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$980
SmarTone
vodafone™
SHARP SX813
SANYO S103
BlackBerry® from Vodafone

MANAGEMENT DISCUSSION AND ANALYSIS

(Financial figures are expressed in Hong Kong dollars)

Review of financial results

Operating revenue rose by $252 million to $3,619 million despite intense market competition, driven by growth in both mobile services revenue and handset sales. Operating profit dropped by $148 million to $344 million, mainly due to higher network costs, incremental marketing expenses for the launch of 3G and the SmarTone-Vodafone brand, and depreciation for the 3G network. Following the commercial launch of 3G service in December 2004, spectrum utilisation fee was expensed as incurred and depreciation started for 3G related capital expenditure. Macau operations continued to contribute positively to the Group's performance in 2004/05.

Turnover increased by $252 million to $3,619 million (2003/04: $3,367 million), with a 6% growth in mobile services revenue and a 12% rise in handsets and accessories sales.

- Mobile services revenue grew by $146 million to $2,635 million (2003/04: $2,489 million), driven by higher roaming, multimedia and prepaid services revenue, partially offset by a reduction in local voice revenue.

  Hong Kong blended ARPU for 2004/05 rose by $11 to $199 (2003/04: $188) as a result of the Group's success in improving the quality of its customer base through continuing efforts to acquire and retain high value customers in both business and consumer segments. The growth in roaming and multimedia usage contributed the largest share of this increase.

  Despite intense market competition and continued downward price pressures in the Hong Kong mobile market, postpaid ARPU for 2004/05 rose by $20 to $231 (2003/04: $211). Revenues from all services other than local voice services recorded healthy growth.

  The key factor for the growth in multimedia services revenue was the Group's continued success in enhancing its total customer proposition. This included the continuing enrichment of SmarTone *iN!* services and the launch of new, compelling products and services, including PC Connect, comprising a high-speed 3G/GPRS data card, and BlackBerry® from Vodafone, a SmarTone-Vodafone Mobile Email service. Multimedia services revenue achieved a strong year-on-year increase of 74%. Data service revenue continued to grow and accounted for 7.3% of services revenue in 2004/05 (2003/04: 5.5%).

- Handsets and accessories sales rose by 12% to $985 million in 2004/05 (2003/04: $878 million) mainly due to the launch of a variety of new handsets with advanced features.

Cost of goods sold and services provided rose by $221 million to $1,456 million in 2004/05 (2003/04: $1,235 million) mainly due to higher costs of handsets sold and increased interconnection, roaming and IDD costs. This reflected the corresponding increases in both handset sales and usage.

Other operating expenses (excluding depreciation, amortisation and loss on disposal of fixed assets) rose by $169 million to $1,357 million in 2004/05 (2003/04: $1,188 million). This was due to an increase in network costs arising from the 3G network rollout, higher sales and marketing expenses incurred for the launch of 3G and the SmarTone-Vodafone brand, and promotion of multimedia services and new handsets.

Depreciation, amortisation and disposal loss rose by $36 million to $488 million in 2004/05 (2003/04: $452 million) mainly due to depreciation for the 3G network, including spectrum utilisation fee capitalised before the commercial launch of 3G service.

Samsung Anycall Z308

(Financial figures are expressed in Hong Kong dollars)

Net finance income fell by $11 million to $48 million in 2004/05 (2003/04: $59 million) mainly due to lower average net cash and debt securities balances.

The financial performance of the Group's mobile business in Macau continued to improve and contribute positively to the Group's performance in 2004/05.

Capital structure, liquidity and financial resources

There had been no major changes in the Group's capital structure during the year. The Group was financed by share capital, internally generated funds and short term Hong Kong dollar floating rate revolving credit facilities during the year. At 30 June 2005, no amount was utilised out of these facilities totalling $300 million.

The Group's net cash inflow from operating activities increased from $801 million in 2003/04 to $846 million in 2004/05. The Group's major outflow of funds during the year ended 30 June 2005 were payment of dividends of $303 million and purchases of fixed assets of $746 million. Cash resources of the Group remain strong with cash and bank balances and investments in held-to-maturity debt securities, net of external borrowings, of $1,852 million as at 30 June 2005.

The Group's capital expenditure amounted to $695 million in 2004/05 as compared to $680 million in 2003/04. Majority of the capital expenditure was for rollout of 3G radio network, upgrade and expansion to further improve network quality and coverage of 2G network, 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 2005/06 but the overall spending is expected to be considerably lower than that in 2004/05.

The directors are of the opinion that the Group can fund its capital expenditure and working capital requirements for 2005/06 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 2005.

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 dollar or United States dollar.

The Group's investments in debts securities are denominated in either Hong Kong dollar or United States dollar with a maximum maturity of 3 years. The Group's policy is to hold its investments in debt securities until maturity.

As at 30 June 2005, the Group's total available banking facilities amounted to $300 million, comprising a 1-year committed interchangeable revolving loan and trade finance facility of $200 million and an uncommitted multi-currency documentary letter of credit facility of $100 million from certain banks. No amount of the facilities was utilised as at 30 June 2005.

The Group required banks to issue performance bonds and letters of credit on its behalf. In certain circumstances, the Group partially or fully collateralised such instruments by cash deposits to lower the issuance cost. Total amount of pledged deposits at 30 June 2005 was $328 million (30 June 2004: $326 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 therefore does not have any significant exposure to foreign currency gains and losses other than those arising due to its United States dollar denominated fixed income investments and bank deposits. 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 30 June 2005 under these performance bonds was $313 million (30 June 2004: $152 million).

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 year ended 30 June 1999. 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.

Bank facilities guarantees

At 30 June 2005, there were contingent liabilities in respect of guarantees given by the Company on behalf of a wholly owned subsidiary relating to short term revolving credit facilities and uncommitted trade finance facility granted by certain banks of up to $300 million (30 June 2004: $600 million).

Employees and share option scheme

The Group had 1,535 full-time employees at 30 June 2005, with majority of which based in Hong Kong. Total staff costs were $359 million in 2004/05 (2003/04: $359 million).

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 579,000 share options which are exercisable at exercise prices range from $8.01 to $9.05 per share from 6 December 2005 to 28 February 2015. No share options were exercised and 77,000 share options were cancelled during the year. At 30 June 2005, 13,092,500 share options were outstanding.

Through various initiatives in the areas of human resources development, the Group is striving to build a strong and committed workforce. The current performance-based remuneration system provides incentives and rewards for outstanding performance.

Sharp SX813