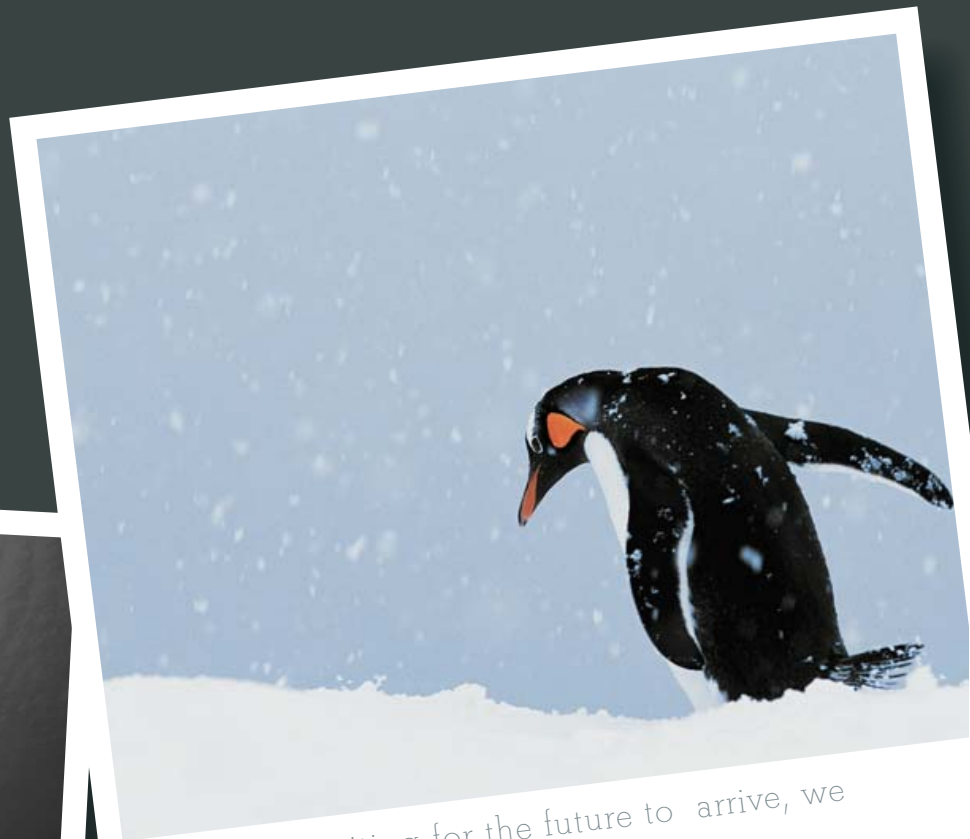


# Performance

NURTURE

*During the year, we received several awards and words of praises that confirmed our Metro Ethernet platform is the top choice for Hong Kong. I believe that you need great long term foresight for investment in infrastructure*





we are not waiting for the future to arrive, we  
are already working with it, every day

## FINANCIAL REVIEW

## Results of Operation

	2005	2004
Year ended 31 August	HK'000	HK'000
Revenues		
International telecommunications services (IDD)	532,595	627,978
Fixed telecommunications network services (FTNS)	604,761	541,902
	<u>1,137,356</u>	<u>1,169,880</u>
Operating (loss) / profit	(158,615)	51,768
Finance costs	(54,462)	(175)
(Loss) / profit before tax	(213,077)	51,593
Tax	6,725	(2,043)
(Loss) / profit attributable to shareholders	<u>(206,352)</u>	<u>49,550</u>

During the period under review, competition remained unrelenting. The 15.2% fall in our IDD revenue to HK\$532.6 million overshadowed our 11.6% increase in FTNS revenues to HK\$604.8 million.

Group EBITDA<sup>1</sup> profit fell from HK\$245.0 million in FY04 to HK\$65.5 million in FY05 due to reduced IDD profitability and ramp-up of FTNS marketing activities. During FY05, we made substantial operating expenditure investments in brand enhancement, including the launch of "Liu Xiang bb1000" campaign in 2H FY05. Liu Xiang, as the reigning Gold medal holder for 110 meter hurdles, is China's first male Olympic Track and Field Gold Medalist.

Depreciation of fixed assets and amortization of goodwill expenses increased by 20.7% to HK\$237.7 million. Finance costs also increased from HK\$175,000 to HK\$54.5 million due to the

interest on US\$125 million senior notes issued in January 2005. (Loss)/profit attributable to shareholders moved from HK\$49.6 million profit in FY04 to HK\$206.4 million loss in FY05.

## LIQUIDITY AND CAPITAL RESOURCES

As at 31 August 2005, the Group had cash and bank balances of approximately HK\$738.4 million and outstanding borrowing of HK\$948.5 million. During the year, we issued a US\$125 million 10-year senior notes at fixed interest rate of 8.75% per annum in January 2005 (equivalent to HK\$971 million). The use of proceeds include the full repayment of an existing HK\$197 million bank loan, capital expenditure for expansion of home pass coverage in Hong Kong from 1.2 million to 1.8 million, additional working capital and for general corporate purpose. The net debt to net asset gearing ratio of the Group for this year is 0.22 times which is calculated as below:

31 August

2005

HK\$'000

Net Debt (note (a))	210,055
Net Assets	970,633
Gearing (times)	0.22

note(a) Includes long term deposit and pledged deposits.

No gearing ratio is presented for last year as the Group was in net cash position.

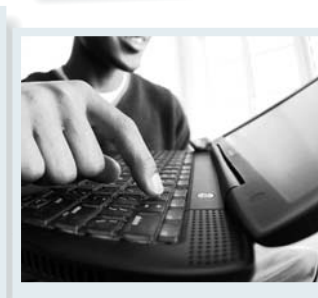
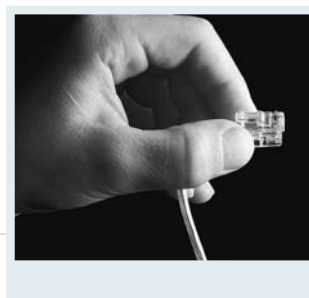
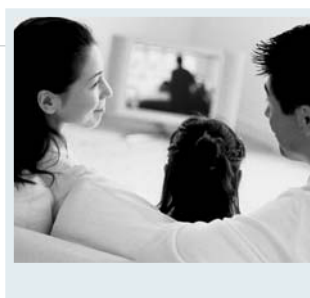
Capital expenditure incurred during the year was HK\$419.1 million, the majority of which, approximately HK\$407.5 million, was invested in the local fixed telecommunications network. Our

network development will require ongoing capital expenditure that will be met by internally generated cashflow and the proceeds from senior notes issued in January 2005.

The debt maturity profiles of the Group as at 31 August 2004 and 2005 were as follows:

	31 August 2005	31 August 2004
	HK\$'000	HK\$'000
Repayable within one year	1,194	32,503
Repayable in the second year	1,218	20,000
Repayable in the third to fifth year	723	60,000
Repayable after the fifth year	945,348	6,667
Total	948,483	119,170

AS SUCH, WE BELIEVE THAT OUR IMPACT ON THE INDUSTRY IN THE NEXT 13 YEARS WILL BE FAR GREATER THAN OUR FIRST 13 YEARS.



The currency denomination for the borrowings was as follows:

	31 August 2005	31 August 2004
	HK\$'000	HK\$'000
United States Dollars		
- Unsecured	945,348	-
Hong Kong Dollars		
- Secured	-	100,000
- Unsecured	3,135	-
Japanese Yen		
- Secured	-	19,170
<b>Total</b>	<b>948,483</b>	<b>119,170</b>

#### Charge on Group Assets

At 31 August 2005, the Group had bank facilities of US\$9.0 million which was secured by a pledged deposit of US\$9.9 million. In addition, an outstanding forward foreign exchange contract was secured by a pledged deposit of RMB4.7 million and certain bank guarantees provided to suppliers and to utility vendors in lieu of payment of utility deposits were secured by pledged deposits of HK\$9.0 million (compared to pledged bank deposits of US\$800,000 and HK\$1.4 million, and a charge over an investment with a market value of US\$468,000 as of 31 August 2004).

#### Exchange Rates

The Group's foreign currency exposures mainly arise from its borrowings denominated in foreign currency and from purchase of goods and services of its overseas operations. The Group periodically reviews the potential costs and benefits of hedging, and when necessary, the Group mainly uses forward foreign exchange contracts to manage the currency exposure.

During the year, the Group arranged RMB forward purchases and US dollar forward purchases of approximately RMB155.6 million and US\$13.4 million to hedge the foreign currency exposure.

#### Contingent Liabilities

As at 31 August 2005, the Group had total contingent liabilities in respect of guarantees provided to suppliers of HK\$6.2 million (31 August 2004: HK\$6.3 million) and to utility vendors in lieu of payment of utility deposits of HK\$3.8 million (31 August 2004: HK\$3.6 million).

#### BUSINESS REVIEW

##### Fixed Telecommunications Network Services (FTNS)

During the year we grew our FTNS subscription base by 166,000 or 35.7% year-on-year to 631,000 subscriptions as of 31 August 2005. Our strategy for growth is to secure both new customer relationships and to up-sell multiple (voice, broadband and IP-TV) services to our existing customers.

On voice services, we grew our subscription base by 57,000 or 24% year-on-year to 294,000 subscriptions. This growth was achieved despite an aggressive market share "win-back" campaign by the incumbent operator. Industry competition for voice services has intensified to the extent that new acquisition pricing is often below the regulated wholesale price of Type II unbundled local loop access. In our view, if the level of competition continues, it will accelerate, industry consolidation towards the key facilities-based carriers.

On broadband services, we grew our subscription base by 32,000 or 16% year-on-year to 229,000 subscriptions. During the year, we focused on service differentiation with the commercial launch of our "bb100" and "bb1000" supported by the Liu Xiang advertising campaign; our service portfolio of "bb10", "bb100" and "bb1000" which respectively offer symmetric 10Mbps, 100Mbps and 1Gbps services, is the most comprehensive service suite available in Hong Kong. Furthermore, we widen the service advantage by introducing value-added services bbDrive (on line virtual hard drive with up to 10G storage), bbGuard (anti-spam and anti-virus package) and bbWatch (full screen IP-TV experience via PC).

On IP-TV, we grew our subscription base by 78,000 or 252% year-on-year to 109,000 subscriptions. In the past twelve months, we have enhanced the service attraction by adding content such as J-League soccer from Japan, 24/7 Korean Movie Channel plus two "Drama Buffet" Near-Video-On-Demand channels that empowers viewers to select and watch drama series by the episode of their choice.

#### International Telecommunications Services (IDD)

At CTI, we have long forewarned the sunset nature of the basic IDD industry. Unlike typical incumbents, instead of fighting the sunset, our approach is to accelerate the sunset by aggressively taking advantage of technological improvement and also new and more efficient business models. For example, if we were in the photography industry we would embrace the digital process rather than continue to invest in traditional film procedures. In FY05, the capital investment required in our IDD business was HK\$11.6 million which represents just 3% of our total HK\$419.1 million capital expenditure spend.

In October 2005, we launched our "2b" global Hong Kong access number service. This Voice Over Internet Protocol (VOIP) service can convert any global broadband access point into a Hong Kong telephone number, such that users around the world can enjoy a virtual presence in Hong Kong. All calls to and from the assigned Hong Kong number enjoy free un-metered local rates, irrespective of the international location of the 2b user. Whilst this service will accelerate the cannibalization of our own IDD services, we believe the addressable global market potential far outweighs our IDD downside within Hong Kong. As such, in Phase I of our 2b investment, we have already provisioned for 1 million subscription capacity, which in the context of Hong Kong's total market 3.8 million fixed line subscriptions appears excessive but in the context of our target global Chinese community base is reasonable.

#### PROSPECTS

Our successful US\$125 million 2015 senior notes issued in January 2005 has altered our 5 year business objectives. Whereas prior to the fund raising, we were managing the business closer toward maturity of the existing investment, securing the 10-year funding has enabled us to set larger and more ambitious targets. Whilst FY05 represents our first ever full year corporate loss in our 13 year history, our gross cash balance of HK\$738.4 million is also the highest in our history. As such, we believe that our impact on the industry in the next 13 years will be far greater than our first 13 years. Over the next three to four years, the strategic investment of our cash balance will be taken precedence over near term profitability. At CTI, we are working towards building the most successful alternative carrier in Hong Kong for the benefit of the community and for our shareholders.

#### EMPLOYEE RELATIONS

As of 31 August 2005, the CTI Group had approximately 3,896 permanent full-time employees, the total staff related cost was approximately HK\$439 million for fiscal year 2005. CTI Group offers remuneration packages consisting of basic salary, bonus and other benefits. Bonus payments are discretionary and dependent on performance of both CTI Group and the individual employee. In addition to the comprehensive medical and life insurance coverage, CTI Group provides share options as well as competitive retirement benefits.

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1. EBITDA for any period means, without duplication, net income for such period, plus the following to the extent deducted in calculating such net income: interest expense, profits taxes, depreciation and amortization expense (excluding any such non cash charge to the extent it represents an accrual of or reserve for cash charges in any future period or amortization of a prepaid cash expense that was paid in a prior period not included in the calculation). EBITDA is not a measure of performance under Hong Kong GAAP but the Company considers that EBITDA is an additional measure utilized by investors in determining a borrower's ability to meet debt service requirements. However, EBITDA does not represent, and should not be used as a substitute for, net earnings or cash flows from operations as determined in accordance with Hong Kong GAAP, and EBITDA is not necessarily an indication of whether cash flow will be sufficient to fund our cash requirements. In addition, our definition of EBITDA may differ from that of other companies

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