Management Discussion and Analysis

(Financial figures are expressed in Hong Kong dollars)

New and revised accounting standards

The Group's accounting policies have been changed 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. The adoption of the new HKFRS has a negative impact of $58 million on profit attributable to equity holders for the year ended 30 June 2006. The major part of this, amounting to $49 million, is attributable to the adoption of Hong Kong Accounting Standard 38 "Intangible Assets" ("HKAS 38") for 3G licence fee. The negative impact on profit attributable to equity holders for the previous year due to adoption of the new HKFRS was $12 million.

The adoption of HKAS 38 requires all mobile licences to be treated as intangible assets. The net present value of annual licence fee payments is recognised as an intangible asset, together with a corresponding liability ("mobile licence fee liability") on the balance sheet. The intangible asset is amortised over the remaining licence period. The deemed interest on the mobile licence fee liability is charged to the profit and loss account as accretion expenses under finance costs. Actual payments of licence fee are set off against the mobile licence fee liability. At the end of the licence period, the intangible asset and its corresponding liability become zero balances.

Effects of changes in the accounting policies on profit attributable to equity holders of the Company, the various balance sheet items and opening equity attributable to equity holders of the Company are summarised in note 3 to the consolidated financial statements.

Review of financial results

Revenues rose by 4% to $3,779 million (2004/05: $3,619 million), primarily driven by a 9% growth in mobile service revenue due to an improvement in ARPU and a modest growth in the average customer number. Operating profit, however, fell by 69% to $105 million (2004/05: $342 million) as operating expenses, depreciation and amortisation rose significantly as a result of 3G network rollout and intensifying market competition. Finance income rose to $56 million (2004/05: $49 million) largely due to improved returns on debt securities and bank deposits. Despite that the Group had no bank and other borrowings throughout the year, finance costs amounted to $70 million for the year ended 30 June 2006 (2004/05: $40 million), comprising mainly of accretion expenses in respect of mobile licence fee liability for 3G arose from a change in accounting policy upon the adoption of HKAS 38. Taxation charge fell accordingly. Profit attributable to equity holders of the Company for the year ended 30 June 2006 fell by 79% to $70 million (2004/05: $327 million).

Revenues increased by $160 million to $3,779 million (2004/05: $3,619 million) due to higher mobile service revenue, partially offset by lower handset and accessory sales.

- Mobile service revenue grew by 9% to $2,871 million (2004/05: $2,635 million). Data, roaming and prepaid services were the main contributors to revenue growth, more than compensating the reduction in local voice revenue resulted from continued downward pressures on tariffs.

  Hong Kong blended ARPU for the year ended 30 June 2006 rose by 7% to $213 (2004/05: $199) against a backdrop of increasing market competition, reflecting the Group's success in improving its customer profile.

  Driven by the success of new and enhanced service offerings, revenue from data and roaming services grew strongly, offsetting the impact of lower postpaid local voice revenue. As a result, postpaid ARPU increased by 6% to $244 (2004/05: $231).

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Multimedia service revenue achieved a strong year-on-year increase of 54% as a result of increasing 3G customer base and the Group's continued success in addressing the needs of different targeted customer segments. Data service revenue grew by 43% and accounted for 13.6% of mobile service revenue for the year ended 30 June 2006 (2004/05: 10.3%).

- Handset and accessory sales fell by 8% to $908 million (2004/05: $985 million) despite higher sales volume, as heavy handset subsidies prevalent in the market resulted in lower average handset selling prices.

Cost of goods sold and services provided rose by $54 million to $1,510 million (2004/05: $1,456 million). Cost of handsets and accessories sold fell by 7% to $886 million (2004/05: $955 million), with the impact of higher sales volume offset by the increase in handset subsidies capitalised. Cost of services provided rose by 25% to $624 million (2004/05: $501 million) as interconnect, prepaid IDD, roaming and data related service costs increased due to higher usage.

Other operating expenses (excluding depreciation, amortisation and loss on disposal of fixed assets) rose by $135 million to $1,467 million (2004/05: $1,332 million). The major areas of increase were network costs, sales and marketing expenses, and an unrealised exchange loss arising from the translation of net monetary assets denominated in United States dollars.

Depreciation and disposal loss rose by $35 million to $486 million (2004/05: $451 million) due to a full year's depreciation of the 3G network charged in 2005/06, as compared to seven months' charges in 2004/05.

Amortisation of intangible assets increased substantially by $161 million to $225 million (2004/05: $64 million).

- During the year ended 30 June 2006, handset subsidy amortisation rose by $135 million to $166 million (2004/05: $31 million) as significant amounts of handset subsidy were offered for customer acquisition and retention. Handset subsidies are deferred and amortised on a straight-line basis over the customer contract periods.

- Mobile licence fee amortisation in respect of 3G and 2G mobile licences, arising upon the adoption of HKAS 38, rose by $25 million to $58 million (2004/05: $33 million) mainly due to the full year impact of mobile licence fee amortisation for 3G for the year ended 30 June 2006, compared to seven months' amortisation in 2004/05. All mobile licence fee is amortised on a straight-line basis over the remaining licence period.

Finance income rose to $56 million (2004/05: $49 million) mainly due to increased return on debts securities and bank deposits, as bank deposit rates rose significantly during the year ended 30 June 2006.

Finance costs increased by $30 million to $70 million (2004/05: $40 million). This was mainly attributable to higher accretion expenses in respect of mobile licence fee liabilities, arising from the adoption of HKAS 38. Accretion expenses for the 3G licence were accounted for upon the commercial launch of 3G services in December 2004. Accretion expenses for a 2G licence were accounted for upon renewal of the GSM 900 licence in January 2006.

Macau operations continued to grow during the year. Operating revenue rose by 17% to $189 million (2004/05: $162 million). Operating profit rose by 29% to $54 million (2004/05: $42 million) amidst strong revenue growth, partially offset by higher network, sales and marketing expenses.

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Capital structure, liquidity and financial resources

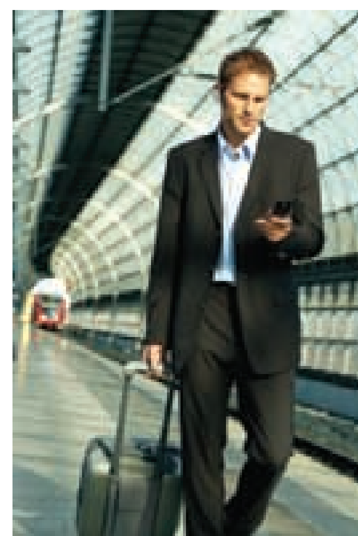
There had been no major changes to the Group's capital structure during the year ended 30 June 2006. The Group was financed by share capital, and internally generated funds during the year. The cash resources of the Group remained strong with investments in held-to-maturity debt securities, cash and bank balances of $2,051 million at 30 June 2006.

During the year ended 30 June 2006, the Group's net cash generated from operating activities and interest received amounted to $1,056 million and $67 million respectively. The Group's major outflows of funds during the year were payments for purchase of fixed assets, handset subsidies and 2004/05 final dividend.

The directors are of the opinion that the Group can fund its capital expenditures and working capital requirements for the year ending 30 June 2007 with internal cash resources and banking facilities.

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 or United States dollars.



The Group's investments in debts securities are denominated in either Hong Kong or United States dollars 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 2006, the Group's total available banking facilities amounted to $100 million. No amount of the facilities was utilised as at 30 June 2006.

The Group is required to arrange for banks to issue performance bonds and letters of credit on its behalf. In certain circumstances, the Group will partially or fully collateralise such instruments by cash deposits to lower the issuance costs. The total amount of pledged deposits at 30 June 2006 was $320 million (30 June 2005: $328 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 debt securities 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 debt securities 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 2006 under these performance bonds was $353 million (30 June 2005: $313 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 2006, there were contingent liabilities in respect of guarantees given by the Company on behalf of a wholly owned subsidiary relating to uncommitted banking facilities granted by a bank of up to $100 million (30 June 2005: $300 million).

Employees and share option scheme

The Group had 1,622 full-time employees at 30 June 2006, with majority of which based in Hong Kong. Total staff costs were $368 million for the year ended 30 June 2006 (2004/05: $366 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. No share options were granted or exercised, and 1,258,000 share options were cancelled during the year ended 30 June 2006. At 30 June 2006, 11,834,500 share options were outstanding.