## Overview

The following discussion should be read in conjunction with the Company's consolidated accounts and the related notes included elsewhere in this annual report. The Group's consolidated accounts have been prepared in accordance with Hong Kong GAAP, which differs in some material respects from US GAAP. For a discussion of these differences and a reconciliation of net profit/(loss) attributable to equity holders of the Company and shareholders' equity to US GAAP, see "Information for US Investors".

The Group showed improved performance in 2006, as it reported its first profit attributable to equity holders. In particular, the Group saw stronger operating results from both India and Israel, a return to operating profit at the mobile business in Hong Kong and a further reduction in operating loss in Thailand. In 2006, turnover from continuing operations increased by 37.0% to HK$33,378 million, as the total customer base increased by 74.7% to 29.6 million customers as of 31 December 2006. Operating profit increased by 134.2% to HK$5,045 million, reflecting improved margins, as the business continued to grow and benefit from economies of scale.

In addition, the Group undertook a number of transactions that affected its results for 2006 or will affect its results going forward.

- In January 2006, Hutchison Essar Limited ("Hutchison Essar"), the Group's India operation, completed the acquisition of 100% of BPL Mobile Cellular Limited, subsequently renamed Hutchison Essar Cellular Limited ("HECL"), which operates in the three licence areas of Maharashtra, Tamil Nadu and Kerala in India, for a consideration of INR11,440 million (approximately HK$1,964 million). The Group recorded an increase in goodwill of HK$4,628 million arising from the acquisition of HECL.

- In March 2006, the Group reorganised its holding structure in Hutchison Essar (the "Reorganisation") in light of changes in the rules governing foreign direct investment in telecommunications operators in India. Following the Reorganisation, the Group held a 37.25% interest in Telecom Investments India Private Ltd., an investment holding company held by the Group and two other parties, which indirectly owned 19.54% of Hutchison Essar. As a result, an increase in goodwill of HK$1,716 million was recorded.

- In June 2006, the Group entered into an agreement to acquire an interest in IndusInd Telecom Network Limited, subsequently renamed Omega Telecom Holdings Private Limited ("Omega"), which owns 5.11% of Hutchison Essar, for a total consideration of US$450 million (approximately HK$3,493 million). As a result, an increase in goodwill of HK$3,020 million was recorded.

- In July 2006, Hutchison Global Communications Holdings Limited ("HGCL"), a wholly owned subsidiary of the Company, disposed of its 100% interest in Vanda IT Solutions & Systems Management Limited ("VISS") for a consideration of HK$105 million to a wholly owned subsidiary of Hutchison Whampoa Limited ("HWL"). There was no gain or loss arising from the disposal.

- In July 2006, Partner Communications Company Ltd. ("Partner"), the Group's Israel operation, completed the acquisition of the transmission business of Med-1 I.C.1 (1999) Ltd. ("Med-1") for a consideration of NIS71 million (approximately HK$124 million). Med-1 is a private company that established a fibre-optic network, a national communication infrastructure deployed throughout Israel, and holds a licence from the Ministry of Communications of Israel to supply communication infrastructure services to Israeli companies.

- In October 2006, Hutchsion Essar completed the acquisition of 100% of Essar Spacetel Private Limited ("Spacetel"), a company that at that time had applications pending for licences for GSM mobile services for the licence areas of Madhya Pradesh, North East, Himachal Pradesh, Bihar, Orissa, Assam, and Jammu and Kashmir in India. In December 2006, Spacetel received licences from the Department of Telecommunications of India for six of the licence areas. The remaining licence, for the licence area of Madhya Pradesh, has been obtained in the first quarter of 2007, positioning Hutchison Essar to extend its services to full nationwide coverage.

- On 11 February 2007, the Group entered into an agreement with a wholly owned subsidiary of Vodafone Group Plc to sell its entire direct and indirect equity and loan interests, held through subsidiaries, in its Indian mobile telecommunications operation comprising Hutchison Essar and its subsidiaries for cash consideration of approximately US$11,080 million (approximately HK$86,570 million) (before costs, expenses and interest payable by the purchaser) (the "India Sale"). The India Sale was approved by the Company's shareholders at an extraordinary general meeting held on 9 March 2007. Subsequently, Essar Teleholdings Limited and certain of its affiliates ("Essar") asserted various rights in relation to the India Sale and threatened to commence proceedings in the Indian courts in order to enforce those alleged rights, including by preventing completion of the India Sale. On 15 March 2007, the Company entered into a conditional settlement agreement (the "Settlement Agreement") with Essar pursuant to which Essar agreed to, amongst others: (i) refrain from doing anything which would prevent, delay or inhibit completion of the India Sale; (ii) use all reasonable endeavours to ensure that completion of the India Sale is achieved as soon as practically possible; (iii) waive rights it has or claims to have in respect of certain matters including those related to the India Sale; and (iv) terminate certain agreements, alleged agreements and understandings relating to the relationship connected to Hutchison Essar. In consideration, and subject to completion of the India Sale and subject to obtaining the approval of its shareholders, the Company agreed to make scheduled payments to Essar aggregating US$415 million (approximately HK$3,243 million) before interest. Upon completion of the India Sale and payment under the Settlement Agreement , the Group is expected to realise an estimated pre-tax gain of approximately US$9,195 million (HK$71,847 million) and a net cash inflow of approximately US$10,585 million (HK$82,708 million).

## Basis of Preparation of Accounts

The results of operations of subsidiaries and associates acquired or disposed of during a year are included in the Group's consolidated accounts commencing from the effective dates of their acquisition or up to the effective dates of their disposal, as the case may be.

During 2006, the Group changed certain accounting policies following the adoption of new or revised HKFRS (which term collectively includes Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and related interpretations) that were effective for accounting periods commencing on or after 1 January 2006. The impact of these changes in HKFRS is detailed in note 2(b) to the Group's accounts.

The Group's subsidiaries are grouped into the following six segments for financial reporting purposes, based on their geographic area of operation and principal business line:

- Hong Kong mobile
- Hong Kong fixed-line
- India
- Israel
- Thailand
- Others

In the years prior to 2005, the Group had five segments for financial reporting purposes. In 2005, the number of segments increased to six as a result of the consolidation of Partner beginning in the second quarter of 2005.

The results of operations of the Macau mobile business are aggregated with the Hong Kong mobile business because the Macau operating company is a subsidiary of the Hong Kong mobile operating company, shares the same management and is significantly smaller in terms of financial results and customer numbers.

"Others" is comprised of the Group's operations in Sri Lanka, Ghana, Indonesia, Vietnam and operations of the Group's corporate office, as well as the non-telecommunications businesses of VISS up to the date of disposal of VISS in July 2006. In July 2005, the Group completed the disposal of the Group's operations in Paraguay; hence the results of the Group's Paraguay operations have been presented as a discontinued operation and are excluded from the "Others" segment.

## Results of Operations

The following table presents, for the years indicated, the major line items in the Group's consolidated income statement, including such amounts expressed as a percentage of the Group's total turnover:

| | Year ended 31 December | | | |
|---|---|---|---|---|
| | 2005 | | 2006 | |
| | (HK$ millions, except percentages) | | | |
| **Consolidated income statement** | | | | |
| | | % | | % |
| Continuing operations: | | | | |
| Turnover | 24,356 | 100.0 | 33,378 | 100.0 |
| Operating expenses | | | | |
| Cost of inventories sold | (2,331) | (9.6) | (2,305) | (6.9) |
| Staff costs | (2,319) | (9.5) | (2,666) | (8.0) |
| Depreciation and amortisation | (4,367) | (18.0) | (5,076) | (15.2) |
| Other operating expenses | (13,256) | (54.4) | (18,330) | (54.9) |
| Operating profit before disposal of investments and others | 2,083 | 8.5 | 5,001 | 15.0 |
| Profit on disposal of investments and others, net | 71 | 0.3 | 44 | 0.1 |
| Operating profit | 2,154 | 8.8 | 5,045 | 15.1 |
| Interest and other finance costs, net | (1,604) | (6.6) | (2,642) | (7.9) |
| Share of results of associates | 86 | 0.4 | (1) | 0.0 |
| Profit before taxation | 636 | 2.6 | 2,402 | 7.2 |
| Taxation | (434) | (1.8) | (826) | (2.5) |
| Profit for the year from continuing operations | 202 | 0.8 | 1,576 | 4.7 |
| Discontinued operations: | | | | |
| Loss from discontinued operations | (352) | (1.4) | – | 0.0 |
| Profit/(loss) for the year | (150) | (0.6) | 1,576 | 4.7 |
| Attributable to: | | | | |
| Equity holders of the Company: | | | | |
| – continuing operations | (416) | (1.7) | 201 | 0.6 |
| – discontinued operations | (352) | (1.4) | – | 0.0 |
| | (768) | (3.1) | 201 | 0.6 |
| Minority interest – continuing operations | 618 | 2.5 | 1,375 | 4.1 |
| | (150) | (0.6) | 1,576 | 4.7 |

## Year ended 31 December 2006 compared with year ended 31 December 2005

### Group results

In April 2005, Partner completed a buy back of its own shares, increasing the Group's interest to over 50%, which resulted in Partner becoming a consolidated subsidiary. Accordingly, the Group's operating profit for 2005 included Partner's contribution for only the last three quarters of 2005, compared with a full year contribution in 2006. The following table sets out the consolidated income statement of Partner's results for (i) the first quarter of 2005, (which was not consolidated in the Group's 2005 accounts), (ii) the last three quarters of 2005, and (iii) the full year of 2005 by combining Partner's results for the first quarter with its results for the last three quarters of 2005.

| | Three months ended 31 March 2005 Partner HK$ millions | Nine months ended 31 December 2005 Partner HK$ millions | Year ended 31 December 2005 Partner HK$ millions |
|---|---|---|---|
| Turnover | 2,138 | 6,612 | 8,750 |
| Cost of inventories sold | (214) | (1,121) | (1,335) |
| Staff costs | (256) | (778) | (1,034) |
| Depreciation and amortisation | (303) | (1,149) | (1,452) |
| Other operating expenses | (964) | (2,732) | (3,696) |
| Operating profit before disposal of investments and others | 401 | 832 | 1,233 |
| Loss on disposal of investments and others | – | (5) | (5) |
| Operating profit | 401 | 827 | 1,228 |

#### Turnover

The Group's turnover increased 37.0% from HK$24,356 million in 2005 to HK$33,378 million in 2006. The key contributor to the underlying growth in turnover was a 74.7% increase in the customer base, which increased to 29.6 million at end of 2006 from 16.9 million at end of 2005. The year-on-year growth in turnover reflects the inclusion of Partner's turnover for the full year in 2006, compared with its inclusion for only three quarters in 2005 as the Group only began to consolidate Partner's results from 1 April 2005. On a like-for-like basis (taking into account Partner's turnover for the first quarter of 2005), turnover in 2006 increased 26.0% compared with 2005.

The Group again recorded a substantial increase in turnover in India, which contributed 46.3% of the Group's total turnover in 2006. With a full-year contribution from Partner in 2006, turnover from Israel represented 29.3%, whilst Hong Kong and Macau accounted for 19.8% (of which mobile operations represented 12.6% and fixed-line operations represented 7.2%), Thailand 3.0% and "Others" segment 1.6%.

The majority of turnover came from mobile telecommunications services, which increased slightly as a portion of total turnover, representing 87.7% compared with 86.2% in 2005. The balance came from fixed-line telecommunications services, which represented 7.2% of total turnover in 2006 compared with 9.0% in 2005, sales of mobile telecommunications products such as handsets and accessories, which represented 4.3%, and other non-telecommunications businesses, principally relating to the IT solutions businesses of VISS, which represented 0.8%. VISS was disposed of in July 2006 and has ceased to contribute to the turnover of the Group.

#### Operating profit before disposal of investments and others

The Group's operating profit before disposal of investments and others improved by 140.1% to HK$5,001 million in 2006, compared with HK$2,083 million in 2005. This year-on-year growth in operating profit before disposal of investments and others reflects the inclusion of Partner's operating profit for the full year in 2006 compared to only three quarters in 2005. On a like-for-like basis (taking into account Partner's operating profit for the first quarter of 2005), operating profit before disposal of investments and others increased by 101.3%. Strong results from operations in India and Israel together with a return to profit at the Hong Kong mobile operations and a further reduction in operating losses in Thailand were the main contributors to this growth.

## Operating expenses

The following table presents a breakdown of operating expenses from continuing operations and the percentage change from year to year:

| | Year ended 31 December | | |
|---|---|---|---|
| | 2005 HK$ millions | 2006 HK$ millions | Change % |
| Cost of inventories sold | 2,331 | 2,305 | -1.1 |
| Staff costs | 2,319 | 2,666 | +15.0 |
| Depreciation and amortisation | 4,367 | 5,076 | +16.2 |
| Other operating expenses | 13,256 | 18,330 | +38.3 |
| Total operating expenses | 22,273 | 28,377 | +27.4 |

Operating expenses in 2006 increased 27.4% compared to a 37.0% increase in turnover in 2006. The increase in operating expenses was primarily attributable to higher levels of activity in the business. As a percentage of turnover, operating expenses decreased from 91.4% in 2005 to 85.0% in 2006. This year-on-year growth in operating expenses reflects the inclusion of Partner's operating expenses for the full year in 2006 compared with only three quarters in 2005. On a like-for-like basis (taking into account Partner's operating expenses and turnover for the first quarter of 2005), operating expenses increased 18.2% over 2005 against a 26.0% increase in turnover over 2005.

Cost of inventories sold decreased 1.1% from HK$2,331 million in 2005 to HK$2,305 million. On a like-for-like basis (taking into account Partner's cost of inventories sold for the first quarter of 2005), cost of inventories decreased 9.4%. The decline was mainly due to the disposal in July 2006 of VISS, which has ceased to contribute to the results of the Group.

Staff costs increased 15.0% from HK$2,319 million in 2005 to HK$2,666 million in 2006, mainly due to the expansion of the Group's business and inclusion of Partner's staff costs for the full year in 2006 compared with only three quarters in 2005. On a like-for-like basis (taking into account Partner's staff costs for the first quarter of 2005), staff costs increased well below the rate of increase in turnover at only 3.5% over 2005. As a percentage of total turnover, staff costs decreased from 9.5% in 2005 to 8.0% in 2006. The smaller increase in staff costs was due to actions commenced in 2005 through rationalisation and outsourcing, especially in the Group's Hong Kong mobile and fixed-line and Thailand operations. The Group also benefited from improving economies of scale.

Depreciation and amortisation increased 16.2% from HK$4,367 million in 2005 to HK$5,076 million. On a like-for-like basis (taking into account Partner's depreciation and amortisation for the first quarter of 2005), depreciation and amortisation expenses increased 8.7%. The increased depreciation was attributable to the continuing network rollout of the Group's operations, principally in India. The increased amortisation charge resulted mainly from the higher amortisation of customer base resulting from the acquisition of HECL in India and the transmission business of Med-1 in Israel.

The following table presents a breakdown of other operating expenses:

| | Year ended 31 December | | |
|---|---|---|---|
| | 2005 HK$ millions | 2006 HK$ millions | Change % |
| Cost of services provided | 8,673 | 11,668 | +34.5 |
| General administrative and distribution costs | 2,087 | 4,265 | +104.4 |
| Operating leases in respect of buildings, hire of plant and machinery | 1,187 | 1,360 | +14.6 |
| Impairment loss on fixed assets | - | 16 | N/A |
| Write-off of customer acquisition and retention costs | 99 | 26 | -73.7 |
| Others | 1,210 | 995 | -17.8 |
| Other operating expenses | 13,256 | 18,330 | +38.3 |

Other operating expenses increased 38.3% from HK$13,256 million in 2005 to HK$18,330 million in 2006. On a like-for-like basis (taking into account Partner's other operating expenses for the first quarter of 2005), other operating expenses increased by 28.9%. The main component of other operating expenses was the cost of services provided, consisting of network costs and associated network operating costs, which increased 34.5% from HK$8,673 million in 2005 to HK$11,668 million in 2006. The increase in the cost of services provided was mainly attributable to continuing growth in the Group's customer base, which resulted in significant increases in interconnection, roaming and IDD charges, as well as the continuing network rollout, which resulted in increased rental fees for cell sites and leased lines.

The increase in other operating expenses was also partly due to a 104.4% increase in general administrative and distribution costs from HK$2,087 million in 2005 to HK$4,265 million in 2006, as well as a 14.6% increase in operating leases in respect of buildings and the hire of plant and machinery from HK$1,187 million in 2005 to HK$1,360 million in 2006, reflecting the general expansion in scale of the businesses and the contribution from subsidiaries acquired during the year. These increases in other operating expenses were offset in part by a 17.8% decline in other expenses and a 73.7% decline in write-off of customer acquisition and retention costs.

Other operating expenses represented 54.9% of the Group's total turnover in 2006, which was comparable to the 54.4% that it represented in 2005.

## Profit on disposal of investments and others, net

During the year, the Group recorded a profit on disposal of investments and others of HK$44 million, comprising the recognition of negative goodwill of HK$45 million from the acquisition of the transmission business of Med-1 by Partner in Israel. In 2005, the Group recorded a profit on disposal of investments and others of HK$71 million, comprising (i) a profit of approximately HK$49 million on disposal of an approximate 4% equity interest in Hutchison Essar as a result of the exercising of call options by Essar, a minority shareholder of Hutchison Essar; and (ii) negative goodwill of HK$27 million resulting from the transfer of a 0.57% equity interest in Hutchison Essar at nil consideration from Essar; and (iii) offset in part by a dilution loss on the Group's shareholding in Partner of approximately HK$5 million as a result of the exercise of share options by holders of options to purchase Partner's shares.

## Operating profit

As a result of the foregoing, the Group recorded an operating profit of HK$5,045 million in 2006, representing an increase of 134.2% from HK$2,154 million in 2005. On a like-for-like basis (taking into account Partner's operating profit for the first quarter of 2005), operating profit increased by 97.5% over 2005. The increase was attributable to the strong results from operations in India and Israel, together with a return to operating profit at the Hong Kong's mobile operations and a further reduction in operating losses in Thailand.

## Interest and other finance costs, net

Net interest and other finance costs principally consisted of interest and other finance costs relating to the Group's debt, net of interest income received from bank deposits, and changes in fair value of derivative instruments. Net interest and other finance costs increased 64.7% from HK$1,604 million in 2005 to HK$2,642 million in 2006, primarily due to higher levels of debt incurred in connection with acquisitions in India. The higher interest expense also arose from the higher levels of Thai Baht-denominated debt, where higher levels of debt were compounded by higher effective interest rates and changes in the exchange rate.

## Share of results of associates

The Group recorded a share of losses from associates of HK$1 million in 2006, compared with a profit of HK$86 million in 2005. The change was due to the consolidation for the first time of the results of Partner beginning in April 2005.

## Profit before taxation

The Group recorded a profit before taxation of HK$2,402 million in 2006, an increase of 277.7% from HK$636 million in 2005.

### Taxation

The Group's taxation charge of HK$826 million in 2006 was comprised of current taxation charge of HK$896 million and a deferred taxation credit of HK$70 million. The Group's current taxation charge increased to HK$896 million compared with HK$229 million in 2005, which was mainly attributable to increased taxable income from the India operations.

The Group recorded a net deferred taxation credit from continuing operations of HK$70 million in 2006, compared with a net deferred taxation charge of HK$205 million in 2005. The net deferred taxation charge in 2005 related to each of the Group's India and Hong Kong mobile operations as well as Partner, where the Group had historical losses. These carry-forward losses were applied to the tax positions as offsets, which led to the credit in 2006.

### Profit from continuing operations

Profit from continuing operations increased to HK$1,576 million in 2006, from HK$202 million in 2005.

### Loss from discontinued operations

The Group did not dispose of any of operations in 2006 that required to be presented as discontinued operations in accordance with HKFRS 5 "Non-current Assets held for Sale and Discontinued Operations", thus no loss from discontinued operations was recorded. In July 2005, the Group disposed of its mobile operations in Paraguay. Accordingly, the mobile operations in Paraguay were presented as discontinued operations in accordance with HKFRS 5 and a loss from discontinued operations of HK$352 million was recorded in 2005.

### Profit attributable to equity holders

Profit attributable to equity holders from continuing operations of the Company in 2006 was HK$201 million (or HK$0.04 earnings per share). In 2005, the loss attributable to equity holders of the Company was HK$768 million (or HK$0.17 loss per share), of which HK$416 million loss (or HK$0.09 loss per share) was from continuing operations and HK$352 million loss (or HK$0.08 loss per share) was from discontinued operations.

## Results of the Group's operating companies

### Turnover

The following table presents a breakdown of turnover by segment and the percentage of total turnover accounted for by each segment:

| | Year ended 31 December | | | |
|---|---|---|---|---|
| | 2005 | | 2006 | |
| | HK$ millions | % | HK$ millions | % |
| India | 9,996 | 41.0 | 15,455 | 46.3 |
| Israel[1] | 6,612 | 27.1 | 9,796 | 29.3 |
| Hong Kong mobile | 3,837 | 15.8 | 4,199 | 12.6 |
| Hong Kong fixed-line | 2,204 | 9.0 | 2,406 | 7.2 |
| Thailand | 1,045 | 4.3 | 1,017 | 3.0 |
| Others | 662 | 2.8 | 505 | 1.6 |
| | 24,356 | 100.0 | 33,378 | 100.0 |

*(1) Israel was not consolidated in the Group's results until April 2005.*

- **India operations.** The Group's India operations accounted for 46.3% of the Group's total turnover in 2006, compared with 41.0% in 2005. Turnover from the India operations increased 54.6% from HK$9,996 million in 2005 to HK$15,455 million in 2006, primarily due to strong growth in the customer base. The customer base increased to approximately 23.3 million at the end of 2006, 104.2% higher than the customer base of 11.4 million at the end of 2005. The growth was mainly driven by an increase in prepaid customers as thresholds to entry and monthly charges continued to fall. The customer base also benefited from the contribution of 1.5 million customers from HECL which was acquired in January 2006. Over 90% of the growth in the year was in the prepaid segment, which generally has lower average revenue per user than the postpaid segment. This increased reliance on the prepaid segment, plus declining monthly charges, were the principal reasons for the slower growth in turnover relative to the growth in the customer base. At the end of 2006, 85.6% of the customer base in India was in the prepaid segment, up from 77.8% at the end of 2005.

- **Israel operations.** Israel accounted for 29.3% of the Group's total turnover in 2006 compared with 27.1% of total turnover in 2005, having been consolidated as a subsidiary only since April 2005. Turnover from the Israel operations increased by 48.2% from HK$6,612 million in 2005 to HK$9,796 million in 2006. This year-on-year growth reflects the inclusion of Partner's turnover for the full year in 2006 compared to only three quarters in 2005. On a like-for-like basis (taking into account Partner's turnover for the first quarter of 2005), turnover increased by 12.0%. The increase was primarily due to the growth in service revenue resulting from higher minutes of use. As of 31 December 2006, Partner's customer base had risen to 2.7 million, an increase of 5.5% compared with 2005, demonstrating Partner's ability to continue to grow its business in a highly competitive market. Growth in turnover was offset in part by a reduction in Partner's average tariff per minute, which resulted from a government-mandated reduction in interconnection tariffs.

- **Hong Kong mobile operations.** The Group's mobile operations in Hong Kong accounted for 12.6% of total turnover in 2006, compared with 15.8% in 2005. Despite intense competition, turnover increased 9.4% from HK$3,837 million in 2005 to HK$4,199 million in 2006. This was mainly driven by growth in 3G customers, who typically have a higher average revenue per user. As of 31 December 2006, the mobile customer base in Hong Kong and Macau had risen to 2.1 million, an increase of 8.5% compared with the same date in 2005. The increased turnover was also partly due to increased roaming revenues. Growth was partially offset by a reduction in turnover from a reduction in the 2G customer base.

- **Hong Kong fixed-line operations.** The Group's fixed-line operations in Hong Kong accounted for 7.2% of total turnover in 2006, compared with 9.0% in 2005. Turnover increased 9.2% from HK$2,204 million in 2005 to HK$2,406 million in 2006, reflecting the growth in all services, in particular international and local data services and residential broadband services. Despite keen competition and pricing pressure, turnover growth in international and local data services was achieved through higher customer demand and additional penetration in the carrier, corporate and regional markets. Revenue from residential broadband also saw growth as a result of an increase in the customer base and average revenue per customer. Local voice customers also grew steadily during the year providing a stable revenue stream.

- **Thailand operations.** The Group's Thailand operations accounted for 3.0% of total turnover in 2006, compared with 4.3% in 2005. Turnover from the Thailand operations decreased slightly from HK$1,045 million in 2005 to HK$1,017 million in 2006. A sharp increase in promotional offers introduced at the beginning of 2006 contributed to significant tariff reductions in the Thai mobile telecommunications market. Price competition amongst operators continued throughout 2006. The decrease in turnover was also partly due to an increase in the percentage of prepaid customers to 57.3% at the end of 2006 compared with 52.9% at the end of 2005. The prepaid segment generally has lower average revenues per user than the postpaid segment. The number of postpaid customers declined 9.9%, while the number of prepaid customers increased by 7.8%.

- **Other operations.** Turnover from other operations consisted of turnover from Sri Lanka, Ghana and non-telecommunications business. These operations collectively accounted for 1.6% of turnover in 2006, compared with 2.8% in 2005. Turnover in 2006 was HK$505 million, a decrease of 23.7% from HK$662 million in 2005, mainly due to the disposal of VISS in July 2006.

## Operating profit

The following table presents a breakdown of operating profit before disposal of investments and others by segment; profit on disposal of investments and others, net; and the percentage of total operating profit accounted for by each segment or line item:

| | Year ended 31 December | | | |
|---|---|---|---|---|
| | 2005 | | 2006 | |
| | HK$ millions | % | HK$ millions | % |
| India | 2,440 | 113.3 | 3,628 | 71.9 |
| Israel[1] | 832 | 38.6 | 1,708 | 33.9 |
| Hong Kong mobile | (420) | (19.5) | 247 | 4.9 |
| Hong Kong fixed-line | 78 | 3.6 | 259 | 5.1 |
| Thailand | (544) | (25.3) | (501) | (9.9) |
| Others | (303) | (14.0) | (340) | (6.8) |
| Operating profit before disposal of investments and others | 2,083 | 96.7 | 5,001 | 99.1 |
| Profit on disposal of investments and others, net | 71 | 3.3 | 44 | 0.9 |
| Operating profit | 2,154 | 100.0 | 5,045 | 100.0 |

*(1) Israel was not consolidated in the Group's results until April 2005.*

The following table presents a breakdown of operating expenses for the stated years by segment and the percentage of operating expenses accounted for by each segment:

| | Year ended 31 December | | | |
|---|---|---|---|---|
| | 2005 | | 2006 | |
| | HK$ millions | % | HK$ millions | % |
| India | 7,556 | 33.9 | 11,827 | 41.7 |
| Israel[1] | 5,780 | 26.0 | 8,088 | 28.5 |
| Hong Kong mobile | 4,257 | 19.1 | 3,952 | 13.9 |
| Hong Kong fixed-line | 2,126 | 9.5 | 2,147 | 7.6 |
| Thailand | 1,589 | 7.1 | 1,518 | 5.3 |
| Others | 965 | 4.4 | 845 | 3.0 |
| Operating expenses | 22,273 | 100.0 | 28,377 | 100.0 |

*(1) Israel was not consolidated in the Group's results until April 2005.*

- **India operations.** Operating profit before disposal of investments and others from the Group's India operations increased 48.7% from HK$2,440 million in 2005 to HK$3,628 million in 2006, representing 71.9% of the Group's total operating profit in 2006. The increase in operating profit reflected continued strong performance from the existing licence areas of Hutchison Essar and improved operating performance in the newer service areas acquired through HECL. Operating expenses for the India business increased 56.5%, which was slightly higher than the growth in turnover of 54.6% reflecting costs associated with the rapid network build-out initiated in 2006 as well as the initial costs of acquisition and integration of HECL, which was acquired in January 2006. Operating expenses in 2006 were also increased by staff costs arising from a performance bonus rights plan adopted by Hutchison Essar in September 2006.

- **Israel operations.** Operating profit before disposal of investments and others from the operations in Israel was HK$1,708 million, representing growth of 105.3% over 2005. This year-on-year growth reflected the inclusion of Partner's contribution for the full year in 2006 compared with only three quarters in 2005. On a like-for-like basis (taking into account Partner's contribution for the first quarter of 2005), Partner's operating profit before disposal of investments and others in 2006 increased 38.5% compared with 2005, which exceeded the 12.0% increase in its turnover. This higher operating profit reflected strong operating performance as well as growth in the number of 3G contract customers, as well as lower government royalty expenses and the implementation of efficiency measures. In addition, Partner recorded a profit on disposal of investments and others of HK$44 million in 2006, including negative goodwill of HK$45 million arising from the acquisition of the transmission business of Med-1.

- **Hong Kong mobile operations.** The Group's mobile operations in Hong Kong recorded an operating profit of HK$247 million in 2006, a turnaround from an operating loss of HK$420 million in 2005. The improvement was mainly due to revenue growth and an improved operating cost structure of the business resulting from a number of cost saving initiatives started in 2005, including staff cost savings from the outsourcing of network maintenance, information technology and call centre operations. Despite growth in turnover and customers, operating expenses in 2006 dropped 7.2% compared with 2005.

- **Hong Kong fixed-line operations.** The Group's fixed-line operations in Hong Kong recorded an operating profit of HK$259 million in 2006, an increase of 232.1% from HK$78 million in 2005. This improvement was due mainly to relative growth in data services and broadband services and an improved operating cost structure for the business resulting from a number of cost saving initiatives launched in 2005 including outsourcing. Operating expenses in 2006 were HK$2,147 million, which was essentially unchanged compared with HK$2,126 million in 2005, despite the business expansion and increased turnover.

- **Thailand operations.** Operating loss from the Thailand operations decreased 7.9% from HK$544 million in 2005 to HK$501 million in 2006, reflecting success in improving the operating cost structure of the business resulting from initiatives launched in 2005 including outsourcing. Operating expenses fell 4.5% to HK$1,518 million reflecting the improved operating cost structure of the business. During the second half of 2006 the Thailand operations increased their provisions against inventory and bad debt.

- **Other operations.** Operating losses from other operations increased to HK$340 million in 2006 from HK$303 million in 2005. The losses were mainly attributable to the inclusion of the operating expenses incurred by the startup operations in Vietnam and Indonesia, operating losses from Ghana and expenses of the Group's corporate office.

  The Group's Vietnam and Indonesia operations did not generate any revenues in 2006 as they were still in the process of being rolled out. In January 2007, the Group announced the launch of HT Mobile, the nationwide mobile communications service operator in Vietnam, and in March 2007 the Group announced the commercial launch of services in Indonesia.

## Liquidity and Capital Resources

### Requirements

The Group's liquidity and capital requirements relate principally to the following:

- capital expenditures for the continuing build-out and expansion of networks in the markets where the Group operates, including purchases of fixed assets and licenses and acquisitions of interests in existing third-party telecommunications companies as well as companies engaged in complementary or related businesses;

- costs and expenses relating to the operation of the businesses, including ongoing costs related to network operations, sales and distribution expenses and customer service; and

- payments of the principal and interest on debt.

As of 31 December 2006, the Group had net current liabilities of HK$17,268 million. Although the Group's operations generated cash during the year, investments in the businesses consumed cash in excess of amounts generated from operations. The consequent financing requirements were met by bank and other loans, including a HK$9 billion credit facility that the Company entered into in November 2005, which is described in greater detail below in "Outstanding debt". The Group has historically met its working capital and other capital requirements principally from cash flow from operating activities and through borrowings from banks. The Group expects that it will continue to fund the capital required to build, maintain and operate telecommunications networks through a combination of cash flow from operating activities and bank borrowings, although it expects that upon completion of the India Sale, the Group will be able to repay up to HK$13.9 billion of outstanding debt and fund other requirements from the cash proceeds of the India Sale.

## Capital expenditure

The following table sets forth the Group's capital expenditure by segment for the years indicated:

| | Capital expenditure on fixed assets Year ended 31 December | | Capital expenditure on other intangible assets Year ended 31 December | |
|---|---|---|---|---|
| | 2005 HK$ millions | 2006 HK$ millions | 2005 HK$ millions | 2006 HK$ millions |
| India | 2,744 | 7,016 | – | 9 |
| Israel(1) | 531 | 848 | – | 1 |
| Hong Kong mobile | 415 | 284 | 477 | 453 |
| Hong Kong fixed-line | 425 | 466 | 98 | 32 |
| Thailand | 282 | 112 | 75 | – |
| Others | 321 | 393 | – | 1,341 |
| Total capital expenditure | 4,718 | 9,119 | 650 | 1,836 |

*(1) Israel was not consolidated in the Group's results until April 2005.*

Capital expenditure on fixed assets increased 93.3% to HK$9,119 million in 2006 from HK$4,718 million in 2005. The increase in capital expenditure on fixed assets was mainly in the India and Israel operations and expansion in the new markets of Indonesia and Vietnam. These increases were offset in part by decreases in capital expenditure on fixed assets in the Hong Kong mobile operations and the Thailand operations. The capital expenditure on fixed assets in India increased as Hutchison Essar continued to invest to broaden its operations in existing and new licence areas. Capital expenditure in Israel increased in part in connection with the continued build-out of Partner's 3G network. The decrease in capital expenditure on fixed assets in Hong Kong mobile operations mainly reflected the completion of the initial investment in building the basic infrastructure of a territory-wide 3G network. The decrease in capital expenditure on fixed assets in Thailand was mainly due to the completion of the principal network build-out and the implementation of cost saving programs. The initial investments in Indonesia and Vietnam are included under "Others" and reflect initial rollout costs.

Capital expenditure on other intangible assets was comprised mainly of telecommunications licences, customer acquisition and retention costs, brand name and customer base. Capital expenditure on other intangible assets in 2005 of HK$650 million represented the additional customer acquisition and retention costs incurred, primarily for 3G customers in Hong Kong, during 2005. In 2006, capital expenditure on other intangible assets increased 182.5% to HK$1,836 million due mainly to the capitalisation of telecommunications licences of HK$1,341 million in Indonesia, with the corresponding amount recorded as licence fee liabilities (representing mainly the discounted value of the fixed annual fees to be paid over the licence period). The increase was offset in part by a decrease in customer acquisition and retention costs from HK$650 million to HK$485 million.

2007 will be a year when the Group continues to invest in Indonesia and Vietnam to establish or further strengthen the Group's position in these markets. The Group expects its principal capital expenditure requirements for 2007 to be approximately HK$6,000 million to HK$7,000 million (excluding India) comprised principally of the following:

- approximately HK$3,000 million to HK$4,000 million in Indonesia for network buildout;
- approximately HK$1,000 million in Vietnam for network buildout; and
- the remainder in Hong Kong and Israel on their 3G networks and maintenance expenditures.

## Outstanding debt

The Group has financed its network buildout and operating costs principally from cash flow from the Group's operating activities and through loans from commercial banks. As of 31 December 2005 and 2006, the ratio of the Group's total debts to total assets was approximately 45% and 49%, respectively.

During 2006, the Group's borrowings increased as the result of additional debt incurred primarily in connection with acquisitions in India. The Group incurred approximately HK$6,000 million in debt to fund the acquisition of its interest in Omega, the reorganisation of its holding company interests and the final payments in respect of HECL and Spacetel. In addition, the Group assumed approximately HK$3,200 million of debt with the acquisition of HECL.

Following the completion of the India Sale, approximately HK$15,300 million of the Group's debt will be assumed by the purchaser. The Group also announced its intention to reduce other debt by up to HK$13,900 million following completion of the India Sale, which would leave it with gross debt of approximately HK$26,000 million and a net cash position of approximately HK$62,000 million.

As of 31 December 2005, 28.8% of the Group's total borrowings, or HK$7,690 million, was repayable within one year, compared with 40.7%, or HK$16,048 million, as of 31 December 2006.

The following table presents information regarding outstanding bank loans and other interest-bearing third-party borrowings and debentures as of 31 December 2006 by segment.

| Country | Fixed/floating interest rate | Maturity | Currency | Committed facility HK$ millions | Current portion HK$ millions | Non-current portion HK$ millions | Total HK$ millions |
|---|---|---|---|---|---|---|---|
| India | Fixed | Feb 2007 – Mar 2015 | INR | 9,899[(1)] | 6,499 | 3,394 | 9,893 |
| | Floating | Mar 2007 – Aug 2009 | INR | 5,079 | 805 | 3,933 | 4,738 |
| | Floating | Feb 2011 – Mar 2011 | USD | 1,092 | – | 1,082 | 1,082 |
| Israel | Fixed | Apr 2009 | USD | 22[(1)] | 10 | 12 | 22 |
| | Floating | Sep 2009 – Mar 2012 | NIS | 5,841[(2)] | 65 | 4,193 | 4,258 |
| Hong Kong mobile | Fixed | Dec 2008 | USD | 551[(1)] | – | 551 | 551 |
| | Floating | May 2008 | HKD | 6,000 | – | 4,539 | 4,539 |
| Hong Kong fixed-line | Fixed | Jan 2014 | HKD | 17 | 2 | 9 | 11 |
| | Floating | Nov 2008 | HKD | 9,000[(3)] | – | 714 | 714 |
| | Floating | Nov 2008 | USD | -[(3)] | – | 4,467 | 4,467 |
| Thailand | Floating | Jan 2007 – Dec 2007 | THB | 2,145 | 1,972 | – | 1,972 |
| | Floating | Jan 2007 – Dec 2007 | JPY | 6,847 | 6,578 | – | 6,578 |
| | Floating | Mar 2010 | USD | 154 | 37 | 94 | 131 |
| Others | Floating | Jan 2007 – Dec 2009 | USD/HKD | 411 | 80 | 381 | 461 |
| HTIL total | | | | 47,058 | 16,048 | 23,369 | 39,417 |

(1) *Includes finance lease obligations as at 31 December 2006.*

(2) *Includes floating rate notes as at 31 December 2006.*

(3) *The HK$9 billion secured revolving loan facility is available for both the Hong Kong fixed-line business and corporate office.*

The following table presents the Group's outstanding bank loans and other interest-bearing third-party borrowings by segment, as well as information regarding maturities and interest expenses for the years ended 31 December 2005 and 2006 in respect of such debt:

| | As at and for the year ended 31 December 2005 | | | |
|---|---|---|---|---|
| HK$ millions | Current portion | Non-current portion | Total borrowings | Interest expenses |
| India | 1,796 | 4,057 | 5,853 | 342 |
| Israel[1] | 58 | 4,483 | 4,541 | 429 |
| Hong Kong mobile | – | 4,128 | 4,128 | 144 |
| Hong Kong fixed-line | 2 | 262 | 264 | 1 |
| Thailand | 5,698 | 1,488 | 7,186 | 299 |
| Others | 136 | 4,584 | 4,720 | 99 |
| | 7,690 | 19,002 | 26,692 | 1,314 |

*(1) Israel was not consolidated in the Group's results until April 2005.*

| | As at and for the year ended 31 December 2006 | | | |
|---|---|---|---|---|
| HK$ millions | Current portion | Non-current portion | Total borrowings | Interest expenses |
| India | 7,304 | 8,409 | 15,713 | 1,050 |
| Israel | 75 | 4,205 | 4,280 | 187 |
| Hong Kong mobile | – | 5,090 | 5,090 | 200 |
| Hong Kong fixed-line | 2 | 5,190 | 5,192 | 8 |
| Thailand | 8,587 | 94 | 8,681 | 504 |
| Others | 80 | 381 | 461 | 335 |
| | 16,048 | 23,369 | 39,417 | 2,284 |

As at 31 December 2006, total borrowings of HK$8,042 million (compared with HK$7,488 million as at 31 December 2005) were guaranteed by members of the HWL Group of Companies (the "HWL Group") and other related companies in respect of loans to the Group's Thailand's operation only. Under the terms of a credit support agreement between the Company and HWL, the Company will pay a guarantee fee charged at normal commercial rates and will provide a counter-indemnity in favour of the HWL Group in respect of guarantees, indemnities and security provided by the HWL Group for so long as there remains a guarantee liability. The total amount of fees paid by the Group to the HWL Group in 2006 in respect of these borrowings was HK$78 million.

As at 31 December 2006, fixed assets and current assets of certain subsidiaries with a carrying value of HK$27,603 million (compared with HK$11,520 million as at 31 December 2005) and HK$30,077 million (compared with HK$6,756 million as at 31 December 2005), respectively were used as collateral for certain of the borrowings. The current portion of borrowings of the Group is secured to the extent of HK$6,594 million (compared with HK$868 million as at 31 December 2005). The non-current portion of borrowings of the Group is secured to the extent of HK$18,249 million (compared with HK$16,748 million as at 31 December 2005).

In December 2006, the Group's Thailand operations extended the maturity date of six outstanding commercial loan facilities with international lenders, totaling JPY117,530 million and THB5,000 million (together approximately HK$8,833 million), by one year. All of the Japanese Yen loan drawings and repayments were converted to Thai Baht payments through cross currency swaps and forward foreign currency contracts.

## Capital resources

The Group historically has met working capital and other capital requirements principally from cash flow from operating activities and through borrowings from banks. If it successfully completes the India Sale, it expects that the cash proceeds received will allow it to rely less on bank borrowings in the near to intermediate future. Bank loans and other debt, and related collateral arrangements and financial and operating covenants, are discussed above in "– Outstanding Debt."

As of 31 December 2006, the Group had net current liabilities of HK$17,268 million comprising a current portion of bank loans and other loans equal to HK$16,048 million and other net current liabilities of HK$1,220 million. As of 31 December 2005, the Group had net current liabilities of HK$5,328 million, comprising a current portion of bank loans and other loans equal to HK$7,690 million and other net current assets of HK$2,362 million. The increase in net current liabilities in 2006 was primarily attributable to an increase in current borrowings of HK$8,358 million, incurred primarily in connection with acquisitions in India.

The following table sets out the major inflows/(outflows) of cash flows of the Group:

| | 2005<br>HK$ millions | 2006<br>HK$ millions |
|---|---|---|
| **Cash flows from operating activities** | | |
| Profit before taxation | 636 | 2,402 |
| Adjustments for: | | |
| – Interest and other finance costs, net | 1,604 | 2,642 |
| – Non-cash items | 4,582 | 5,249 |
| – Profit on disposal of investments and others, net | (71) | (44) |
| – Share of results of associates | (86) | 1 |
| – Changes in working capital | 524 | (1,721) |
| **Cash generated from operations** | 7,189 | 8,529 |
| Net interest and other finance costs and taxes paid | (1,912) | (3,015) |
| Net cash generated from operating activities | 5,277 | 5,514 |
| **Cash flows from investing activities** | | |
| Net purchases of fixed assets | (4,030) | (7,747) |
| Additions to customer acquisition and retention costs, additions to prepaid capacity and maintenance, advance payments for network roll-out, non-current loan to a related company, and increase in long-term deposits | (987) | (973) |
| Upfront and fixed periodic payments for telecommunications licences | – | (236) |
| Prepayments for acquisition of subsidiaries | (4,011) | (788) |
| Purchases of subsidiaries and additional investment in certain subsidiaries | (1,403) | (5,218) |
| Purchase of transmission business | – | (124) |
| Proceeds on disposal of interest in subsidiaries | 669 | 2 |
| Net cash used in investing activities | (9,762) | (15,084) |
| **Cash flows from financing activities** | | |
| Net cash flows from financing activities and changes in restricted cash | 4,577 | 8,074 |
| Proceeds from exercise of share options | – | 194 |
| Net cash flows from minority shareholders | 242 | 914 |
| Net cash provided by financing activities | 4,819 | 9,182 |

The Group's net cash inflow from operating activities in 2006 was HK$5,514 million, an increase of HK$237 million compared with HK$5,277 million in 2005. The increase was mainly attributable to the significant increase in profit before tax to HK$2,402 million, resulting from increased operating profit contributions from India and Israel, reflecting the general growth of those businesses and increased operating profit for the mobile operations in Hong Kong, which was partially offset by the start-up losses in Vietnam and Indonesia. The increase in net cash inflow from operating activities was also due to the increased non-cash items of HK$5,249 million, comprised mainly of depreciation and amortisation, reflecting higher levels of investments, and the amortisation of telecommunications licences and other intangibles assets arising from the step-up acquisition of Partner in April 2005. This increase was partially offset by the working capital outflows of HK$1,721 million in 2006 compared with working capital inflow of HK$524 million in 2005, which was mainly due to the outflow relating to an increase in trade receivables, other receivables and prepayments of HK$2,029 million, reflecting the general expansion of the business, as well as the acquisition of HECL in January 2006.

The Group's net cash outflow from investing activities amounted to HK$15,084 million in 2006, compared with HK$9,762 million in 2005. The net cash outflow from investing activities consisted mainly of net capital expenditures on fixed assets (mainly network rollout) of HK$7,781 million and HK$5,259 million of acquisition costs. In 2005, the net cash outflow comprised mainly capital expenditures on fixed assets (mainly network rollout) of HK$4,046 million and HK$4,011 million of advance payments made in connection with the acquisition of HECL and BPL Mobile Communications Limited (which has not been completed) in India.

The Group's net cash inflow from financing activities amounted to HK$9,182 million in 2006, compared with HK$4,819 million in 2005. The increase mainly reflected a net increase in loans in the amount of HK$8,073 million in 2006 as compared with HK$4,571 million in 2005, primarily to fund network build-out and operations by operating companies as well as the first time inclusion of the debt from HECL as a result of the consolidation of HECL in January 2006. The increase in net cash inflow from financing was also partly due to net cash inflows from minority shareholders of HK$914 million, which primarily reflected additional capital contributions from minority shareholders of Hutchison Essar, which were offset in part by quarterly dividend payments to the minority shareholders of Partner.

## Contractual obligations

The following table sets forth selected information regarding the Group's contractual obligations to make future payments as of 31 December 2006:

| | | Payments due within | | |
|---|---|---|---|---|
| **HK$ millions** | **Total** | **1 year** | **1- 5 years** | **After 5 years** |
| Purchase obligations | 18,487 | 18,190 | 230 | 67 |
| Operating lease obligations | 4,306 | 924 | 1,726 | 1,656 |
| Borrowings | 39,417 | 16,048 | 23,056 | 313 |
| Interest on borrowings[1] | 3,515 | 2,032 | 1,476 | 7 |
| Licence fees liabilities | 2,808 | 259 | 1,446 | 1,103 |
| Total contractual obligations | 68,533 | 37,453 | 27,934 | 3,146 |

*(1) Interest on borrowings comprised the amount of interest to be accrued at interest rates of between 1.1% to 10.4%.*

## Off-balance sheet arrangements

In addition to the contractual obligations discussed above, the Group had commitments that could require material payments in the future. These commitments are not included in the consolidated balance sheet.

As of 31 December 2006, the Group had contingent liabilities in respect of performance guarantees of HK$319 million, and certain claims against subsidiaries in Israel and India were pending in the amount of HK$1,014 million and HK$251 million, respectively. The performance guarantees principally related to guarantees that had been given prior to the disposal of VISS in July 2006 in favour of counterparties of VISS and its affiliates under various financing and equipment purchase transactions entered into by them. The Company is not aware of any circumstance that would require it to perform under these guarantees, which have been counter-indemnified by the purchaser of VISS, which is a member of the HWL Group.

In October 2001, the Group's subsidiary in Hong Kong was issued a 3G licence for a duration of 15 years. For the first five years of the term of the license, fixed annual licence fees were payable. Beginning from the sixth year of the licence, variable licence fees are payable amounting to 5% of network turnover in respect of the relevant year; or the Appropriate Fee (as defined in the Licence) in respect of the relevant year whichever is greater. The net present value of the Appropriate Fee has already been recorded in the Group's financial statements as licence fees liabilities. Under the terms of the licence, the actual amount due could be greater than the amount recorded.

The Group's subsidiary in Israel, Partner, is committed to pay royalties to the Government of Israel equal to 3.5% of its "income from cellular services" as defined in the "Telecommunications (Royalties) Regulations, 2001", which includes all kinds of income of Partner from the provision of telecommunications services under the licence – including airtime, roaming services and non-recurring connection fees, but excluding income transferred to another holder of a communications licence and deducting bad debts, payments to another communication licensee in respect of interconnection, payments for roaming services to foreign operators and expenses related to the sale of equipment. The rate of royalty payments paid by cellular operators has been reduced annually by 0.5%, since 1 January 2006 and will continue to be reduced until it reaches a level of 1%.

The Group is required under the relevant shareholders' agreements relating to its interests in the operating companies in Thailand to provide funding for operating expenses and capital expenditures of the operating companies or the intermediary holding companies through which the Group holds the interests in these operating companies. To date, the Group has met these funding obligations primarily through procuring guarantees for third-party loans to these companies, but the Group may in the future fund these operating expenses and capital expenditures directly.

The Group holds an option to acquire the HWL Group's mobile telecommunications related interests in Hutchison Telecommunications Argentina S.A..

The Group holds call options, both directly and indirectly, which, if exercised, would entitle it to additional equity interests in the non-wholly owned investment holding companies in India through which it holds indirect interests in Hutchsion Essar, in each case subject to applicable regulatory approvals. Conversely, some Indian shareholders hold put options that could, again subject to applicable regulatory approvals, require the Group to purchase additional equity interests in those investment holding companies. Some of the call and put options are exercisable at fair market value of the investment holding companies, as determined or agreed by the parties (and if no agreement is reached, as determined in accordance with a pre-agreed formula or by a specified independent investment bank, as the case may be) at the time of exercise of the relevant option. Other call and put options are exercisable at a price determined in accordance with a formula specified in the relevant options agreement. Upon successful completion of the India Sale, the Group would no longer be subject to these put and call options.

## Factors Affecting Our Results of Operations

### Planned disposal of India

On 11 February 2007 the Company entered into an agreement to sell its entire direct and indirect equity and loan interests, held through subsidiaries, in its Indian mobile telecommunications operation comprising the Hutchison Essar group of companies. The sale is expected to be completed in the second quarter of 2007. The results and operations of the Group will be significantly affected by this disposal. During 2006, the business being sold represented 46% of the Group's total turnover, 72% of the Group's total operating profit and 42% of the Group's total operating expenses. In addition, as of 31 December 2006, the business being sold held 40% of the Group's total outstanding debt. Upon completion of the India Sale, the results of the India operations for 2007 and prior years will be presented in the Group's income statement as discontinued operations.

In consideration of the disposal, the Company will receive approximately US$11.1 billion (HK$87 billion) in cash. Upon completion of the India Sale and payment under the Settlement Agreement, the Group is expected to realise an estimated pre-tax gain of approximately US$9,195 million (HK$71,847 million) and net cash inflow of approximately US$10,585 million (HK$82,708 million).

The Group has committed to declare a special dividend to shareholders equal to HK$6.75 per share, or approximately HK$32 billion in aggregate, upon completion of the India Sale. In addition, the Company expects to repay up to HK$13,900 million of outstanding debt which, combined with the debt being assumed by the purchaser, would result in significantly reduced interest expense and generation of net interest income. The Group has also stated that it will announce a dividend policy in the third quarter of 2007. The remaining cash will leave the Group well capitalised to take opportunities to expand the group as opportunities arise.

### New licences and acquisitions

In recent years, the Group has expanded its operations through the acquisition of new telecommunications licenses, as well as through the acquisition of interests in existing third-party telecommunications operators. For example in January 2006 the Group completed the acquisition of HECL in India.

The start-up of newly licensed operations and the acquisition and subsequent integration of newly acquired third-party telecommunications operators generally entail significant capital and operating expenditures, including licence fees, cash consideration paid or debt incurred in connection with the acquisition, purchase of new equipment, build-out and maintenance of networks, marketing of new products and services and the addition of employees. If successful, new operations and acquisitions may also lead to significant customer and revenue growth. Accordingly, new operations and acquisitions affect the comparability of the results of the Group's operations for different years.

Vietnam is a new service area for which the Group received governmental approval in February 2005 of the business cooperation contract with Hanoi Telecommunications to jointly build and operate a network. The Group expects peak funding to be approximately US$250 million (HK$1,945 million), which will be financed from internally generated funds and external borrowings. The Group recognises its interest in the business cooperation to the extent of the assets that it controls and the liabilities and expenses that it incurs, and the share of the income that it earns from the sale of goods or services under the terms of the business cooperation contract. The Group launched services in Vietnam in January 2007.

In July 2005, the Group completed the acquisition of a 60% equity interest in PT Hutchison CP Telecommunications (formerly named PT Cyber Access Communications) ("PT Hutchison CP") for consideration of US$120 million (HK$934 million). Towards the end of 2005, the Group commenced the expansion of PT Hutchison CP's nationwide wireless network, which it expects to launch commercially at the end of March 2007. The Group and PT Hutchison CP's other shareholders have agreed to provide funding to PT Hutchison CP pro rata to their respective equity interests with an initial committed amount of US$300 million (HK$2,334 million).

### Regulatory changes

In Israel, regulatory changes significantly reducing call and SMS termination tariffs became effective on 1 March 2005. Call termination tariffs have been reduced from NIS0.45 per minute prior to 1 March 2005 to NIS0.29 per minute on 1 March 2006 and to NIS 0.26 per minute on 1 March 2007, with an additional reduction to NIS0.22 per minute mandated to be effective 1 March 2008. SMS termination tariffs were reduced from NIS0.285 to NIS0.05 on 1 March 2005 and to NIS0.22 per minute on 1 March 2006. These tariff reductions caused call revenue to increase less rapidly than the rate of increase of total network minutes.

In addition, number portability, which is expected to be implemented in Israel in 2007, is expected to lead to higher customer retentions costs and a rise in churn rates.

## Market Risk Hedging and Derivatives

The Group is exposed to market risk from changes in interest rates and currency exchange rates. Interest rate risk exists principally with respect to the Group's financial liabilities bearing interest at floating rates. Interest rate risk also exists with respect to the fair value of fixed rate financial assets and liabilities. Exchange rate risk exists with respect to the Group's financial assets and liabilities denominated in currencies other than Hong Kong dollars. The Group is also subject to exchange rate risks with respect to its operations and investments outside Hong Kong. The Group manages these risks by a variety of methods, including the use of a number of derivative financial instruments such as cross currency and interest rate swap contracts. All transactions in derivative financial instruments are undertaken for risk management purposes only. No instruments are held by the Group for trading or speculative purposes.

(i) Foreign currency exposure

The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures. Foreign exchange risk arises from future commercial transactions, recognised assets and liabilities and net investments in foreign operations.

For overseas subsidiaries and associates and other investments, which consist of non-HK dollar and non-US dollar assets, the Group generally endeavours to establish a natural hedge with an appropriate level of borrowings in those same currencies. For overseas businesses that are in the development phase, or where borrowings in the local currency are not attractive, the Group may not borrow in the local currency and may instead monitor the development of the businesses' cashflow and the debt markets and, when appropriate, would expect to refinance these businesses with local currency borrowings. Exposure to movements in exchange rates on individual transactions directly related to the underlying businesses is minimised using forward foreign exchange contracts and currency swaps where active markets for the relevant currencies exist.

(ii) Interest rate exposure

The Group's main interest risk exposures relate to its borrowings which bear interest at floating rates. The Group manages its interest rate exposure with a focus on reducing the Group's overall cost of debt and exposure to changes in interest rates. When considered appropriate, the Group uses a combination of interest rate swaps and forward rate agreements to manage its long-term interest rate exposure and exposure to short-term interest rate volatility respectively.

The following table summarises the carrying amounts, fair values, principal cash flows by maturity date and weighted average interest rates of the Group's current and non-current liabilities as at 31 December 2006 that are sensitive to exchange rats or interest rates. Data presented below includes bank loans and other third party borrowings:

| | 31 December 2006 Maturities | | | | 31 December 2006 | |
|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | Thereafter | Total | Fair value |
| | (HK$ in millions except rates) | | | | | |
| **Local currency:** | | | | | | |
| Hong Kong Dollars: | | | | | | |
| Fixed rate | 1 | 2 | 2 | 6 | 11 | 11 |
| Average weighted rate(1) | 7.5% | 7.5% | 7.5% | 7.5% | 7.5% | 7.5% |
| Variable rate | 80 | 5,223 | – | – | 5,303 | 5,303 |
| Average weighted rate(1) | 4.73% | 4.94% | – | – | 4.94% | 4.94% |
| Sub-total | 81 | 5,225 | 2 | 6 | 5,314 | 5,314 |
| **Foreign currency:** | | | | | | |
| Thai Baht: | | | | | | |
| Variable rate(2) | 8,588 | 37 | 37 | 19 | 8,681 | 8,681 |
| Average weighted rate(1) | 6.05% | 5.73% | 5.73% | 5.73% | 6.05% | 6.05% |
| Sub-total | 8,588 | 37 | 37 | 19 | 8,681 | 8,681 |
| Indian Rupees: | | | | | | |
| Fixed rate | 6,499 | 3,387 | 4 | 3 | 9,893 | 9,806 |
| Average weighted rate(1) | 8.58% | 7.01% | 25.54% | 22.35% | 8.05% | 8.06% |
| Variable rate | 806 | 2,156 | 1,776 | – | 4,738 | 4,738 |
| Average weighted rate(1) | 8.87% | 8.61% | 9.69% | – | 9.06% | 9.06% |
| Sub-total | 7,305 | 5,543 | 1,780 | 3 | 14,631 | 14,544 |
| New Israel Shekels: | | | | | | |
| Variable rate | 65 | 264 | 1,149 | 2,780 | 4,258 | 4,249 |
| Average weighted rate(1) | 5.78% | 5.66% | 4.52% | 4.25% | 4.43% | 4.43% |
| Sub-total | 65 | 264 | 1,149 | 2,780 | 4,258 | 4,249 |
| US Dollars: | | | | | | |
| Fixed rate | 9 | 559 | 5 | – | 573 | 573 |
| Average weighted rate(1) | 7.25% | 4.41% | 7.25% | – | 4.48% | 4.48% |
| Variable rate | – | 4,874 | 4 | 1,082 | 5,960 | 5,960 |
| Average weighted rate(1) | – | 6.23% | 7.37% | 6.21% | 6.23% | 6.23% |
| Sub-total | 9 | 5,433 | 9 | 1,082 | 6,533 | 6,533 |
| Total | 16,048 | 16,502 | 2,977 | 3,890 | 39,417 | 39,321 |

*(1) Weighted average rates of the portfolio at the year end.*

*(2) Included Japanese Yen borrowings of HK$6,578 million and US dollar borrowings of HK$131 million which were swapped into Thai Baht borrowings as at 31 December 2006.*

## Reconciliation to US GAAP

The consolidated accounts of the Group have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS", which term collectively includes Hong Kong Accounting Standards ("HKAS") and related interpretations) issued by the Hong Kong Institute of Certified Public Accountants, which differ in various material aspects from US GAAP. These material differences, as they apply to our consolidated accounts can be read in the "information for US Investors" section.

The following table sets forth a comparison of our net profit/(loss) attributable to equity holders of the Company and shareholders' equity in accordance with HKFRS and US GAAP for the years indicated:

| | As at or for the year ended 31 December | |
|---|---|---|
| | **2005** | **2006** |
| | **HK$ millions** | **HK$ millions** |
| Net profit/(loss) attributable to equity holders of the Company | | |
| HKFRS | (768) | 201 |
| US GAAP | (915) | (493) |
| Shareholders' equity | | |
| HKFRS | 16,170 | 16,659 |
| US GAAP | 13,680 | 13,349 |