



Chairman's Statement

(Financial figures are expressed in Hong Kong dollars)

I am pleased to announce the financial results of the Group for the year ended 30 June 2006. This year saw a significant growth in service revenue and continued improvements in key operating metrics, a creditable performance in a mature and highly competitive mobile market like Hong Kong. The results, however, are adversely affected by the significant increase in handset subsidy amortisation arising from competition in the market, and 3G costs.

Financial Highlights

Turnover of the Group grew by 4% to \$3,779 million, driven by 9% increase in service revenue. Earnings before interest, tax, depreciation and amortisation ("EBITDA") was \$816 million, representing 5% decrease from last year. Profit attributable to equity holders and earnings per share for the year amounted to \$70 million and \$0.12 respectively.

The Group's accounting policies have been amended with the adoption of the new/revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards (collectively referred to hereinafter "new HKFRS") which are effective for accounting periods commencing on or after 1 January 2005. Comparative figures have been restated accordingly.

The adoption of the new HKFRS has a negative impact of \$58 million on profit attributable to equity holders for the year under review. The major part of this, amounting to \$49 million, is attributable to the adoption of Hong Kong Accounting Standard 38 "Intangible Assets" for 3G licence fee. The negative impact on profit attributable to equity holders for the previous year due to the adoption of the new HKFRS was \$12 million.

Dividend

With the modest level of profit for this year, your Board recommends a full distribution of profit attributable to equity holders, representing a final dividend of \$0.12 per share. Your Board, however, still considers that the normal dividend policy is to distribute two-thirds of profit.

Business Review

Hong Kong Mobile Business

The Hong Kong market remains very competitive, notwithstanding the recent market consolidation. The persistence of fierce price competition exerts substantial pressure on tariffs and handset prices, as well as industry revenue and profitability. Against this backdrop, SmarTone-Vodafone continued to achieve significant service revenue growth and improvements in key operating metrics during the year. This reflects the company's unique customer franchise, underpinned by its strong brand, targeted and differentiated propositions, focused distribution as well as emphasis on customer relationship management.



With an improving customer profile, blended ARPU for the year rose by 7% to \$213. Postpaid ARPU increased by 6% to \$244, driven by the continued growth in data and roaming usage. Data revenue registered 43% increase on last year and represented 13.6% of service revenue. The increase was attributable to the robust growth in adoption of multimedia services, stimulated by 3G, and outweighed the decline in local voice revenue.

Total customer base increased from 1,011,000 as of 30 June 2005 to 1,063,000 as of 30 June 2006. Postpaid churn rate for June 2006 was 2.5%, an improvement on 2.8% for June 2005.



During the year, fierce competition in the market triggered a significant increase in handset subsidies. Coupled with the increase in network expenses and depreciation arising from 3G as well as the full year impact of 3G licence fee, profitability decreased substantially. Nevertheless, SmarTone-Vodafone is on track in pursuing revenue growth via 3G, with the focus on offering compelling services for targeted customer segments. This is evidenced by the growth in 3G customers and their significantly higher ARPU. The 3G customer base now stands at 160,000, representing just over 20% of postpaid customer base.



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To meet the rising expectations and needs of customers, SmarTone-Vodafone launched a range of new service propositions for consumers and businesses, leveraging on the latest technology and its customer focus. These further extend the company's leadership in service excellence and innovation.

- Earlier in the year, SmarTone-Vodafone introduced a number of consumer-oriented service propositions in the areas of music, news and betting. All of these are generating significant traction with our customers.
- SmarTone-Vodafone Mobile Broadband, Hong Kong's first commercial service enabled by HSDPA (High-Speed Downlink Packet Access), offers customers broadband Internet access speed of up to 1.8 Mbps. Riding on the company's Hong-Kong-wide HSDPA network, it enables customers to enjoy secured true broadband everywhere. Two service offerings, *Flexi* and *Contract*, were introduced to meet different needs of customers. SmarTone-Vodafone also initiated a new indirect distribution channel for *Flexi* to better address certain customer segments.
- With SmarTone-Vodafone Mobile Email, the company is the only operator in Hong Kong offering customers a choice of mobile email solutions to properly address their needs, based on their email systems, scale, device preferences and total cost of ownership. To complement its proposition, SmarTone-Vodafone also offers the widest range of Handheld Business Devices.
- Traveller is a service proposition targeted at roaming customers. It focuses on providing customers with call screening to prevent nuisance calls and to save on roaming expenses while travelling; and automatic phonebook backup on a centralised database to ensure access to phonebook even when a phone is lost. These service features are combined with a pioneering same-rate tariff for roaming in five key destinations in Asia, providing predictable charging as well as outstanding savings.



Macau Mobile Business

The mobile business in Macau continued to achieve growth in turnover and profits during the year, driven by increase in customer base. The company has recently submitted a bid to the Government of the Macau Special Administrative Region for a 3G licence.

Prospects

The mobile industry is undergoing rapid changes. With intensifying market competition, rapidly evolving technologies and changing customer requirements, there will be both challenges and opportunities ahead. To enhance value for shareholders, your Company will continue to focus on increasing revenue market share with its targeted and differentiated propositions for specific customer segments. It will also explore and

develop new revenue streams by introducing new services.

Given the high customer expectations, competitive environment and compact geography of the Hong Kong market, SmarTone-Vodafone has rolled out a high quality HSDPA network with Hong-Kong-wide coverage at commercial launch in June 2006. Besides much higher data speed, the network offers increased capacity and improved network economics which open up opportunities for the company to roll out new services to address wider communications needs of customers.



Toshiba TX62

With fierce price competition, increase in handset subsidy amortisation as well as higher operating expenses arising from the development and marketing of new services, profitability is expected to be under continuing pressure in the year ending 30 June 2007. Initiatives for further improving efficiency and managing costs are being implemented to mitigate the potential impact on profitability.

Appreciation

Dr. Sachio Semmoto retired as independent non-executive director of the Company during the year. I would like to take this opportunity to express my gratitude to Dr. Semmoto for his invaluable contributions and advice. I would also like to extend my appreciation to our customers and shareholders for their continuous support, to our fellow directors for their guidance, as well as to our staff for their dedications and hard work.

Raymond Kwok Ping-luen

Chairman

Hong Kong, 28 August 2006

