REVIEW OF OPERATIONS

Overview

The Group recorded its second consecutive profitable year in 2004. The continued profitability of the Group, despite aggressive price-based market competition and a need for extra resources for 3G roll-out, clearly reflected the success of SUNDAY's core strategies to deliver efficiency and quality in all areas of operation and to segment the market for service development and delivery, in anticipation of the potential of the 3G technology. The subscriber base increased to 684,000, with strong data service revenue growth and an improvement in churn.

During the year, the Group entered into a supply contract and facility agreement with Huawei Tech. Investment Co., Limited ("Huawei Tech."), a subsidiary of China's Huawei Technologies Co., Ltd. ("Hwawei"), under which Huawei Tech. will provide a turnkey solution for the roll-out of SUNDAY's 3G network and services and the required long-term financing. As a result, the Group is well positioned to roll out its 3G services with quality network and service and at a time when more 3G mobile phones with the functionalities and affordability demanded by consumers become available.

Mobile Services

The year 2004 was another year of challenges. Some competitors launched aggressive price promotions and heavy handset subsidies to secure short-term gains. The result was a general increase in voice traffic but an overall decrease in revenues due to lower ARPU.

Recognising the short-sightedness of competing aggressively on price in the current commoditised market, while maintaining its competitiveness in that market, SUNDAY continued to invest in the quality of its service delivery and its creative approach focused on market segmentation, with the view to laying a strong foundation for an advantageous starting position in the high value-added market that the 3G technology will usher in beginning in 2005.

As a result, despite difficult market conditions, SUNDAY's focus on service and network quality and the segmentation strategy enabled the Group to grow its mobile subscriber base, which increased by 4% to 684,000, and to reduce churn. Revenue from the mobile services business for 2004 declined by 10% to HK$1,032 million from HK$1,150 million in 2003 as ARPU in 2004 fell to HK$180, in line with an industry-wide decline.

Quality

The Group focused on further enhancing the customer service levels in 2004 and achieved remarkable results. The efforts made to improve the overall customer experience with SUNDAY were recognised by the industry. In 2004, SUNDAY was awarded the "Best-in-Class" award for customer service level management from Asia-Pacific Customer Management Consortium, and the customer hotline teams in Hong Kong and Shenzhen also won a total of ten group and individual awards from the Call Centre Association.

The Group continued to make customer retention a priority and the average monthly gross churn rate for 2004, calculated as a percentage of opening subscribers, improved by 22% to 3.9%, as compared with 5.0% in 2003. The churn rate has further improved since the fourth quarter of 2004, and the churn rate in December 2004 was 3.7%.

While building out the 3G network and preparing for the launch of 3G services, SUNDAY also continued to enhance its 2G/2.5G network, adding new sites to improve coverage and quality.

To ensure continuous improvement in the service and network quality, SUNDAY engaged an independent market research firm to implement more extensive "mystery shopper", "mystery call" and focus group exercises in order to gain an insight into current levels of quality and to identify areas for further improvement.

Segmentation

In anticipation of the potential of the 3G technology, SUNDAY has reorganised its operations around distinct customer segments which centre on demographic attributes such as age, ethnicity and lifestyle as well as customer behaviour patterns. There was also increased use of quality assurance techniques to improve and monitor service delivery. The customer-oriented segmentation approach has enabled us to gain insights into how better to tailor our service offerings and to deliver tailored services to different customer segments, which will be vital to attracting and retaining customers in the 3G era.

The efforts started to bear fruit in 2004. SUNDAY recorded strong growth in data service revenues, which rose by 32% as compared with 2003. The youth segment has also shown strong and continued growth in subscriber numbers and a higher than average ARPU since its launch in 2003.

Efficiency

SUNDAY has been far-sighted in implementing a number of efficiency initiatives since 2002, including the establishment of an operations centre in Shenzhen, China. Its ability to operate with a lean and efficient structure is therefore proving to be an important competitive advantage. Total operating expenses (excluding depreciation) in 2004 was 12%, or HK$75 million, lower than that in 2003, despite the impact of initial start-up costs incurred for its 3G roll-out.

3G roll-out

The data services introduced by SUNDAY to date are an important precursor to its future 3G services, since the 3G technology is expected to move consumers further away from the commoditised mass market of mobile voice communications towards ever more tailored multimedia mobile services. SUNDAY's efforts have allowed the Group to post a strong increase in data service revenues, which rose by 32% to HK$82 million in 2004, while its share of total mobile service revenues also increased to 9% by December 2004. The growth was particularly encouraging as it pointed to the more marked shift towards more data services that will occur in 2005 as the 3G technology gains mainstream adoption as more new and affordable 3G handsets become available in the market.

SUNDAY's partnership with Huawei, which is a leading telecommunications equipment manufacturer based in Shenzhen, China, provides important competitive advantages for the Group. It has strengths in areas that will be critical to success in the 3G arena, including the IP core network platform and service creation as well as an end-to-end solution. The proximity of Huawei's base in Shenzhen to Hong Kong gives SUNDAY a significant edge over its rivals in developing tailor-made services and launching them quickly.

The technical infrastructure will be ready for launch in 2005. During 2004, the Group successfully implemented the network roll-out plan on schedule.

The Group has worked smoothly with other best-of-class vendors to deploy a number of key operating systems, including new billing and business intelligence systems and a complete website revamp.

SUNDAY also appointed a new marketing agency during the year to advise on the 3G launch. The 3G technology offers the opportunity to make life more fun through a wide variety of entertaining content, intriguing handsets and innovative services. This promise of the technology aligns with SUNDAY's brand perception.

Therefore, SUNDAY's 3G strategy is firmly in place and management has made decisions on timing, technology partnership and marketing that will give SUNDAY a competitive advantage.

Sales of Mobile Phones and Accessories

Revenue from sales of mobile phones and accessories increased by 17% to HK$127 million. The business made a gross loss of HK$17 million as compared with a gross loss of HK$24 million in 2003, despite an increased use of handset promotions in the market to help upgrade existing customers for ongoing retention programmes and to acquire new customers. The improvement was mainly attributable to the adoption of the future-focused strategy — offering handset subsidy promotions for products which are most likely to encourage an increase in data usage, and the introduction of premium phones, such as the Mitsubishi M900 phone, the first mobile phone with a 2 mega-pixel camera launched in Hong Kong.

FINANCIAL REVIEW

Turnover and Gross Profit

Total turnover for the year declined 8%, or HK$101 million, as compared with 2003 to HK$1,159 million. The decrease was mainly attributable to aggressive price promotions by operators during the year.

Gross profit in 2004 decreased by 14% to HK$802 million as compared with 2003, mainly due to lower tariff rates and lower mobile services revenue.

Revenues from mobile services and the sales of mobile phones and accessories accounted for 89% and 11%, respectively, of the total turnover in 2004.

Operating Expenses (Excluding Depreciation)

Operating expenses (excluding depreciation) in 2004 reduced by 12% to HK$544 million and fell slightly from 54% to 53%, as a percentage of mobile services revenue, as compared with 2003. This was achieved while improving service and network quality and additional operating costs resulting from the 3G network roll-out. The continued decrease in operating expenses over the past few years has been a direct result of the various efficiency improvement initiatives implemented since 2002 and continued tight cost control.

Significant savings were made in all cost components. In particular, both the salary and related costs and other operating costs decreased by 15% and 13%, respectively, in 2004 despite an increase in headcount and the 3G roll-out. This largely reflects the efficiency gains resulted from the set-up of an operations centre in Shenzhen in 2002, which has also provided better service quality.

The results for the year ended 31st December 2004 are set out as follows:

	Year ended 31st December			
	2004			2003
	Group (HK$ million)	3G business (HK$ million)	2G business (HK$ million)	Group (HK$ million)
Operating expenses (excluding depreciation)	544	41	503	619
EBITDA	261	(41)	302	315
Net profit/(loss)	6	(43)	49	27

Operating expenses for 2G operations in 2004 amounted to HK$503 million, a 19% decrease as compared with 2003. As a percentage of mobile service revenue, the operating expenses for 2G operations fell from 54% in 2003 to 49% in 2004.

EBITDA

EBITDA for the year amounted to HK$261 million, a decrease of 17% as compared with 2003. The decrease was mainly attributable to a decrease in service revenue resulting from intense market competition and 3G related operating costs.

EBITDA represents earnings before interest income, finance costs, taxation, depreciation, amortisation and share of loss from a joint venture.

Profit for the year

Finance cost for 2004 amounted to HK$26 million, HK$26 million less than 2003. The decrease was mainly due to lower average debt level and lower average borrowing rates in 2004 as compared with 2003.

The Group recorded a net profit of HK$6 million as compared with a net profit of HK$27 million in 2003. The decrease in net profit was mainly attributable to the decrease in service revenues and the 3G related operating costs.

CAPITAL EXPENDITURE

Capital expenditure for 2004 amounted to HK$356 million, which was mainly incurred for the roll-out of the 3G network. The capital expenditure also included capitalised 3G licence fees and 3G operating expenses of HK$50 million and HK$30 million, respectively.

The Group's 2G/2.5G mobile network is substantially complete. Capital expenditure incurred for 2G/2.5G network in 2004 was mainly for the ongoing enhancements in the service quality and coverage of the mobile network.

Capital expenditure in 2005 is expected to increase further as the Group's 3G network will be substantially completed in 2005. It is expected that total capital expenditure for the construction of the 3G network over a three-year period up to 2006 will amount to HK$1.2 billion.

LIQUIDITY AND FINANCIAL RESOURCES

Cash flow from operations

Net cash inflow from operating activities of the Group in 2004 amounted to HK$185 million, a decrease of HK$57 million over 2003. The decrease in cash inflow from operating activities primarily resulted from lower service revenues.

Financing

In 2004, the capital expenditure and working capital requirements of the Group were mainly funded by cash flow generated from operating activities and the long-term loan facilities provided by Huawei Tech.

In January 2004, Mandarin Communications Limited ("Mandarin"), the Company's main operating subsidiary, repaid the outstanding principal of HK$721 million and accrued interest of the bank and vendor loans.

In May 2004, Mandarin and the Company entered into a supply contract and a facility agreement with Huawei Tech. in respect of the supply of the 3G network and the provision of the long-term financing in relation thereto. In November 2004, a supplemental agreement to the supply contract and an amendment and restatement agreement relating to the facility agreement were signed to give Mandarin flexibility to purchase and install the most technologically advanced equipment available. The amendment and restatement agreement relating to the facility agreement comprises the following loan and credit facilities:

- an equipment supply facility of HK$1,208 million;
- a general facility of HK$500 million; and
- a 3G performance bond facility.

In 2004, HK$178 million was drawn from the equipment supply facility to pay for invoices issued under the supply contract, of which HK$105 million was non-cash drawdown. The facility has a term of 7.5 years and the outstanding loans are repayable by eight semi-annual instalments commencing four years after the date of the facility agreement.

The general facility of HK$500 million had been fully drawn, of which HK$75 million was repaid during the year. As at 31st December 2004, the outstanding balance was HK$425 million. The next repayment amounts to HK$75 million, which will be made in July 2006, and the remaining balance will be repaid by instalments until July 2011.

The 3G performance bond facility is for the issuance of the performance bonds required by the Office of Telecommunications Authority ("OFTA") in the years 2004 — 2010 (inclusive) under the term of the 3G licence. In October 2004, a performance bond of HK$211 million was issued to OFTA under this facility.

As security for the provision of the above loan and credit facilities under the facility agreement, Huawei Tech. was granted a security package with terms that are standard for similar project financing arrangements which includes a charge over all the assets, revenues and shares of certain wholly-owned subsidiaries of the Company and a corporate guarantee by the Company. Huawei Tech. also benefits from representations, financial covenants and general covenants customary to transactions of this nature.

As at 31st December 2004, the Group had total long-term loans (before deferred charges) of HK$603 million, and cash reserves of HK$116 million. Net debt (total bank and vendor loans less cash reserves) amounted to HK$487 million, and the net debt-to-equity ratio was 69% as at 31st December 2004. The long-term loans outstanding as at 31st December 2004 will mature in the following periods:

	HK$'000
Within one year	—
In the second year	75,000
In the third to fifth year	239,074
After the fifth year	289,074
	603,148

FOREIGN EXCHANGE EXPOSURE

Substantially all revenues, expenses, assets and liabilities are denominated in Hong Kong dollars.

International roaming payables and receivables are netted and settled on a monthly basis in Special Drawing Rights ("SDR"). As at 31st December 2004, the net SDR-denominated payables were insignificant. The Group has not experienced significant foreign exchange movements 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 US dollar remains in effect. The Group will continue 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 this 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 roll-out of the 3G network and limited choice and availability of 3G handsets may hinder the deployment of new technologies.
- Expected benefits from investments 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 773 employees as at 31st December 2004, of which 502 were in Hong Kong and 271 were in Shenzhen. Total salaries and related costs incurred in 2004 amounted to HK$129 million as compared with HK$152 million in 2003. 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 has adopted a new share option scheme and terminated the share option scheme adopted in 2000 (the "Old Scheme'') on 22nd May 2002. Upon the termination of the Old Scheme, no further options will be offered thereunder but the provisions of the Old Scheme will remain in full force and effect in respect of the existing options granted.

FORWARD-LOOKING STATEMENTS

Certain statements contained in this report may be viewed as "forward-looking statements". Such forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause the actual performance, financial condition or results of operations of the Company to be materially different from any future performance, financial condition or results of operations of the Company implied by such forward-looking statements.