

REVIEW OF OPERATIONS

Overview

SUNDAY achieved a significantly improved business performance during 2002, and recorded sustained growth in the subscriber base and service revenue. EBITDA of the Group for 2002 increased by 135% to HK\$240 million before restructuring costs. Loss for the year decreased by 57% to HK\$91 million before restructuring costs, and by 45% to HK\$117 million after restructuring costs.

The Group implemented various initiatives to enhance network quality and coverage, strengthen the sales and marketing functions, and improve customer service quality during the year. Combined with the efforts made in churn reduction, ongoing cost control and business process re-engineering, the Group delivered significant improvement in operating results in 2002 with subscriber numbers, mobile revenues, average revenue per user (“ARPU”) and operating efficiencies all higher.

The Group also recorded positive cash flow of HK\$129 million from operating activities in 2002 as compared with a cash outflow of HK\$89 million in 2001. The positive cash flow from operating activities was sufficient to cover finance costs and maintenance capital expenditure. As at 31st December 2002, net debt was HK\$577 million. Net debt started to reduce from the fourth quarter of 2002 and will continue to reduce until maturity.

Mobile Services

The mobile services business achieved sustained growth in both revenue and the subscriber base. In 2002, SUNDAY’s mobile subscriber base increased by 9% to 603,000 as compared with 2001. Revenue from mobile services business recorded a 5% increase from HK\$1,165 million to HK\$1,218 million.

During the year, SUNDAY implemented various initiatives to improve further its services to subscribers. The Group has enhanced the network quality and coverage, improved customer services, and strengthened the sales and marketing functions.

In 2002, the Group established a dedicated task force to monitor enhancement of its network performance. The number of cell sites increased by 17% in 2002 to over 1,050 sites to improve network quality and coverage in 2002. The high quality of the network enabled SUNDAY to be named the “Official Mobile Network Operator” at the ITU Telecom Asia 2002, a major international telecommunications event.

The Group has adopted a segmented approach to the market by providing tailor-made services targeted to different market segments. More innovative programmes aimed at clearly defined customer segments will be rolled out in 2003, which will support future growth in the mobile services business.

A number of programmes, including the “Superstar Club”, were also launched in 2002 to enhance customer care for SUNDAY subscribers in order to foster customer loyalty. The Group also introduced new billing tools, achieving greater efficiency and cost savings in billing management and providing better response to billing related inquiries from subscribers. As a result, SUNDAY received the “Outstanding Billing Implementation — Telecoms” award in *Tarifica’s Billing Magazine* Globe Awards 2002.

The monthly gross churn rate, calculated as a percentage of opening subscribers, reduced to 3.5% in December 2002 from 7.8% in December 2001, with the implementation of effective retention programmes and an easing of market conditions. While the churn may increase modestly in response to changes in market conditions, the Group will continue to make customer retention a priority and maintain a tight control over churn.

In addition to continued subscriber growth and significantly improved churn, ARPU has shown a modest rising trend in 2002 following increasing revenue from wireless data, reversing a trend observed during the past four years of declining ARPU. Monthly postpaid ARPU for December 2002 was HK\$207 as compared with HK\$205 in December 2001. Average ARPU for 2002 was HK\$209 as compared with HK\$219 in 2001.

The prepaid SIM cards have continued to record significant growth since their launch in 2000. Subscriber numbers grew by 57,000 or 43% to 189,000 in 2002 over 2001. ARPU from these subscribers was HK\$93 in 2002, comparable to that of 2001.

The gross profit percentage of mobile services was 82% in 2002, slightly higher than that of 2001 because of decreases in connection charges.

Wireless Data Services

In 2002, SUNDAY launched a series of new wireless data applications and services based on the GPRS (general packet radio services) technology.

A new line of data services was launched in the fourth quarter of 2002, which provides subscribers with a wide array of mobile entertainment through the use of MMS (multi-media messaging) enabled terminals, offered at simple, affordable tariffs. Such services include “SUNDAY Games” for a collection of interactive games, “My Album” for personalised MMS photographs, and “SUNDAY Look!Hear!” for downloads of popular MMS content. The Group has also launched a new series of wireless communications services, the “Handy Workstations” and “ICQ for SMS”, for e-mail and instant messaging using mobile phones.

More mobile phones supporting MMS or other data services based on GPRS technology were introduced to the market in 2002, and this trend will continue in 2003. Combined with the launch of inter-operator MMS services among the six wireless operators in Hong Kong in December 2002, these should allow both the usage and revenue of wireless data services to grow at faster rates in 2003. Revenue of wireless data services accounted for approximately 5% of mobile services revenue by December 2002.

Introducing a broad range of wireless data services is an important development in providing specialised products to individual customer segments, and is a vital step to ensure a successful future with 3G.

MVNO Joint Venture with Shell

In January 2002, the Group formed a joint venture with the Shell group to operate as a mobile virtual network operator (“MVNO”) on a pilot basis. The joint venture ceased operations in September 2002 as the operating results of this pilot project indicated that MVNOs had limited potential.

Sales of Mobile Phones and Accessories

Revenue from sales of mobile phones and accessories continued to decrease, mainly owing to a reduction in sales volumes as the handset subsidy level has been significantly reduced since 2000. In consequence, while such revenue decreased by 53% to HK\$115 million in 2002, the Group earned a gross profit of HK\$2 million from sales of mobile phones and accessories as compared with a gross loss of HK\$2 million in 2001.

FINANCIAL REVIEW

Turnover and gross profit

Total turnover for the year declined 6% as compared with 2001 to HK\$1,342 million, mainly due to a 53% decrease in revenue from the sales of mobile phones and accessories. Because the Group did not earn a profit from selling handsets in the past, the decline in revenues is favourable for the Group. Revenues from mobile services and the sales of mobile phones and accessories accounted for 91% and 8% respectively of the total turnover in 2002.

Therefore, despite the lower total turnover, however, gross profit for the Group improved by HK\$55 million, or 6%, to HK\$1,008 million in 2002, due to the sustained growth in the mobile services revenue, which was 5% higher at HK\$1,218 million.

Operating expenses (excluding depreciation)

Before restructuring costs of HK\$26 million, operating expenses (excluding depreciation) decreased by 10% to HK\$770 million and fell from 73% to 63% as a percentage of mobile services revenue. After restructuring costs, operating expenses (excluding depreciation) decreased by 7% from HK\$854 million in 2001 to HK\$796 million in 2002. This was a direct result of reduced acquisition costs from lower churn rate and higher productivity.

The Group established an operations centre in Shenzhen in mainland China in 2002 to provide various support services to SUNDAY and better position the Group for future opportunities to provide services in China. The new centre helps reduce operating costs as well as provide higher productivity and better service quality by leveraging the lower labour costs in mainland China.

In December 2002, the Group restructured its operations to revamp the organisational structure and reprioritise functions and responsibilities. The restructuring will help the Group take advantage of the next phase in wireless communications with a lean but efficient operating structure and a more focused employee team to strive for the Group's objective of improved profitability.

It is expected that the real benefits from this new operations centre in Shenzhen and the restructuring will be fully reflected in the Group's 2003 results. Total one-off expenses incurred in relation to the re-location of functions to Shenzhen and the restructuring in December 2002 amounted to approximately HK\$26 million, of which termination benefits, mainly severance pay and payments in lieu of notice to redundant or terminated staff were HK\$25 million.

EBITDA

With the sustained growth in gross profit and reduction in operating expenses, EBITDA increased by HK\$138 million, or 135%, to HK\$240 million before restructuring costs. After restructuring costs, EBITDA increased by 110% to HK\$214 million as compared with 2001. EBITDA represents earnings before interest income, finance costs, taxation, depreciation, amortisation and share of losses from joint ventures.

Loss for the year

Loss for the year was reduced by 57% from HK\$212 million in 2001 to HK\$91 million before restructuring costs, and by 45% to HK\$117 million after restructuring costs. The better performance was mainly attributable to the improvements in operating results as described above and partly offset by the share of losses from joint ventures.

CAPITAL EXPENDITURE

The Group's 2G/2.5G mobile network is substantially complete. Capital expenditure incurred in 2002 was mainly for the ongoing enhancement of the mobile network for data services and setting up the Shenzhen operations centre. In terms of cash flow, capital expenditure payments including deposit payments for 2002 amounted to HK\$69 million, direct drawdown from the revolving facility provided by a major vendor, Nortel Networks (Asia) Limited ("Nortel"), amounted to HK\$49 million, and capitalised 3G licence fees amounted to HK\$50 million.

Following the investment already made by the Group to expand coverage and provide capacity for GPRS services, capital expenditure in 2003 will decline further and will be mainly for maintenance of the 2G/2.5G network. The financial impact of 3G is not expected to be felt before 2004.

LIQUIDITY AND FINANCIAL RESOURCES

Cash flow from operations

The Group recorded positive cash flow of HK\$129 million from operating activities in 2002 as compared with a cash outflow from operations of HK\$89 million in 2001. The improvement in the cash flow from operations primarily resulted from the increases in operating revenues and effective cost reductions.

Financing

In 2002, the capital expenditure and working capital requirements of the Group were mainly funded by cash flow generated from operating activities and the revolving facility from Nortel. In 2002, HK\$49 million was drawn from Nortel's revolving facility for equipment purchases, which was non-cash drawdown. On 17th May 2002 the expiry date of the revolving facility provided by Nortel was extended to 11th September 2004.

As at 31st December 2002, the outstanding bank loan and vendor loan balances were repayable in seven quarterly instalments through September 2004, and were secured by a charge over all the assets, revenues and shares of certain subsidiaries of the Company, including Mandarin Communications Limited, the main operating subsidiary. The bank loans and vendor loans bear interest at prevailing market rates.

The Group had total bank and vendor loans of HK\$785 million, cash reserves of HK\$208 million and an available revolving facility of HK\$481 million. Net debt (total bank and vendor loans less cash reserves) amounted to HK\$577 million, and the net debt-to-equity ratio was 86% as at 31st December 2002.

On 30th July 2002, the Group entered into various documents to amend its bank loans and vendor loan facilities in order to accommodate changes to the structure of the Group, as well as to vary certain financial covenants. The maturity date of the loans, amounts lent and interest provisions have not been altered. The Directors believe that the agreed amendments to the financing documentation are beneficial to the Group.

FOREIGN EXCHANGE EXPOSURE

Substantially all revenues, expenses, assets and liabilities are denominated in Hong Kong dollars except for the US\$155 million vendor loan facility provided by Nortel. As at 31st December 2002, the outstanding vendor loan amounted to US\$47 million and the Group had a bank deposit of US\$24 million. The international roaming payables and receivables are netted and settled on a monthly basis in Special Drawing Rights ("SDR"). As at 31st December 2002, the net SDR-denominated payables were insignificant. The Group has not experienced foreign exchange movement and does not anticipate foreign exchange losses as long as the Hong Kong SAR Government's policy to peg the Hong Kong dollar to the U.S. dollar remains in effect. The Group will monitor its foreign exchange exposure and market conditions to determine if any hedging is required.

KEY RISKS

The business performance of the Group is subject to market competition and regulatory changes. Some forward looking statements made in the annual report with respect to SUNDAY's corporate plans or strategies are made based on management's assumptions and beliefs in the light of the information currently available to it.

The key risks include, without limitation, the following:

- Increased competition may reduce market share or revenues
- Delays in the development of handsets and network may hinder the deployment of new technologies
- Expected benefits from investment in the networks, licences and new technologies may not be realised
- Regulatory decisions and changes could adversely affect the Group's business
- ARPU may not be increased by the introduction of new services.

EMPLOYEES AND SHARE OPTION SCHEME

The Group had a total of 683 employees as at 31st December 2002, of which 510 employees were in Hong Kong and 173 employees were in Shenzhen. Excluding the termination benefits, total salaries and related costs incurred in 2002 amounted to HK\$219 million as compared with HK\$233 million in 2001. The Group offers comprehensive remuneration and benefits packages to all employees. Remuneration of employees is maintained at competitive levels, and promotion and salary increments are assessed based on individual and Group performance. Other staff benefits include Mandatory Provident Fund schemes, subsidised medical care and subsidies for external educational and training programmes.

The Group adopted a share option scheme on 1st March 2000 ("Old Scheme"). On 22nd May 2002, the shareholders of the Company approved the adoption of a new share option scheme ("New Scheme") and the termination of the operation of the Old Scheme. Upon the termination of the Old Scheme, no further options will be offered under the Old Scheme but the provisions of the Old Scheme will remain in full force and effect in respect of the existing options granted. Details of the New Scheme are disclosed in note 22 to the accounts.