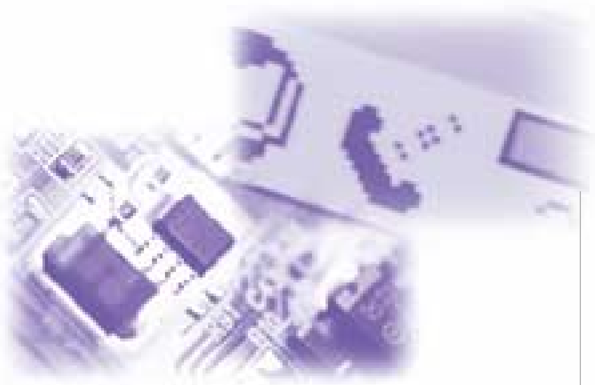
MANAGEMENT DISCUSSION AND ANALYSIS

SmarTone continued to perform strongly in a fiercely competitive market. Subscriber number increased by 13% over the previous year to over 980,000.



Overview

SmarTone continued to perform strongly in a fiercely competitive market. Subscriber number increased by 13% over the previous year to over 980,000.

The Group recorded a full year EBITDA profit of HK$75 million compared to last year's figure of HK$320 million. This is attributable to two principal factors. In the Mobile business, revenue was impacted adversely by the decrease in ARPU which more than offset the increase in the number of subscribers. In the LMDS business, the EBITDA loss almost tripled to HK$153 million, compared to HK$55 million in the financial year 2000.

However, this year's overall drop in EBITDA masks an improving trend in the second half of the year for both the Mobile and the LMDS businesses. The overall EBITDA in the second half of the year recorded a profit of HK$94 million compared to an EBITDA loss of HK$19 million in the first half of the year.

After due consideration in evaluating the future prospects of its non-Mobile operations, namely the LMDS and the Teleport businesses, the Group decided to make a provision totaling HK$167 million against the carrying value of the related assets to reflect the uncertainty of future cashflows that may be generated from these businesses.

The loss attributable to shareholders has been reduced to HK$284 million this year (2000: HK$363 million loss).

Mobile

Starting this year, the Group has adopted a more prudent approach in presenting the turnover net of retention discounts and sales incentives.

The Group achieved a full year EBITDA profit of HK$228 million for its Mobile business. In particular, Mobile EBITDA improved from HK$82 million recorded in the first half result to HK$146 million in the second half due to cost rationalisation put in place in the second half of the year.

Mobile's turnover decreased from HK$2,864 million in the financial year 2000 to this year's HK$2,437 million, principally due to two factors. Firstly, the Group's Mobile services revenue dropped by 7.4% to HK$2,211 million (2000: HK$2,387 million) due to a lower ARPU. The ARPU figure as at 30 June 2001 was HK$202 compared to HK$242 at the end of the previous year. Since the year end, there has been a modest improvement in ARPU due to expiry of lower value tariff plans promoted in 2000 and the launch of new high value but competitive tariff plans. The other reason for the decrease in turnover was the 56.3% reduction in handset sales when compared to the financial year 2000, and resulted in a decrease in turnover of HK$262 million.

Mobile's operating costs dropped by 2.4% to HK$1,412 million (2000: HK$1,447 million), with accelerating reduction in the second half of the year. Much of the cost savings came from a reduction in sales and marketing expenses of HK$42 million, and a 12% reduction in Mobile's headcount when compared with last year. However, these cost savings were partly offset by the start-up operating expenses of the Macau mobile business unit and the growth in headcount in the Hong Kong mobile business in the first half of the year, prior to the introduction of cost reduction measures, as well as redundancy costs.

The average monthly churn rate for the year ended 30 June 2001 was 5.5% which is within the industry's average.

The financial results of Macau Mobile, which did not commence commercial service until July 2001, are not material to the financial results of the Group for the year ended 30 June 2001.

LMDS

Since the launch of the LMDS business in July 2000, the operating result has been disappointing due to intense market competition and difficulties encountered in gaining access to buildings. The operating costs of the business increased very substantially and far out-paced the revenue generated. In the light of the adverse business conditions and in the absence of signs of improvement in the foreseeable future, the Group undertook a restructuring programme in April 2001, reducing the LMDS's headcount substantially. Efforts have also been made in all facets of its operations with the objective of further enhancing efficiency and minimising losses. Following this restructuring, the LMDS business EBITDA loss for the second half of the year was reduced to HK$52 million from the HK$101 million EBITDA loss recorded for the first half of the year. Subsequent to the year end, another round of restructuring was completed and the LMDS business functional activities have been absorbed into the Mobile unit in order to achieve greater operational efficiency. The Group has an outstanding performance bond with the regulatory authorities in respect of the LMDS business licence. The Group plans to fulfil its obligations in the most appropriate way in order to minimise future losses.

A provision of HK$135 million was made at 30 June 2001 against the carrying value of LMDS assets to reflect the uncertainty of future cashflows that can be generated from this business.

Subsidiaries, associates and other investments

One new trading subsidiary, in which the Group has a 72% interest, was established during the year – SmarTone Comunicações Móveis, S. A. This company undertakes the Group's mobile communications business in Macau.

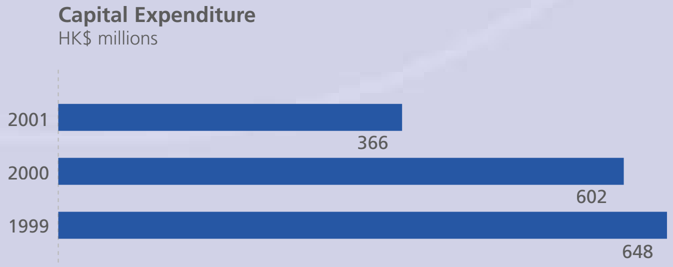
The Group invests in various venture capital and equity funds which, in turn, invest in technology businesses substantially related to wireless communications. The carrying value of these investments in the Group's balance sheet at 30 June 2001 was HK$63 million compared to HK$22 million at 30 June 2000.

There were no disposals of subsidiaries, associates or other investments during the year ended 30 June 2001.

Capital structure, liquidity and financial resources

The Group is financed entirely by share capital and internally generated funds and has no external borrowings. The cash reserves of the Group remain strong with cash and bank balances of HK$3,478 million at 30 June 2001.

The Group had a net cash inflow from operating activities during the year ended 30 June 2001 of HK$230 million. In addition, interest of HK$207 million was received. The Group had three major outflows of funds during the year, purchases of fixed assets of HK$461 million, repurchase of its own shares for HK$109 million and payment of handset subsidies of HK$94 million. These expenditures were met from the Group's operating cash inflow and existing cash resources.



In the year ended 30 June 2001, 11,407,000 shares were repurchased for HK$109 million.

The Directors of the Group are of the opinion that the Group can fund its capital expenditure for the year ended 30 June 2002 from current cash resources.

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 maintained materially in Hong Kong dollars and placed on deposit with banks in Hong Kong. The treasury policy determines the credit rating of permissible banks and the total amount of deposit to be placed with any individual bank. Deposits are currently placed only with banks with a Moody credit rating of Baa or better.

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 secure such instruments by cash deposits to lower their issuance cost. At 30 June 2001, the Group had charged cash deposits totaling HK$131 million for such purpose. No other assets of the Group were subject to any charge.

Functional currency and foreign exchange exposure

The functional currency of the Group is the Hong Kong dollar and all material revenues, expenses, assets and liabilities are denominated in Hong Kong dollars. The Group does not therefore have any significant exposure to gains or losses arising from the movement of foreign currency exchange rates against the Hong Kong dollar. It does not currently undertake any foreign exchange hedging activity. The Group undertakes regular reviews to ascertain whether any foreign exchange exposures have arisen. The Group will then determine, on an individual basis, if any hedging is required dependent upon the size and nature of the exposure and prevailing market conditions.

Contingent liabilities

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 2001 under these performance bond was HK$134 million. A bank, on the Group's behalf, has also issued a letter of credit to guarantee its obligations under a lease out lease back arrangement entered into during the year ended 30 June 1999. The Directors are of the opinion that the risk of the Group being required to make any payment under this guarantee is remote. The Group has no other material contingent liabilities.

Employees and share option scheme

The Group employed approximately 1,300 full-time employees as at 30 June 2001, with the majority in Hong Kong. Staff 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 a mandatory provident fund scheme and medical and dental care insurance. Staff members are provided with both internal and external training appropriate to each individual's requirements.

The Group has an employee share option scheme, details of which are included in the notes to the accounts.

Staff Number