Management Discussion and Analysis

BUSINESS OVERVIEW

During the year, China Motion Telecom International Limited and its subsidiaries (collectively, the "Group") placed its focus on management and operational restructuring with a view to strengthening its competitive edge and accordingly, the business development was affected. In addition, due to the intense competition in the telecommunications markets, the Group's performance for the year under review was also affected.

The Group recorded a turnover of HK$840,222,000, an increase of 9.9% over last fiscal year and incurred a loss of HK$228,478,000 for the year, representing a 52% decrease when compared with last year.

International Telecommunications Services

For the year ended 31 March 2006, the international telecommunications services business reported turnover amounting to HK$638,170,000, representing an increase of 18% over last fiscal year. The business division mainly covers wholesale and retail IDD services. During the year, IDD voice traffic continued to increase reaching 3,741 million minutes, representing an increase of 32% over the previous fiscal year.

Growth in voice traffic and turnover for the Group's wholesale IDD business benefited mainly from the Group's dedication in recent years to expand in overseas markets. The wholesale IDD business continued to be the Group's most significant source of income, accounting for almost 74% of the Group's turnover. However, due to keen competition in the wholesale IDD market and the decrease in the PRC minutes rate, the gross profit margin was severally declined, bringing a loss in this business during the year under review.

"ChinaOne", the Group's global retail IDD brand, has established a stable customer base and gained popularity over the years owing to continuous enhancement in marketing efforts and service quality. Not only did the retail IDD business perform well in Hong Kong for the year, but it also successfully penetrated and won recognition from overseas Chinese communities in Canada, Singapore and the United States. During the year, the Group's overseas business developed steadily. No further expansion in overseas markets was made due to the Group's focus on internal reorganisation.

Mobile Communications Services

During the year under review, mobile communications services posted a turnover of HK$105,824,000, a 9% increase compared to last year and accounting for approximately 13% of the Group's total turnover. Over the past few years, the Group's Mobile Virtual Network Operator ("MVNO") business has been steadily improving, recording a satisfactory performance and stable profit this year. The Group also actively expanded its MVNO business under the "CM Mobile" brand through several strategic moves, including expansion of the proprietary distribution and sales channels, formulation of various marketing strategies to cater to customer requirements, provision of a diversified product portfolio, and improvement of service quality. Under the severe market competition, the Group has also continued to carry out more cost-effective marketing strategies to attract high-usage customers shuttling between Hong Kong and China in order to enhance profitability. In general, the mobile communications service business has remained stable in local and overseas markets during the year, which is in line with the management's forecast.

Distribution and Retail Chain

Facing fierce market competition, the Group aggressively introduced a series of measures to optimise the operational efficiency of the distribution and retail chain business, and hence improved its performance. For the year ended 31 March 2006, the distribution and retail chain business recorded a turnover of HK$96,228,000, representing a decrease of 24% over the previous year and accounting for approximately 11% of the Group's total turnover.

During the year, the Group continued to identify "CM Concept" as the one-stop-shop sales platform for its telecommunications products and services. Following the market trend, the Group readjusted its development focus by reducing hardware sales (cellular phone and fittings) and emphasising sales efforts in its telecommunications services. As of 31 March 2006, the Group had 17 "CM Concept" stores in operation *(2005: 25)*. As of the latest date available, the number of stores has subsequently increased to 19 in total. The reduction in the number of stores which was largely attributable to the increase in rental costs and the expiry of leases had significant effect on the overall performance of the Group's retail business.

CMTH

By reason of China Motion Telecom Holdings Limited's ("CMTH") breach of the acquisition agreement resulting that CMTH was not able to transfer the stage two acquisition of its 25% equity interest in China Motion Netcom Services Co., Ltd. which currently provides VoIP related services in China to the Group, the Group issued a notice of rescission regarding the acquisition agreement to CMTH on 19 December 2005. In re-assessing the VoIP related business, the Group had recognised impairment charges of totally HK$126,599,000 in respect of such VoIP related business in the previous fiscal year and further impairment charges of totally HK$58,022,000 during the year. There was no material adverse impact on daily operations or working capital from these provisions. The Group will continue to discuss possible arrangements with CMTH and reserves the right to recover all losses arising from rescission.

Regarding the outstanding debts due to the Group from CMTH, the Group made a full provision of HK$334,331,000 in the previous financial year. During the year, no repayments were received from CMTH. Accordingly, the remaining balance of the consideration designated for stage two acquisition as mentioned above was reclassified as amount due from CMTH. In view of the current financial position of CMTH, the Group has made full provision on the amount due from CMTH of HK$58,028,000 for the year. However, the Group has sought legal and financial advice in Hong Kong and China and is eagerly seeking for the best solution with CMTH on this issue. The Group reserves the right to pursue legal action to recover the debts with a view to serving the best interests of its shareholders.

PROVISION FOR IMPAIRMENT

Considering the future benefits derived from certain investments in the PRC and devaluation of certain telecommunications equipment, the Group had re-assessed their value and thus taken a prudent approach to make the relevant provisions of HK$58,022,000 and HK$63,767,000 respectively. However, such provisions had a material impact on the Group's financial results but had no material adverse effect on the daily operations or working capital of the Group.

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PROSPECTS

Looking forward, the Group will continue to rationalise the operations of its core businesses and improve its internal management processes in a pragmatic manner, with a view to enhancing the operational efficiency of each business. Furthermore, the Group remains dedicated to ensuring the healthy development of value-added services and to re-establishing a new marketing system to drive overall business development and help cement our position in the vibrant Asia Pacific telecommunications market.

FINANCIAL POSITION

At 31 March 2006, the Group's bank balances and cash amounted to HK$37,362,000. Total borrowings and obligations under finance leases amounted to HK$83,327,000. The Group's bank loans are repayable in monthly bases and the last installment will be in August 2013. The gearing ratio of total borrowings as a percentage of the total capital and reserves attributable to equity holders of the Company was 182% *(2005: 41%)*.

At 31 March 2006, the Group had aggregate banking facilities of approximately HK$46 million (excluding property mortgage loans), which were fully utilised. Subsequent to the balance sheet date, the Group had successfully obtained additional banking facilities of approximately HK$40 million.

The Group will strive to implement stringent cost control measures and explore fund-raising opportunities in order to enhance and strengthen its liquidity position and financial resources for operational requirements.

CONTINGENT LIABILITIES

At 31 March 2006, the Group had contingent liabilities amounting to HK$38,673,000 *(2005: HK$40,463,000)* in respect of guarantees given to third parties against non-performance of contractual obligations by subsidiaries.

EXPOSURES TO FLUCTUATIONS IN EXCHANGE RATES

The Group is exposed to the fluctuations in Renminbi and United States dollars as certain expenses payable by and trade receivables from customers are settled in these currencies respectively.

EMPLOYEES AND REMUNERATION POLICIES

At 31 March 2006, the Group had 272 full-time staff. Total staff costs (including directors' emoluments) incurred for the year amounted to HK$98,241,000 *(2005: HK$111,351,000)*. The Group's remuneration policy is in line with prevailing market practice on performance of individual staff.

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