risk exists with respect to our financial assets and liabilities denominated in currencies other than Hong Kong dollars. We are also subject to exchange rate risks with respect to our operations and investments outside Hong Kong.

As of 31 December 2003, 28.6% of our borrowings were denominated in Hong Kong dollars, 27.2% in India Rupees, 19.3% in Thai Baht, 17.6% in Japanese Yen and 7.3% in U.S. dollars. As of 31 December 2004, 29.8% of our borrowings were denominated in Hong Kong dollars, 28.9% in India Rupees, 14.5% in Thai Baht, 24.8% in Japanese Yen, 1.6% in U.S. dollars and 0.4% in other currencies.

We regularly assess our interest rate and currency exchange exposures and determine whether to adjust or hedge our position. We may use derivative instruments to hedge or adjust our exposures. For example, during 2004, our Thailand operations entered into currency swap arrangements with banks to hedge against the exchange risk in relation to their Japanese Yen and U.S. dollar denominated borrowings. Similarly, India operations entered into a currency and interest rate swap arrangement with a bank to swap its floating rate U.S. dollar denominated borrowings into fixed rate India Rupee borrowings in order to hedge its currency and interest rate exposure. See Note 19 to our accounts. We have used, and intend to continue to use, derivative financial instruments only for hedging purposes and not for speculative purposes. Since most of our borrowings are in the same currencies as those used by the underlying operations, we believe that any potential depreciation of our operating currencies will not have a material adverse effect on our financial condition and results of operations.

Our financial assets and liabilities as of 31 December 2003 and 31 December 2004 consisted mainly of non-derivative assets and liabilities, which were presented at their fair values. The fair values of our fixed-rate and floating-rate borrowings approximate their fair values since they bear interest at rates close to the prevailing market rates.

The following tables summarise the carrying amounts, fair values, principal cash flows by maturity date and weighted average interest rates of our short-term and long-term liabilities as of 31 December 2004 that are sensitive to exchange rates or interest rates. Data presented below includes bank loans and other third-party borrowings.

| | 31 December 2004 Maturities | | | | | | 31 December 2004 | |
|---|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | Thereafter | Total | Fair Value |
| | (HK$ millions except rates) | | | | | | | |
| Local currency: | | | | | | | | |
| Fixed rate | $1 | $1 | $1 | $2 | $2 | $7 | $14 | $14 |
| Average weighted rate[1] | 7.50% | 7.50% | 7.50% | 7.50% | 7.50% | 7.50% | 7.50% | 7.50% |
| Variable rate | $5,164 | – | – | – | $17 | – | $5,181 | $5,181 |
| Average weighted rate[1] | 1.14% | – | – | – | 3.07% | – | 1.15% | 1.15% |
| Sub-total | $5,165 | $1 | $1 | $2 | $19 | $7 | $5,195 | $5,195 |
| Foreign currency: | | | | | | | | |
| Thai Baht: | | | | | | | | |
| Fixed rate | $439 | – | – | – | – | – | $439 | $439 |
| Average weighted rate[1] | 2.80% | – | – | – | – | – | 2.80% | 2.80% |
| Variable rate[2] | $3,744 | $2,395 | $402 | $41 | $41 | $21 | $6,644 | $6,644 |
| Average weighted rate[1] | 3.08% | 3.11% | 2.97% | 2.23% | 2.23% | 2.23% | 3.07% | 3.07% |
| Sub-total | $4,183 | $2,395 | $402 | $41 | $41 | $21 | $7,083 | $7,083 |
| India Rupee: | | | | | | | | |
| Fixed rate | $318 | $2 | – | – | – | – | $320 | $320 |
| Average weighted rate[1] | 7.28% | 0% | – | – | – | – | 7.23% | 7.23% |
| Variable rate[3] | $4,075 | $650 | – | – | – | – | $4,725 | $4,725 |
| Average weighted rate[1] | 7.15% | 4.99% | – | – | – | – | 6.85% | 6.85% |
| Sub-total | $4,393 | $652 | – | – | – | – | $5,045 | $5,045 |
| U.S. dollars: | | | | | | | | |
| Variable rate[4] | $49 | – | – | – | – | – | $49 | $49 |
| Average weighted rate[1] | 5.44% | – | – | – | – | – | 5.44% | 5.44% |
| Sub-total | $49 | – | – | – | – | – | $49 | $49 |
| Others: | | | | | | | | |
| Fixed rate | $54 | – | – | – | – | – | $54 | $54 |
| Average weighted rate[1] | 3.87% | – | – | – | – | – | 3.87% | 3.87% |
| Sub-total | $54 | – | – | – | – | – | $54 | $54 |
| Total | $13,844 | $3,048 | $403 | $43 | $60 | $28 | $17,426 | $17,426 |

(1) Weighted average rates of the portfolio at the year end.

(2) Including Japanese Yen borrowings of HK$4,326 million and U.S. dollar borrowings of HK$227 million which were swapped into Thai Baht borrowings as of 31 December 2004. See Note 19 to the accounts.

(3) Including U.S. dollar borrowings of HK$623 million which were swapped into India Rupee borrowings as of 31 December 2004. See Note 19 to the accounts.

(4) Excluding the HK$4 million interest-bearing loan from minority shareholders of one of our operating companies as of 31 December 2004.

| | 31 December 2004 Maturities | | | | | | 31 December 2004 | |
|---|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | Thereafter | Total | Gain/(loss) |
| | (HK$ millions except rates) | | | | | | | |
| Interest Rate/Foreign Currency Swaps | | | | | | | | |
| Receive US$/Pay INR Contract Amount | – | $623 | – | – | – | – | $623 | $(12.0) |
| Weighted Average Contractual Exchange Rate (INR/US$) | – | 45.72 | – | – | – | – | 45.72 | – |
| Weighted Average pay rate | – | 4.30% | – | – | – | – | 4.30% | – |
| Weighted Average receive rate | – | 1.81% | – | – | – | – | 1.81% | – |
| Foreign Currency Swaps | | | | | | | | |
| Receive US$ /Pay THB Contract Amount | $42 | $41 | $41 | $41 | $41 | $21 | $227 | $13.4 |
| Weighted Average Contractual Exchange Rate (THB/US$) | 41.33 | 41.33 | 41.33 | 41.33 | 41.33 | 41.33 | 41.33 | – |
| Receive JPY/Pay THB | | | | | | | | |
| Contract Amount | $2,903 | $1,122 | $301 | – | – | – | $4,326 | $90.8 |
| Weighted Average Contractual Exchange Rate (JPY/THB) | 0.3644 | 0.3654 | 0.3771 | – | – | – | 0.3656 | – |

## Critical Accounting Policies

The preparation of financial statements often requires the selection of specific accounting methods and policies from several acceptable alternatives. Furthermore, significant estimates and judgments may be required in selecting and applying those methods and policies in the recognition of the assets and liabilities in our consolidated balance sheet, the turnover and expenses in our consolidated profit and loss account and the information that is contained in the significant accounting policies and notes to our accounts. Our management bases its estimates and judgments on historical experience and various other assumptions that it believes are reasonable under the circumstances. Actual results may differ from these estimates and judgments under different assumptions or conditions.

We believe that the following are some of the more critical judgment areas in the application of our accounting policies under Hong Kong GAAP that affect our reported financial condition and results of operations. For a further discussion of the application of these and other accounting policies, see Note 3 to our accounts.

## Long-lived Assets

We have substantial investments in tangible and intangible long-lived assets, primarily our mobile and fixed-line telecommunications networks and licences. Changes in technology or changes in our intended use of these assets may cause the estimated period of use or value of these assets to change.

Intangible and tangible assets are tested for impairment when an event occurs that might affect asset carrying values. We continually monitor our businesses, markets and business environments and make judgments and assessments about whether such an event has occurred. A provision for impairment in value is recognised with respect to an asset to the extent that the carrying amount cannot be recovered either by selling the asset or from the discounted future earnings from operating the asset.

Management judgment is required in the area of asset impairment, particularly in assessing whether: (1) an event has occurred that may affect asset values; (2) the carrying value of an asset can be supported by the net present value of future cash flows from the asset, estimated using cash flow projections; and (3) the cash flow is discounted using an appropriate rate. Changing the assumptions selected by management to determine the level, if any, of impairment, including the discount rates or the growth rate assumptions in the cash flow projections, could significantly affect our reported financial condition and results of operations.

In 2004, OFTA announced a 3 years moratorium upon expiry of the CDMA licence in 2005, in order for us to migrate our CDMA customers to 2G or 3G networks. In addition, as part of our cost saving initiatives, certain network and information technology services and maintenance were outsourced. As a result of the foregoing, we recorded an impairment loss on telecommunications and network equipment of HK$142 million for the year ended 31 December 2004.

## Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of our share of the net assets of the acquired subsidiary company or associated company at the date of acquisition. Up to 31 December 2003, goodwill was amortised using the straight line method over its estimated useful life and assessed for impairment at each balance sheet date. From 1 January 2004, with the early adoption of Hong Kong Financial Reporting Standards ("HKFRS") 3 "Business combination", goodwill is not subject to amortisation and the accumulated amortisation as at 31 December 2003 has been eliminated with a corresponding decrease in the cost of goodwill. Goodwill is tested annually for impairment, as well as when there are indications of impairment. The early adoption of HKFRS 3 from 1 January 2004 represents a change in the accounting policy for goodwill and resulted in a decrease of HK$540 million in goodwill amortisation expenses for the year ended 31 December 2004.

## Deferred Taxation

Deferred tax is provided, using the liability method, for temporary differences arising between the tax bases of assets and liabilities and their carrying values in our consolidated financial statements. Deferred tax liabilities are provided in full on all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the deductible temporary differences (including tax losses) can be utilised.

We have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the recognition criteria for deferred tax assets recorded in relation to cumulative tax loss carry forwards. Our assumptions regarding future profitability and the anticipated timing of utilising the tax holiday period available to our India businesses require significant judgment, and significant changes in these assumptions from period to period may have a material impact on our reported financial condition and results of operations. As of 31 December 2004, we had recognised HK$844 million in deferred tax assets.

## Depreciation of Property, Plant and Equipment

Our business is capital intensive. Depreciation of operating assets constitutes a substantial operating cost for us. The cost of our property, plant and equipment, principally telecommunications and network equipment, is charged to depreciation expense over their estimated useful lives.

We depreciate our telecommunications and network equipment using the straight-line method over their estimated useful lives. We periodically review changes in our technology and industry conditions, asset retirement activity and salvage values to determine adjustments to estimated remaining useful lives and depreciation rates. During the year ended 31 December 2004, we re-assessed the useful lives of certain of our telecommunications and network equipment in relation to our Hong Kong fixed-line business. As a result of this re-assessment, we concluded that the useful lives of these assets should be extended from 6.7 to 25 years to 20 to 35 years. We consider this to be a change in accounting estimate and have therefore accounted for the change prospectively from 1 January 2004. The effect of this change in accounting estimate is to decrease depreciation charge for the year ended 31 December 2004 by HK$57 million.

Actual economic lives may differ from our estimated useful lives. Periodic reviews could result in a change in our depreciable lives and therefore our depreciation expense in future years.

## Amortisation of Telecommunications Spectrum Licences

Our 2G and 3G telecommunications spectrum licences are amortised on a straight-line basis over the remaining licence period from the date of the first commercial usage of the related spectrum. The legal term of the licence period is used as the amortisation period. The actual economic lives may differ from the licence period, which could impact the amount of amortisation expense.

## Amortisation of Telecommunications Customer Acquisition Costs

Costs to acquire mobile telecommunication customers are capitalised and amortised over the minimum enforceable contractual period. In the event that a customer terminates a service contract prior to the expiration of the minimum enforceable contractual period, any unamortised customer acquisition costs are written off.

Up to 31 December 2003, customer acquisition costs were amortised over the estimated customer relationship period. In the event that a customer terminated a service contract prior to the expiration of the estimated customer relationship period, any unamortised customer acquisition costs were written off. The early adoption of the current interpretation of HKAS 38 from 1 January 2004 has resulted in an addition of HK$260 million in the amortisation of customer acquisition costs, resulting in a decrease in operating profit of HK$260 million for 2004.

## Revenue Recognition

Our postpaid and prepaid revenues are generated based on tariff plans. Postpaid revenues are recognised upon delivery of services and when collectibility is reasonably assured, and prepaid revenues are recognised based on the prepaid billing system when the services have been provided to the prepaid customers or when the services periods have expired.

## Foreign Exchange

Our reporting currency is Hong Kong dollars. The accounts of our overseas subsidiaries and associated companies and jointly controlled entities are translated into Hong Kong dollars using the year-end rates of exchange for the balance sheet and the average rates of exchange for the year for the profit and loss items. A significant portion of our turnover, operating profit (loss), assets and loans are related to our overseas operations, and are generally denominated in currencies other than our reporting currency. Accordingly, fluctuations in the exchange rate between our reporting currency, the Hong Kong dollar, and India Rupee, Thai Baht and New Israeli Shekel could have a significant impact on our reported profit (loss), assets or liabilities.

## Reconciliation to US GAAP

Our consolidated financial statements are prepared in accordance with Hong Kong GAAP, which differs in various material aspects from US GAAP. These material differences, as they apply to our consolidated financial statements can be read in the "Information for US Investors" section.

The following table sets forth a comparison of our net (loss) profit attributable to shareholders and shareholders' (deficits) equity in accordance with Hong Kong GAAP and US GAAP for the years indicated:

| | As of or for the year ended 31 December | |
|---|---|---|
| | 2003 | **2004** |
| | (HK$ millions) | |
| Net (loss) profit attributable to shareholders | | |
| Hong Kong GAAP | (214) | **72** |
| US GAAP | (358) | **(247)** |
| Shareholders' (deficits) equity | | |
| Hong Kong GAAP | (6,375) | **14,287** |
| US GAAP | 13,139 | **12,495** |

## Recent Accounting Pronouncements

### US GAAP

#### *SFAS 123(R)*

In December 2004, the FASB issued FASB Statement No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123R") which replaces FASB Statement No. 123, "Accounting for Stock-Based Compensation" and supersedes APB No. 25, "Accounting for Stock Issued to Employees". SFAS No. 123R will provide investors and other users of financial statements with more complete and neutral financial information by requiring that the compensation cost relating to share-based payment transactions be recognised in the financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. Public entities (other than those filing as small business issuers) will be required to apply SFAS No. 123R as of the first interim or annual reporting period that begins after 15 June 2005. The adoption of SFAS 123R is not expected to have a significant impact on the consolidated financial statements.

#### *SFAS 153*

In December 2004, the FASB issued FASB Statement No. 153, "Exchanges of Nonmonetary Assets", which amends APB Opinion No. 29, "Accounting for Nonmonetary Transactions", to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. Under SFAS no. 153, exchanges of nonmonetary assets, except for exchanges of nonmonetary assets that do not have commercial substance, should be measured based on the fair value of the assets exchanged. The provisions of this Statement shall be effective for nonmonetary asset exchanges occurring in fiscal periods beginning after 15 June 2005. We are currently assessing the impact of the standard on our consolidated financial statements.

**Dennis Pok Man Lui**
Chief Executive Officer
Hong Kong, 7 March 2005