US$500,000,000

PCCW-HKT CAPITAL NO.3 LIMITED

(incorporated in the British Virgin Islands with limited liability)

5.25% GUARANTEED NOTES DUE 2015

irrevocably and unconditionally guaranteed by

PCCW-HKT TELEPHONE LIMITED

香港電話有限公司

(incorporated in Hong Kong with limited liability)

The US$500,000,000 5.25% Guaranteed Notes due 2015 (the Notes) offered hereby by PCCW-HKT Capital No.3 Limited (the Issuer) will be irrevocably and unconditionally guaranteed (the Guarantee) by PCCW-HKT Telephone Limited 香港電話有限公司 (the Guarantor).

The Notes will bear interest from July 20, 2005 at the rate set forth above, payable semi-annually in arrear on January 20 and July 20 of each year (commencing January 20, 2006). The Notes are not redeemable prior to maturity, except that the Notes may be redeemed, in whole but not in part, at 100% of their principal amount plus accrued interest in the event of certain developments affecting taxation as described in this Offering Circular.

The Notes will be unsecured and will rank equally with all other unsecured and unsubordinated obligations of the Issuer, and the Guarantee will be unsecured and will rank equally with all other unsecured and unsubordinated obligations of the Guarantor.

The Notes have been rated "Baa2" by Moody's Investors Service, "BBB" by Standard & Poor's Ratings Services and "BBB+" by Fitch Ratings.

Approval in-principle has been obtained for the listing of the Notes on the Singapore Exchange Securities Trading Limited (the SGX-ST). The SGX-ST assumes no responsibility for the correctness of any statements made or opinions expressed or reports contained in this Offering Circular. Admission of the Notes to the Official List of the SGX-ST is not to be taken as indication of the merits of the Issuer, the Guarantor or the Notes. The offering and settlement of the Notes is not conditioned on obtaining a listing.

Investing in the Notes involves risks. Please see "Risk Factors" beginning on page 7.

Issue Price 99.142%

The Notes and the Guarantee have not been and will not be registered under the United States Securities Act of 1933, as amended (the Securities Act), or any state securities laws and are being offered only (i) to qualified institutional buyers under Rule 144A and (ii) outside the United States to non-U.S. persons in compliance with Regulation S. Prospective purchasers that are qualified institutional buyers are hereby notified that the seller of Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A. For a description of certain restrictions on transfer, see "Transfer Restrictions."

It is expected that delivery of the Notes will be through the facilities of The Depository Trust Company, Euroclear and Clearstream on or about July 20, 2005, against payment therefor in immediately available funds.

HSBC

July 13, 2005

The Issuer and the Guarantor are responsible for the accuracy and completeness of the information in this Offering Circular and the Issuer and the Guarantor represent and warrant that the information in this Offering Circular is in all material respects in accordance with the facts and does not omit anything likely to affect the accuracy and completeness of such information in any material respect, provided that for the information provided by third-party sources contained herein, the Issuer and the Guarantor accept responsibility for accurately reproducing such information but accept no further or other responsibility in respect of such information.

Investors should only rely on the information contained in this Offering Circular. The information contained in this Offering Circular is given only as at the date of this Offering Circular. The Guarantor's or the Issuer's business, financial condition, results of operations and prospects may have changed since that date.

This Offering Circular is based on information provided by the Issuer and the Guarantor and by other sources that they believe are reliable. No assurance can be given that such information from other sources is accurate or complete.

THIS OFFERING CIRCULAR DOES NOT CONSTITUTE AN OFFER TO SELL, OR A SOLICITATION OF AN OFFER TO BUY, ANY NOTE OR THE GUARANTEE OFFERED HEREBY BY ANY PERSON IN ANY JURISDICTION IN WHICH IT IS UNLAWFUL FOR SUCH PERSON TO MAKE SUCH AN OFFER OR SOLICITATION. NEITHER THE DELIVERY OF THIS OFFERING CIRCULAR NOR ANY SALE MADE HEREUNDER SHALL UNDER ANY CIRCUMSTANCES IMPLY THAT THERE HAS BEEN NO CHANGE IN THE AFFAIRS OF THE ISSUER, THE GUARANTOR OR ITS SUBSIDIARIES OR THAT THE INFORMATION SET FORTH HEREIN IS CORRECT AS AT ANY DATE SUBSEQUENT TO THE DATE HEREOF.

The distribution of this Offering Circular and the offering of the Notes and the Guarantee in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Issuer, the Guarantor and the manager set forth in "Plan of Distribution" in this Offering Circular (the Manager) to inform themselves about and to observe any such restrictions. No action is being taken to permit a public offering of the Notes or the Guarantee or the distribution of this Offering Circular in any jurisdiction where action would be required for such purposes. There are restrictions on the offer and sale of the Notes and the Guarantee, and the circulation of documents relating thereto, in certain jurisdictions including the United States, the European Economic Area, the United Kingdom, Singapore, Hong Kong, Japan, Germany, France and the British Virgin Islands, and to persons connected therewith. For a description of certain further restrictions on offers, sales and resales of the Notes and the Guarantee and distribution of this Offering Circular, see "Plan of Distribution" and "Transfer Restrictions."

This Offering Circular has been prepared by the Issuer and the Guarantor solely for use in connection with the offering of the Notes and the Guarantee related thereto and described herein. The Issuer, the Guarantor and the Manager reserve the right to reject any offer to purchase the Notes offered hereby in the primary market, in whole or in part, for any reason. Each prospective purchaser in the United States agrees not to distribute this Offering Circular to any person other than such prospective purchaser and persons retained to advise that prospective purchaser with respect thereto.

Each person receiving this Offering Circular acknowledges that (i) such person has been afforded an opportunity to request from the Issuer and the Guarantor and to review, and has received, all additional information considered by it to be necessary to verify the accuracy of, or to supplement, the information contained herein, (ii) such person has not relied on the Manager or any person affiliated with the Manager in connection with any investigation of the accuracy of such information or its investment decision, and (iii) no person has been authorized to give any information or to make any representation concerning the Issuer, the Guarantor or the Notes (other than as contained herein and information given by duly authorized officers and employees of the Issuer and the Guarantor in connection with investors' examination of the Issuer and the Guarantor and the terms of the offering of the Notes) and, if given or made, any such other information or representation should not be relied upon as having been authorized by the Issuer, the Guarantor or the Manager.

IN MAKING AN INVESTMENT DECISION, INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE ISSUER AND THE GUARANTOR AND THE TERMS OF THE OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED. THE NOTES HAVE NOT BEEN RECOMMENDED BY THE ISSUER, THE GUARANTOR, THE MANAGER OR ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS OFFERING CIRCULAR. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

NO REPRESENTATION OR WARRANTY, EXPRESS OR IMPLIED, IS MADE BY THE MANAGER AS TO THE ACCURACY OR COMPLETENESS OF THE INFORMATION SET FORTH HEREIN, AND NOTHING CONTAINED IN THIS OFFERING CIRCULAR IS, OR SHALL BE RELIED UPON AS, A PROMISE OR REPRESENTATION, WHETHER AS TO THE PAST OR THE FUTURE. THE MANAGER HAS NOT INDEPENDENTLY VERIFIED ANY OF SUCH INFORMATION AND ASSUMES NO RESPONSIBILITY FOR ITS ACCURACY OR COMPLETENESS.

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IN CONNECTION WITH THIS OFFERING, THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED (HSBC) OR ANY PERSON ACTING FOR HSBC MAY OVER-ALLOT NOTES OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE NOTES AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL.

HOWEVER, THERE IS NO ASSURANCE THAT HSBC (OR PERSONS ACTING ON BEHALF OF HSBC) WILL UNDERTAKE STABILIZATION ACTION. ANY STABILIZATION ACTION MAY BEGIN ON OR AFTER THE DATE ON WHICH ADEQUATE PUBLIC DISCLOSURE OF THE TERMS OF THE OFFER OF THE NOTES IS MADE AND, IF BEGUN, MAY BE ENDED AT ANY TIME, BUT IT MUST END NO LATER THAN 30 DAYS AFTER THE ISSUE DATE OF THE NOTES.

NOTICE TO NEW HAMPSHIRE RESIDENTS

Neither the fact that a registration statement or an application for a license has been filed under Chapter 421-B of the New Hampshire Revised Statutes Annotated (RSA 421-B) with the Secretary of State of New Hampshire nor the fact that a security is effectively registered or a person is licensed in the State of New Hampshire constitutes a finding by the Secretary of State of New Hampshire that any document filed under RSA 421-B is true, complete and not misleading. Neither any such fact nor the fact that an exemption or exception is available for a security or a transaction means that the Secretary of State has passed in any way upon the merits or qualifications of, or recommended or given approval to, any person, security or transaction. It is unlawful to make, or cause to be made, to any prospective purchaser, customer or client, any representation inconsistent with the provisions of this paragraph.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements under the captions "Summary," "Summary — Use of Proceeds," "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Business" and elsewhere in this Offering Circular constitute "forward-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance and achievements of the Issuer, the Guarantor, or PCCW or industry results to be materially different from any future results, performance or achievements, expressed or implied, by such forward-looking statements. Such factors include, among other things, the following:

- increased competition in the Hong Kong telecommunications markets and the continuing negative effects from the regulatory constraints that apply to the Guarantor;
- the effects of the regulatory decisions relating to broadband access services;
- the Guarantor's ability to implement its business plan as a consequence of its substantial debt;
- the Guarantor's exposure to interest rate risk;
- the risks associated with the Guarantor's position in the PCCW Group and transactions with affiliates;
- the risk that the Guarantor's intercompany advances to PCCW will not be repaid;
- the risks associated with Reach;
- the Guarantor's ability to obtain additional capital;

- the risks associated with the expansion of the Guarantor's operations outside Hong Kong; and
- other factors referenced in this Offering Circular. See "Risk Factors."

AVAILABLE INFORMATION

For so long as the Notes and the Guarantee related thereto remain outstanding and are "restricted securities" within the meaning of Rule 144(a)(3) of the Securities Act, the Guarantor will furnish, upon the request of any holder or beneficial owner, such information as is specified in paragraph (d)(4) of Rule 144A under the Securities Act, to such holder or beneficial owner or to a prospective purchaser of such Note and the Guarantee related thereto or interest therein who is a Qualified Institutional Buyer within the meaning of Rule 144A, in order to permit compliance by such holder or beneficial owner with Rule 144A in connection with the resale of such Note or beneficial interest therein in reliance on Rule 144A unless, at the time of such request, the Guarantor is subject to the reporting requirements of Section 13 or 15(d) of the U.S. Securities Exchange Act of 1934, as amended (the Exchange Act), or is included in the list of foreign private issuers that claim exemption from the registration requirements of Section 12(g) of the Exchange Act (and therefore is required to furnish the U.S. Securities and Exchange Commission certain information pursuant to Rule 12g3-2(b) under the Exchange Act).

In addition, for the convenience of holders of the Notes, for so long as such information is not otherwise publicly available, the Guarantor will furnish to the trustee and make available to holders of the Notes, in English, the annual audited consolidated financial statements of the Guarantor for its most recent calendar year (or, at its option, most recent fiscal year), commencing with the year ended December 31, 2005, not later than four months after the date upon which the financial period ended, and its interim unaudited consolidated financial statements for the first six months of such calendar or fiscal year, commencing with the six month period ended June 30, 2005, not later than three months after the end of that six month period. Such annual audited consolidated financial statements or interim unaudited consolidated financial statements, as the case may be, will include a period-to-period comparison to the relevant period of the prior year.

ENFORCEABILITY OF CIVIL LIABILITIES

The Issuer is a limited liability company incorporated in the British Virgin Islands and the Guarantor is a company incorporated with limited liability under the laws of Hong Kong. All of the directors and officers of the Issuer and the Guarantor (and certain parties named in this Offering Circular) reside outside the United States. All or substantially all of the assets of the Issuer and the Guarantor and of the directors and officers of the Issuer and the Guarantor are located outside the United States. As a result, it may not be possible for investors to enforce against such persons, the Issuer or the Guarantor in the United States the federal securities laws of the United States, or to enforce judgments obtained in the United States courts predicated upon the civil liability provisions of the federal securities laws of the United States, including the Securities Act and the Exchange Act.

The Issuer has been advised by British Virgin Islands counsel that judgments based upon civil liability provisions of the federal securities laws of the United States would only be enforceable in the British Virgin Islands if such judgments were final and conclusive monetary judgments for a definite sum and the British Virgin Islands courts were satisfied in each case that (i) the original court had jurisdiction in the matter and the Issuer either submitted to such jurisdiction or was resident or carrying on business within the original court's jurisdiction and was duly served with process; (ii) the judgment given by the original court was not in respect of penalties, taxes, fines or similar fiscal or revenue obligations; (iii) in obtaining judgment there was no fraud on the part of the person in whose favor judgment was given or on the part of the original court itself; (iv) recognition or enforcement of the judgment in the British Virgin Islands would not be contrary to public policy; and (v) the proceedings pursuant to which judgment was obtained were not contrary to principles of natural justice.

The Guarantor has been advised by its Hong Kong counsel that judgments based upon civil liability provisions of the federal securities laws of the United States would be enforceable in Hong Kong if such judgments were final and conclusive monetary judgments for a debt or definite sum and the Hong Kong courts were satisfied in each case that (i) the original court had jurisdiction in the matter and the Guarantor either submitted or agreed to submit to such jurisdiction or was carrying on business within the original court's jurisdiction; (ii) the judgment given by the original court was not in respect of penalties, taxes, fines or similar fiscal or revenue obligations; (iii) the judgment is not impeachable for fraud; (iv) recognition or enforcement of the judgment in Hong Kong would not be contrary to public policy; and (v) the proceedings pursuant to which judgment was obtained were not contrary to principles of natural justice.

CERTAIN DEFINED TERMS AND CONVENTIONS

In this Offering Circular, unless otherwise specified or the context otherwise requires, all references to "Hong Kong" are to the Hong Kong Special Administrative Region of the People's Republic of China, all references to the "PRC" are to the People's Republic of China, all references to "H.K. dollars," "HK$" or "cents" are to Hong Kong dollars and cents and all references to "U.S. dollars" or "US$" are to the lawful currency of the United States of America. For convenience, certain Hong Kong dollar amounts have been translated into U.S. dollars based on the prevailing exchange rate of HK$7.77 = US$1.00, the noon buying rate in New York City for cable transfers in Hong Kong dollars as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate) on December 31, 2004. Such translations should not be construed as representations that the Hong Kong dollar or U.S. dollar amounts referred to herein could have been, or could be, converted into U.S. dollars or Hong Kong dollars, as the case may be, at that or any other rate or at all. The Noon Buying Rate on July 12, 2005 was HK$7.78 = US$1.00.

As used in this Offering Circular, the "Issuer" refers to PCCW-HKT Capital No.3 Limited, the "Guarantor" refers to PCCW-HKT Telephone Limited, "PCCW" refers to PCCW Limited and/or its consolidated subsidiaries, as the context may require, "PCCW Group" refers to PCCW and its consolidated subsidiaries, "Reach" refers to Reach Ltd. and/or its consolidated subsidiaries, as the context may require, "HKTI" and "Reach Networks" refer to Reach Networks Hong Kong Limited (formerly known as Hong Kong Telecom International Limited, Cable & Wireless HKT International Limited and PCCW-HKT International Limited), "HKT" refers to PCCW-HKT Limited (formerly known as Cable & Wireless HKT Limited, and prior to that, Hong Kong Telecommunications Limited) and/or its consolidated subsidiaries, as the context may require, "HKT Group" refers to HKT and its consolidated subsidiaries, "Cascade" refers to Cascade Limited, "IMS" refers to PCCW IMS Limited, "SUNDAY" refers to SUNDAY Communications Limited and "Pacific Century Group" refers to the group of companies of which Li Tzar Kai, Richard is the chairman and chief executive. Additionally, "TA" refers to the Hong Kong Telecommunications Authority, which is given broad statutory powers to regulate the telecommunications industry and "OFTA" refers to the Office of the Telecommunications Authority which supports the TA and acts under delegated authority on telecommunications matters in Hong Kong.

Any discrepancies in the tables included herein between the listed amounts and the totals thereof are due to rounding.

SUMMARY

The following summary is qualified in its entirety by the more detailed information and the audited financial statements of the Guarantor and notes thereto appearing elsewhere in this Offering Circular (the Audited Financial Statements).

THE GUARANTOR

The Guarantor is the leading provider of fixed-line telecommunications services in Hong Kong. The Guarantor has the most extensive digital network in Hong Kong, and its broadband network coverage currently passes more than 95% of Hong Kong homes and all major business areas in Hong Kong utilizing fiber-to-the-building and digital subscriber line (DSL) technology. The Guarantor provides a wide range of services including:

- *Local Telephony Services* — The Guarantor is the leading provider of fixed-line services in Hong Kong, with the most extensive digital network in Hong Kong and a broadband capability that covers almost all of Hong Kong's residential and commercial buildings.

- *Local Data and Broadband Services* — Within Hong Kong, the Guarantor provides a backbone for corporate data networks and provides high speed data services to other service operators, offering broadband-based Internet Protocol-Virtual Private Network (IP-VPN), frame relay and Asynchronous Transfer Mode (ATM) services that allow high volume transmissions of integrated data, voice and video traffic for corporate networks. The Guarantor also provides broadband and narrowband Internet access services.

- *International Telecommunications Services* — The Guarantor provides retail outgoing international direct dialing (IDD), retail international private leased circuits (IPLCs) and retail international data services and receives delivery fees for origination and termination of international calls on the Guarantor's network.

- *Other Services* — Consists primarily of call center and technical, maintenance and other subcontracting services provided by the Guarantor to other subsidiaries of PCCW or third parties.

The Guarantor is an indirect wholly owned subsidiary of PCCW and forms the most significant part of PCCW's telecommunications services business.

The Guarantor was incorporated as a private limited company in Hong Kong in 1925 to acquire part of the business of China and Japan Telephone and Electric Company Limited, which had operated Hong Kong's first public telephone services since 1882. In the same year, the Guarantor was awarded the sole right to provide Hong Kong's local telephone services for 50 years. This right was subsequently extended to 1995, at which time the Guarantor, along with three other companies, was granted a non-exclusive license valid until 2010 and renewable for up to 15 years at the discretion of the TA. After ten years of competition, the Guarantor has retained, based on the Guarantor's estimates and OFTA's statistics, as at December 31, 2004, a market share of approximately 68% of exchange lines in service in Hong Kong, representing approximately 67% of residential exchange lines and approximately 69% of business exchange lines.

Over the past several years, in the face of progressive deregulation and a highly competitive environment, the Guarantor has transitioned its business focus from a reliance on local telephone services and retail IDD services as the primary financial driver of its business to a more balanced portfolio of local and international voice, data, value-added and wholesale connectivity services. With its significant investments in its broadband communications network, the Guarantor has benefited from the strong growth in demand for high speed data and Internet services to date.

Competitive Strengths

The Guarantor believes that the following are its principal competitive strengths:

The Guarantor's network provides unmatched coverage and advanced technology to customers in Hong Kong.

One of the Guarantor's key competitive advantages is its advanced telecommunications network, which is the most extensive digital network in Hong Kong. Moreover, the Guarantor's telecommunications infrastructure includes the vast majority of "last mile" access in Hong Kong, connecting residential and commercial building access lines to the core telephone network.

The Guarantor has an experienced management team with significant operational expertise

The Guarantor has long been the leading provider of fixed-line telecommunications services in Hong Kong. It has a management team with extensive and diverse experience in both the development and delivery of telecommunications services. The Guarantor believes that the synergies created by its management experience, technical expertise and advanced technology should enable it to move more quickly than its competitors to identify, adopt, acquire, develop and exploit emerging technologies.

The Guarantor has a reputation for quality and strong customer relationships

The Guarantor believes that its products and services have a reputation for quality and reliability and enjoy a high level of brand recognition among its customers. The Guarantor's extensive and advanced networks, including its broadband network, allow it to provide a comprehensive set of high-quality services, encompassing voice, high-speed data, video services and interactive multimedia services to both residential and business customers. The Guarantor believes that its brand recognition and reputation for quality will continue to provide a competitive advantage in the increasingly competitive Asian telecommunications and data services markets.

Business Strategy

The Guarantor's strategy revolves around the following key initiatives:

- utilizing its broadband network platform to launch new services and capture the high growth potential of data services businesses;
- implementing advanced customer relationship management (CRM) capabilities to enhance service quality, strengthen customer relationships and increase the sale of value-added services;
- broadening its products and services range and providing integrated telecommunications services with the goal of slowing customer churn and maintaining premium revenue per customer;
- focusing on wholesale services opportunities in the telecommunications industry;
- exploring regional business and expansion possibilities, including in the Greater China region; and
- continuing to focus on cost control and efficiency measures.

Registered Office

The Guarantor's registered office is located at 39th Floor, PCCW Tower, TaiKoo Place, 979 King's Road, Quarry Bay, Hong Kong. The Guarantor's telephone number is +852 2888 2888. The Guarantor was incorporated in Hong Kong and its company number is 676. The Guarantor's objects clause is set out in clause 3 of its memorandum of association.

THE ISSUER

The Issuer is a wholly owned subsidiary of the Guarantor which was incorporated on June 13, 2001 as a company with limited liability under the laws of the British Virgin Islands. The Issuer has no material assets and will conduct no business, except relating to the offering, sale and issuance of indebtedness and the lending of the proceeds thereof to the Guarantor and any other activities in connection therewith. The registered office of the Issuer is located at P.O. Box 957, Offshore Incorporations Centre, Road Town, Tortola, British Virgin Islands. The Issuer was incorporated in the British Virgin Islands and its company number is 449029. The Issuer's objects clause is set out in clause 4 of its memorandum of association.

USE OF PROCEEDS

The net proceeds of the offering of the Notes, after deducting underwriting discounts but not offering expenses, are expected to be US$493,710,000 and will be lent by the Issuer to the Guarantor. The Guarantor will use the proceeds for general corporate purposes.

THE OFFERING

The following is a brief summary of the terms of the offering of the Notes. For a more complete description of the terms of the Notes, see "Description of the Notes and Guarantee" in this Offering Circular. Terms used but not defined herein have the meanings set forth in "Description of the Notes and Guarantee."

Issuer	PCCW-HKT Capital No.3 Limited.
Guarantor	PCCW-HKT Telephone Limited.
Notes Offered	US$500,000,000 aggregate principal amount of 5.25% Guaranteed Notes due 2015 (the Notes).
Guarantee	Payment of principal of, and interest and any Additional Amounts on, the Notes is irrevocably and unconditionally guaranteed by the Guarantor. Payments of principal, interest and other amounts on the Notes are not guaranteed by PCCW or any of its subsidiaries other than the Guarantor.
Issue Price	99.142% of principal amount, plus accrued interest, if any.
Maturity Date	July 20, 2015
Interest Payment Dates	January 20 and July 20, commencing January 20, 2006.
Interest	The Notes will bear interest from July 20, 2005 at the rate of 5.25% per annum, payable semi-annually in arrear.
Further Issues	The Issuer and the Guarantor may, from time to time, without the consent of the holders of the Notes, create and issue further securities having the same terms and conditions as the Notes in all respects (or in all respects except for the issue date, issue price, and the first interest payment date and, to the extent necessary, certain temporary securities law transfer restrictions). Additional notes issued in this manner will be consolidated and form a single series with the previously outstanding Notes.
Ranking of the Notes	The Notes will constitute direct, unconditional, unsubordinated and unsecured obligations of the Issuer ranking *pari passu* in right of payment with all other unsecured and unsubordinated obligations of the Issuer (other than obligations preferred by applicable law) and senior in priority of payment and in all other respects to all other Indebtedness of the Issuer that is designated as subordinate or junior in right of payment to the Notes.

Ranking of the Guarantee	The Guarantee will constitute a direct, unconditional, unsubordinated and unsecured obligation of the Guarantor ranking *pari passu* in right of payment with all other unsecured and unsubordinated obligations of the Guarantor (other than obligations preferred by applicable law) and senior in priority of payment and in all other respects to all other Indebtedness of the Guarantor that is designated as subordinate or junior in right of payment to the Guarantee.
Certain Covenants	The Issuer and the Guarantor have agreed to observe certain covenants. See "Description of the Notes and Guarantee."
Additional Amounts	In the event that certain British Virgin Islands or Hong Kong taxes are payable in respect of payments under the Notes or the Guarantee or the intercompany loan of the proceeds of the offering of the Notes from the Issuer to the Guarantor (the Intercompany Loan), the Issuer or the Guarantor, as the case may be, will, subject to certain exceptions, pay such Additional Amounts under the Notes, the Guarantee or the Intercompany Loan, as the case may be, as will result, after deduction or withholding of such taxes, in the payment of the amounts that would have been payable in respect of the Notes, the Guarantee or the Intercompany Loan, as the case may be, had no deduction or withholding been required. See "Description of the Notes and Guarantee — Payment of Additional Amounts."
Tax Redemption	The Notes are not redeemable prior to maturity except that the Notes may be redeemed at any time at the option of the Issuer, in whole but not in part, at 100% of the principal amount thereof, plus accrued and unpaid interest, in the event, as a result of certain developments affecting taxation described herein, either (x) the Issuer or the Guarantor is, or would be, obligated to pay Additional Amounts in respect of the Notes or Guarantee or (y) the Guarantor is, or would be, obligated to pay Additional Amounts in respect of the Intercompany Loan. See "Description of the Notes and Guarantee — Optional Tax Redemption."
Transfer Restrictions	The Notes and the Guarantee have not been and will not be registered under the Securities Act or any state securities laws and are being offered only (i) to qualified institutional buyers under Rule 144A and (ii) outside the United States to non-U.S. persons in compliance with Regulation S. For a description of certain restrictions on transfer, see "Plan of Distribution" and "Transfer Restrictions."
Governing Law.	The Notes, the Guarantee and the Indenture will be governed by, and construed in accordance with, the laws of the State of New York.

Denomination, Form and Registration	The Notes will be issued in minimum denominations of US$100,000 and integral multiples of US$1,000 above that amount. The Notes will be traded on the SGX-ST in a minimum trading board lot size of US$200,000 for so long as the Notes are listed on the SGX-ST. Notes offered in the United States to qualified institutional buyers in reliance on Rule 144A will be represented by one or more permanent global notes in fully registered form without interest coupons deposited with HSBC Bank USA, National Association as custodian for, and registered in the name of, Cede & Co., as nominee of The Depository Trust Company (DTC). Notes offered outside the United States to non-U.S. persons in reliance on Regulation S will be represented by one or more permanent global notes in fully registered form without interest coupons deposited with HSBC Bank USA, National Association as custodian for, and registered in the name of, Cede & Co., as nominee of DTC for the respective accounts of Euroclear Bank S.A./N.V., as operator of the Euroclear System (Euroclear) and Clearstream Banking, societe anonyme, Luxembourg (Clearstream). Prior to the 40th day after the later of the commencement of the offering of the Notes and the Closing Date (the date payment for the Notes is made to the Issuer by the Manager), beneficial interests in the Regulation S global notes may be held only through Euroclear or Clearstream. DTC will credit the account of each of its participants, including Euroclear and Clearstream, with the principal amount of Notes being purchased by or through such participant. Beneficial interests in the global notes will be shown on, and transfers thereof will be effected only through, records maintained by DTC and its direct and indirect participants, including Euroclear and Clearstream.
Ratings	The Notes have been rated “Baa2” by Moody’s Investors Service, (Moody’s), “BBB” by Standard & Poor’s Ratings Services (S&P) and “BBB+” by Fitch Ratings (Fitch). Security ratings are not recommendations to buy, sell or hold the Notes. **Ratings are subject to revision or withdrawal at any time by the rating agencies. See “Ratings.”**
Listing	Approval in-principle has been obtained for the listing of the Notes on the SGX-ST. The offering and settlement of the Notes is not conditioned on obtaining a listing.
Trustee	HSBC Bank USA, National Association.

RISK FACTORS

Any potential investor should carefully consider the following risk factors, together with all of the other information contained in this Offering Circular, before making an investment decision. These risk factors could cause the Guarantor's future results to differ materially from those expressed or implied in any forward-looking statements made by the Guarantor. The risks and uncertainties described below are not the only ones the Guarantor faces. Additional risks and uncertainties not presently known to the Guarantor or that the Guarantor currently considers immaterial may also harm the Guarantor's business.

Increased competition has adversely affected the Guarantor's business and the Guarantor remains subject to negative effects from regulatory constraints.

The Hong Kong Government's policies relating to the liberalization of the telecommunications industry in Hong Kong have resulted in increasing competition for the Guarantor in the markets for local and international telecommunications services.

In 1995, the Guarantor's monopoly on fixed-line telecommunications services expired, paving the way for the granting of new fixed telecommunications network services (FTNS) licenses to the Guarantor and three other fixed-line local carriers: Hutchison Global Communications Limited, New World Telecommunications Limited (New World Telecommunications) and Wharf T&T Limited (Wharf). The FTNS licenses are valid until 2010 and renewable for an additional period of up to 15 years at the discretion of the TA. The Hong Kong Government also granted additional licenses in 2000 for the operation of FTNS over hybrid coaxial networks or local fixed networks based on wireless technologies. Six cellular companies, four of which hold 3G licenses, also operate in the market. One of these six companies is SUNDAY, in which PCCW acquired a majority stake on June 22, 2005.

On January 1, 2003, full liberalization of the local and external FTNS markets, took effect following a statement on the issue by the TA on January 11, 2002. See "Business — Regulation." The introduction of full liberalization, alternative service providers and alternative technologies (e.g. Voice over Internet Protocol (VoIP)) for the provision of fixed-line services has increased and will continue to increase competition for the Guarantor. With full liberalization, the grant of new licenses does not explicitly require capacity or infrastructure investment. However, no new FTNS licenses will be granted to those applicants who primarily rely on interconnection with and access to the infrastructure of other FTNS licensees to roll out their network or provide their services. Since full market liberalization in January 2003, several new wireline-based FTNS licenses have been granted. Consequently, the Guarantor's results of operations, cash flows and financial position could be adversely affected.

Competition in the market for IDD services was initiated in 1999 as a result of the Hong Kong Government's issuance of external telecommunications services (ETS) licenses to numerous providers. An ETS license gives the licensee the right to lease international private circuits from licensed international facility-based carriers at market rates for the operation of international call services. Further competition with respect to the provision of international services from facilities-based carriers was initiated in 2000 as a result of the Hong Kong Government's granting of additional external fixed telecommunications network services (EFTNS) licenses. The Guarantor's market position in the retail market for IDD and other international services has also been affected by the presence of other service providers whose operations may be augmented through strategic alliances with global and/or foreign strategic partners and mobile telecommunications service providers. These developments may make the international retail market even more competitive in the future.

Increased competition has resulted and may continue to result in price reductions, reduced gross margins, loss of market share, under-utilization of resources and additional promotional, marketing and customer acquisition expenses. These factors have adversely affected, and may continue to adversely affect, the Guarantor's results of operations, cash flows and financial position.

In addition, the Guarantor may continue to restructure its telephony operations to reflect changes from a highly regulated environment to a highly competitive one. The Guarantor could suffer material adverse effects on its results of operations, cash flows and financial position, if it is unable to restructure its operations as required, or in time, to face these competitive challenges. The Guarantor has previously taken substantial write-offs in light of competitive pressures and rapid advancements in technology and the Guarantor can give no assurance that similar write-offs will not be required in the future.

On January 14, 2005 the Guarantor exchanged its FTNS license for a new Fixed Carrier (FC) license. The primary change is the Guarantor's move from an "ex ante" tariff regime (where TA prior approval of all of its tariff revisions was required) to an "ex post" tariff regime (where the Guarantor gives the TA notice one day before it effectuates a tariff revision such as a discount, promotion or services bundle). The FC license does not contain any language that suggests the Guarantor is dominant in any market. These changes were the result of the Guarantor's applications to be declared non-dominant and its litigation strategy and will assist its ability to compete on a more level-playing field with other entrants. Nevertheless, the Guarantor's new license does not grant it non-dominance status. There is also a mandated local loop unbundling (i.e., Type II interconnection) requirement for narrowband (e.g., voice telephony) and broadband (e.g., Internet access). Although it will be phased out by mid-2008, this has facilitated market share acquisition by the other entrants. Continued pricing pressure from the Guarantor's competitors and its new found ability to price competitively may lead to further price declines and more severe competition in the fixed line market. If the Guarantor is not able to compete effectively within the constraints of its new FC license or if the TA's interpretation of the scope of constraints of the FC license is more stringent than the Guarantor's interpretation, its results of operations, market position and financial condition may be adversely affected.

As a further step to monitor and regulate the telecommunications market, the Hong Kong Government enacted the Telecommunications (Amendment) Ordinance 2003 (2003 Ordinance) in July 2003, which deals specifically with merger and acquisition activities by carrier licensees in Hong Kong's telecommunications sector. The 2003 Ordinance gives the TA the power to review mergers and acquisitions concerning carrier licensees and to take appropriate actions when it determines that the transaction would substantially lessen market competition without any outweighing public benefits. The TA also has the right to impose additional conditions on the carrier licensee including unwinding the merger or acquisition. A de novo appeal to the Telecommunications (Competition Provisions) Appeal Board (Competition Board) of the TA's decision is also part of the 2003 Ordinance. The 2003 Ordinance may have an adverse effect on the Guarantor's ability to grow its carrier and fixed line business through mergers and acquisitions.

More generally, the Hong Kong telecommunications industry operates under licenses granted by OFTA. The Guarantor's operations could be adversely affected if any of its existing licenses are amended, not renewed or revoked. The industry will be more competitive if new licenses are granted by OFTA to other service providers. The effect of any future regulatory changes on the viability or competitiveness of the Guarantor's business cannot be accurately predicted.

Regulatory decisions relating to broadband access services could adversely affect the Guarantor.

In November 2000, the TA issued a statement on the regulatory framework for broadband interconnection, including the principles underlying the determination of broadband unbundled local loop arrangements and interconnection charges. Following the approval of OFTA, on October 19, 2001, the Guarantor published a new wholesale tariff which sets out the terms and conditions upon which other FTNS operators in Hong Kong may interconnect with the Guarantor's copper local loops on an unbundled basis to provide broadband services. At the end of 2001, further to the request of two other operators, New World Telecommunications and Wharf, OFTA initiated two determination proceedings to determine the terms, conditions and rates for broadband Type II unbundling.

On May 15, 2002, the TA issued a direction under section 36B of the Telecommunications Ordinance to Wharf and the Guarantor directing the Guarantor to promptly implement broadband Type II unbundling upon receipt of a request from Wharf. Pursuant to a request for judicial review, the TA's direction was found by the High Court on June 30, 2004 to be unlawful. The Guarantor continues to offer broadband unbundled loops in accordance with its wholesale tariff, as amended, but not in accordance with the TA's decision.

The Type II interconnection review was a public consultation initiated by the Secretary for Commerce, Industry and Technology of the Hong Kong Government on May 23, 2003 to review the policy of compulsory unbundling of local loops due to the changing market landscape, the advent of new or improved technologies and the fact that seven years have passed since narrowband unbundling was implemented. On July 6, 2004, the Executive Council released its decision to ultimately phase out both narrowband and broadband compulsory unbundled local loop by June 30, 2008. While New World Telecommunications has withdrawn its request for a determination, Wharf has asked the TA to resume the determination. In response, the TA has asked the Guarantor and Wharf whether the TA's 2001 acceptance of Wharf's request for a determination should be vacated. The Guarantor submitted a reply on July 8, 2005. Until mid-2008 when compulsory local loop unbundling will be withdrawn, these determination proceedings, and other further actions by the Hong Kong Government, may mandate pricing and terms and conditions which, if less favorable to the Guarantor than those provided in the published tariff, may adversely affect the Guarantor's business, financial condition, or results of operations.

In the Interconnection and Related Competition Issues Statement No. 7 (Second Revision) published on March 18, 2002, OFTA completed a review of its interconnection charging principles initially established in 1995. In Statement No. 7, OFTA reconfirmed that in future determinations for Type II interconnection and Type I interconnection (i.e., interconnection between network gateways) it would continue to use a long run average incremental cost (LRAIC) approach and apply a current cost standard subject to the use of historical cost on certain items (land, building, copper infrastructure pre-1995) to the costing of network assets. On June 18, 2002, OFTA indicated it could further revise Statement No. 7 to make it applicable to both broadband and narrowband interconnections. On November 12, 2004, OFTA announced that it would review the charging methodology for mobile and value added service interconnection to the Guarantor's FTNS network. See "Business — Regulation." These reviews may result in interconnection charge levels less than those currently in existence and may adversely affect the Guarantor's business, results of operations or financial condition.

The Guarantor's substantial debt could impair its ability to implement its business plan.

The Guarantor has incurred significant indebtedness and, subject to limitations imposed by lenders, may incur additional debt in the future. As at December 31, 2004, the Guarantor had outstanding long term indebtedness of approximately HK$15,967 million, as adjusted to give effect to (i) the Notes offered hereby and (ii) the drawdown of HK$500 million (approximately US$64 million) under the Guarantor's five-year revolving credit facility entered into in December 2003. See "Description of Other Indebtedness." The Guarantor has also guaranteed obligations of other PCCW Group companies (excluding subsidiaries of the Guarantor) in the aggregate principal amount of HK$9,313 million as at December 31, 2004. See "Related Party Transactions" and Note 31 of the Audited Financial Statements.

As long as the Guarantor has a substantial amount of debt, the consequences of this debt to the Guarantor's business, among other things could be to:

- limit the Guarantor's ability to take advantage of significant new business opportunities;
- make it more difficult for the Guarantor to satisfy its payment obligations if market or operational conditions deteriorate;
- increase the Guarantor's vulnerability to general adverse economic and industry conditions;

- limit the Guarantor's flexibility in planning for, or reacting to, changes in its business and the industry in which the Guarantor operates;

- require the Guarantor to dedicate a substantial portion of its cash flow from operations to payment of its existing debt, reducing the availability of its cash flow to fund working capital, capital expenditure, acquisitions, research, development and other general corporate requirements; and

- place the Guarantor at a competitive disadvantage compared to its competitors that have less debt.

The Guarantor is exposed to interest rate risk.

The Guarantor's long-term loan facilities bear interest at a floating rate. As of July 12, 2005, HK$500 million has been drawn under these facilities. As a result, any significant increase in interest rates would increase the Guarantor's payment obligations and could adversely affect the Guarantor's financial condition and results of operations.

Position of the Guarantor in the PCCW Group and transactions with affiliates.

The Guarantor is an indirect wholly owned subsidiary of PCCW. Li Tzar Kai, Richard, the chairman of PCCW, is also chairman and chief executive of the Pacific Century Group and chairman of Pacific Century Regional Developments Limited. As at June 28, 2005, Li Tzar Kai, Richard was deemed to be interested in approximately 26.62% of PCCW's issued share capital under the Hong Kong Securities and Futures Ordinance (HKSFO). As a result, Li Tzar Kai, Richard may be considered to have significant influence over PCCW.

PCCW has the ability to elect all of the Guarantor's directors and control the Guarantor's management and policies, including dividend and financing policies. Subject to applicable covenants and applicable law, the Guarantor has the ability to loan or dividend funds or transfer assets to other members of the PCCW Group, guarantee or support the obligations of other members of the PCCW Group, or borrow funds for the purpose of making transfers to other members of the PCCW Group. The Notes do not restrict the Guarantor from taking any of these actions. The Guarantor has guaranteed obligations of other PCCW Group companies (excluding subsidiaries of the Guarantor) in the aggregate principal amount of HK$9,313 million as at December 31, 2004. See "Related Party Transactions" and Note 31 of the Audited Financial Statements.

The Guarantor engages in transactions with Reach and with certain subsidiaries and other affiliates of PCCW on an arm's length basis. Transactions with Reach have in the past included connectivity agreements under which the Guarantor purchased international connectivity services from Reach Networks, a wholly owned subsidiary of Reach, and currently include the provision of network services from Reach Networks to the Guarantor and other affiliates of PCCW, as well as the provision of domestic connectivity services from the Guarantor to Reach Networks. Transactions with certain other subsidiaries and affiliates of PCCW include the provision of telecommunications products and services and the acquisition of operations from, and disposition of operations to, PCCW affiliates. The Guarantor's transactions with affiliates may create the potential for conflicts of interest. See "Related Party Transactions."

The Guarantor's intercompany advances to PCCW may not be repaid.

The Guarantor's balance sheet as at December 31, 2004 reflects, as an asset, HK$4,476 million in advances that it has made to PCCW. The advances have no fixed term and are partly non-interest-bearing and unsecured. The Guarantor's ability to recover these advances will depend on a number of factors, including the ability of PCCW to pay, which may in turn depend on the receipt of dividends, advances or other payments from the Guarantor. In connection with the capital reduction effected by PCCW in 2004, the Guarantor agreed to subordinate these advances to amounts PCCW owed to certain of its creditors as of the time of the capital reduction. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources" and "Related Party Transactions."

The Guarantor will be susceptible to risks associated with Reach.

In April 2005, PCCW and Telstra Corporation Limited (Telstra) agreed on a new operating model under which Reach would operate as an outsourcer of telecommunications network services for the PCCW Group (including the Guarantor) and Telstra and its subsidiaries (the Telstra Group). If Reach were unable for any reason to provide the PCCW Group with such services, the Guarantor's business could be significantly disrupted. In addition, as a result of the PCCW Group's commitments under Reach's new operating model, the Guarantor's ability to acquire telecommunications network services from other service providers at potentially lower costs or on better terms than those supplied by Reach may be limited. As a result, the PCCW Group's relationship with Reach could have a material adverse effect on the Guarantor's business, results of operations and financial condition.

The Guarantor may not be able to obtain additional capital.

The Guarantor expects to continue to make investments to maintain and upgrade its local fixed-line network and market its new and existing services. In addition, the Guarantor's free cash flow will be significantly impaired by its principal repayment and interest obligations in respect of its indebtedness. Accordingly, while the Guarantor's capital expenditures in future years are likely to be lower than expenditures in the past, it will have less free cash flow to fund those expenditures.

The Guarantor may have to obtain additional financing if:

- the Guarantor's business plan changes or is accelerated; or
- the Guarantor's turnover and operating cash flow do not grow as expected.

Financing may not be available to the Guarantor when the Guarantor needs it, or, if it is available, it may only be available on terms that are unfavorable to the Guarantor. If the Guarantor cannot raise sufficient additional funds on commercially acceptable terms, the Guarantor may need to delay or abandon some of its development and expansion plans or otherwise forgo market opportunities.

The Guarantor will be susceptible to risks associated with expanding its operations outside Hong Kong, which could harm its operating results.

The Guarantor plans to offer the network, operations and management experience and expertise that it has acquired in Hong Kong to clients and business partners in markets outside of Hong Kong, including the PRC. The Guarantor expects to commit substantial time and development resources to customizing and developing its products and services for markets outside of Hong Kong, such as the PRC, and to developing relevant sales and support channels. The Guarantor's ability to expand into these markets may be constrained by the pace of deregulation in individual markets, including the timing of removal of restrictions on foreign participation. In addition, operations outside of Hong Kong will be subject to certain risks, including:

- lack of familiarity with the overseas market, such as customer preferences and competitors' practices;
- multiple and conflicting regulations relating to communications, use of data and control of Internet access;
- changes in regulatory requirements, tariffs and import and export restrictions, particularly in the PRC;

- increased costs associated with complying with the laws of numerous jurisdictions;
- fluctuations in currency exchange rates;
- lack of clarity in the interpretation of laws and regulations, particularly in the PRC;
- insufficient protection of intellectual property rights, particularly in the PRC;
- changes in political and economic stability; and
- potentially adverse tax consequences.

Any of these factors could have a material and adverse effect on the Guarantor's business, results of operations and financial condition.

The Guarantor has been assessed taxes from previous years as a result of a dispute with the Inland Revenue Department.

The Guarantor has been in dispute with Hong Kong's Inland Revenue Department (IRD) regarding the deductibility of interest payments and related financing expenses totaling HK$1,708 million in previous years' tax computations. Subsequent to December 31, 2004, the Guarantor received additional assessments totaling HK$240 million as a result of a disallowance by the IRD of the deductions in dispute. The Guarantor believes its grounds for claiming the deductions are reasonable and has lodged a formal objection to the IRD against the additional assessments and accordingly no provision for taxation has been made in the Guarantor's financial statements. However, if the Guarantor ultimately loses the dispute, it could adversely affect the Guarantor's results of operations.

Any asset impairment could adversely affect the Guarantor's financial results.

The Guarantor owns fixed assets and has made loans in the form of advances to its parent company, and is required to review these assets for impairment at the end of each financial year with reference to their recoverable amounts. The recoverable amount of an asset is the greater of its net selling price and its value-in-use. If the carrying value of an asset is higher than its recoverable amount, asset impairment will be charged to the income statement. The recoverable amount is dependent on the prevailing market conditions, nature of the asset, its resale value, its estimated future cash flows and the discount rate that reflects current market assessment of the time value of money and the risks specific to the asset. The carrying value (net of any impairment previously recognized) of fixed assets and loans to its parent company as at December 31, 2004 were HK$11,809 million and HK$4,476 million, respectively. As such, any reduction in the recoverable amount of an asset below its carrying value could be charged to the income statement and could adversely affect the Guarantor's financial results.

Currently contemplated regulatory initiatives relating to VoIP service could adversely affect the Guarantor.

On October 4, 2004, OFTA initiated a consultation on how VoIP services should be regulated. The consultation paper raised issues concerning the licensing of VoIP services and the manner in which such services could be provided. It also dealt with the allocation of telephone numbers and number portability rights, the need to provide any-to-any connectivity, network interconnection and Calling Line Identification, the payment of interconnection charges, and a range of consumer welfare issues. On June 20, 2005, the TA released its policy statement on the regulation of VoIP services in Hong Kong. The TA adopted a two tier licensing regime for VoIP providers and indicated that the first tier providers would have similar rights and obligations as the current FTNS/FC licensees as they would be providing a substitutable voice service. The second tier providers would have fewer rights and obligations, as they would be offering services that would not be substitutable for existing voice services. Additional consultations will be held on service quality and numbering issues, although the first tier VoIP service providers would have access to eight digit numbers and number porting rights and enjoy interconnection rights as well. The outcomes of the additional consultations are expected to be announced by OFTA by year end 2005. Depending on the outcome of commercial negotiations and the additional consultations on VoIP, such services could pose a serious competitive threat to the Guarantor's fixed line and IDD business, resulting in reduced revenues and margins.

The Guarantor may enter into potential business combinations, strategic investments and acquisitions.

The Guarantor may enter into new business combinations, strategic investments and acquisitions. However, the Guarantor might not be able to enter into new business combinations, strategic investments and acquisitions due to regulatory or other constraints and this could have a material adverse effect on the Guarantor's results of operations. In addition, acquisitions typically involve a number of risks, including:

- the difficulty of integrating the operations and personnel of the acquired companies;
- the potential disruption to the Guarantor's ongoing business and the distraction of its management;
- the difficulty of incorporating acquired technology and rights into the Guarantor's products and services;
- unanticipated expenses related to acquired technologies and their integration into existing technologies;
- the difficulty of maintaining uniform standards, controls, procedures and policies;
- the impairment of relationships with employees and customers as a result of integration of new management and personnel;
- potential unknown liabilities associated with acquired businesses;
- higher than planned funding requirements to preserve and grow the value of acquired companies or, if the Guarantor is unable to obtain access to such funds, possible loss of value of the acquired companies; and
- adverse effects on the Guarantor's reported operating results due to the amortization of and potential impairment provision for goodwill associated with acquisitions and losses sustained by acquired companies after the date of acquisitions.

The Guarantor's ability to introduce new technologies, to successfully respond to technological developments and to adapt existing technologies may be limited.

The Guarantor's operations depend on the successful deployment of continuously evolving technologies, particularly in view of its expansion plans in the broadband market and its response to technological and industry developments.

The Guarantor cannot be certain that technologies will be developed in time to meet changing market conditions, that they will perform according to expectations or that they will achieve commercial acceptance. The failure of vendor performance or technology performance to meet the Guarantor's expectations or the failure of technology to achieve commercial acceptance could mean that the Guarantor has to make additional unexpected capital expenditures. In addition, the Guarantor may not be able to adapt its services to changing market conditions or establish and maintain effective distribution channels for its services. Competitors may adapt more successfully to changing market conditions, establish more effective distribution channels or introduce technologies that make the Guarantor's products and services less competitive.

Loss of key management and other qualified personnel could weaken the Guarantor's business.

A small group of key executive officers manages the Guarantor and the loss of services of one or more of these key individuals could affect the Guarantor's ability to make successful strategic decisions. The service contracts with these executive management are terminable with notice periods ranging from three to twelve months. The Guarantor cannot guarantee that these contracts will allow it to retain key employees. Additionally, the Guarantor does not presently maintain any key person insurance.

The Guarantor's management believes that the Guarantor's growth and success will depend in large part on its ability to attract, train, retain and motivate highly skilled and qualified managerial, sales, marketing, administrative, operating and technical personnel. The loss of key personnel, or the inability to find additional qualified personnel, could materially and adversely affect the Guarantor's prospects and financial position.

A recurrence of severe acute respiratory syndrome (SARS), or other similar outbreaks in the PRC, Hong Kong or certain other Asian countries, may adversely affect the Guarantor's business, results of operations and financial condition.

In the first half of 2003, the PRC, Hong Kong, Taiwan, Singapore and certain other Asian countries encountered an outbreak of SARS, a highly contagious form of atypical pneumonia. In April 2004, there were several confirmed cases of SARS in Beijing. The recurrence of a SARS outbreak, or other similar outbreaks, in the PRC, Hong Kong or certain other Asian countries may adversely affect the Guarantor's ability to conduct business development, in particular, in the PRC and Taiwan. A recurrence or any similar outbreak may have an adverse effect on the Guarantor's customers and the demand for the Guarantor's products and services due to a general slowdown of the economy, and the prolonged effects of a recurrence or any similar outbreak may have a material adverse impact on the Guarantor's business, results of operations and financial condition.

Hong Kong's relationship with the rest of the PRC is unpredictable and could disrupt the Guarantor's business.

Hong Kong is a special administrative region of the PRC with its own government. Hong Kong enjoys a high degree of autonomy from the PRC under the principle of "one country, two systems." However, there can be no assurance that the Guarantor's financial condition and results of operations will not be adversely affected as a consequence of the exercise of Chinese sovereignty over Hong Kong.

Almost all of the Guarantor's operating assets are located in Hong Kong, and a majority of the Guarantor's turnover is derived from operations conducted in Hong Kong. As a result, the Guarantor's financial condition and results of operations may be influenced by the political situation in Hong Kong and by the general state of the Hong Kong economy and the economies of the surrounding region, particularly the PRC.

An economic downturn could adversely affect the Guarantor's results of operations.

From mid-1997 to 2004, many countries in Asia experienced significant economic downturns and related financial difficulties. The decline in the value of most Asian currencies has led to many Asian companies experiencing difficulties servicing foreign currency-denominated debt and thereby defaulting on their debt payments. The economic crisis adversely affected domestic growth rates across the Asia-Pacific region. While economic conditions in many of these countries have improved, the Guarantor's business, results of operations and financial condition could be materially and adversely affected if there are economic downturns in these Asian or other countries in the future.

Currency fluctuations could adversely affect the Guarantor's results of operations.

Although a major part of the Guarantor's outstanding debt and guarantee obligations are denominated in currencies other than Hong Kong dollar, the Guarantor has entered into a series of hedging transactions to swap most of these liabilities back into the Hong Kong dollar. The Hong Kong dollar has been pegged to the US dollar since 1983. However, there is no assurance that such a peg will be maintained in the future. Therefore the Guarantor's results of operations and ability to discharge its obligations could be adversely affected by the discontinuation or revaluation of the peg between the Hong Kong dollar and US dollar.

Risks relating to complicated transactions and contractual arrangements.

The Guarantor has entered into a number of complicated transactions and contractual arrangements. These include, among other things, financing and other contracts and instruments, investments, acquisitions and sales agreements and other contractual arrangements. These transactions and contractual arrangements could give rise to differences in interpretation, disputes, claims or other developments which could have a material adverse effect on the Guarantor's business, financial condition or results of operations.

Differences exist between Hong Kong GAAP and U.S. GAAP and changes will occur in Hong Kong GAAP.

The audited financial information included in this Offering Circular has been prepared and presented in accordance with Hong Kong generally accepted accounting principles (Hong Kong GAAP). Significant differences exist between Hong Kong GAAP and U.S. generally accepted accounting principles (U.S. GAAP) which might be material to the financial information contained herein. The Guarantor has made no attempt to quantify the impact of those differences. In making an investment decision, investors must rely upon their own examination of the Guarantor, the Issuer, the terms of the offering of the Notes and the financial information contained herein. A qualitative discussion of these differences is set out in "Summary of Certain Differences Between Hong Kong GAAP and U.S. GAAP."

Risks associated with limited liquidity of the Notes.

No public market exists for the Notes. Approval in-principle has been obtained for the listing of the Notes on the SGX-ST; however, the offering and settlement of the Notes is not conditioned on obtaining a listing. The Manager intends, but is under no obligation, to make a market in the Notes and no assurances can be given as to whether a trading market for the Notes will develop or as to the liquidity of any such trading market. If any of the Notes are traded after their initial issue, they may trade at a discount or premium from their initial offering price, depending on prevailing interest rates, the market for similar securities and the market for the Notes and other factors, including general economic conditions and the Guarantor's financial condition, performance and prospects. No assurance can be given as to the future price level of the Notes after their initial issue.

EXCHANGE RATES

The Hong Kong dollar is freely convertible into other currencies (including the U.S. dollar). Since October 17, 1983, the Hong Kong dollar has been pegged to the U.S. dollar at the rate of HK$7.80 to US$1.00. The central element in the arrangement which gave effect to this peg is that, by agreement between the Hong Kong Government and the three Hong Kong banks that issue Hong Kong dollar banknotes, The Hongkong and Shanghai Banking Corporation Limited, Standard Chartered Bank and Bank of China, certificates of indebtedness (which are issued by the Hong Kong Government Exchange Fund to the banknote issuing banks to be held as cover for their banknote issue) are issued and redeemed only against payment in U.S. dollars, at the fixed exchange rate of US$1.00 to HK$7.80. When banknotes are withdrawn from circulation, the banknote issuing banks surrender the certificates of indebtedness to the Hong Kong Government Exchange Fund and are paid the equivalent amount of U.S. dollars at the fixed rate of exchange.

The market exchange rate of the Hong Kong dollar against the U.S. dollar continues to be determined by the forces of supply and demand in the foreign exchange market. In light of the fixed rate for the issue of Hong Kong currency in the form of banknotes, as described above, however, the market exchange rate has not deviated significantly from the level of HK$7.80 to US$1.00 since October 17, 1983. Exchange rates between the Hong Kong dollar and other currencies are influenced by the pegged rate between the U.S. dollar and the Hong Kong dollar. During the general economic downturn in Asia in 1998, however, the Hong Kong Government intervened on several occasions in the foreign exchange market by purchasing Hong Kong dollars and selling U.S. dollars to support the value of the Hong Kong dollar.

The following table sets forth the average, high, low and period-end exchange rates between the Hong Kong dollar and the U.S. dollar (in HK$ per US$1.00) at the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York for the periods indicated (the Noon Buying Rate).

	Hong Kong Dollars/U.S. Dollars Noon Buying Rate			
Year Ended December 31,	**Average Rate[(1)]**	**High**	**Low**	**Period-End**
2000	HK$7.79	HK$7.80	HK$7.77	HK$7.80
2001	7.80	7.80	7.80	7.80
2002	7.80	7.80	7.80	7.80
2003	7.79	7.80	7.71	7.76
2004	7.79	7.80	7.76	7.77
2005 (through July 12)	7.79	7.80	7.77	7.78

(1) Determined by averaging the rates on each business day during the relevant period.

THE ISSUER

The Issuer, a wholly owned subsidiary of the Guarantor, was incorporated as a company with limited liability under the laws of the British Virgin Islands on June 13, 2001. Its registered office is located at P.O. Box 957, Offshore Incorporations Centre, Road Town, Tortola, British Virgin Islands. The Issuer, whose primary purpose is to act as a financing subsidiary of the Guarantor, will remain a wholly owned subsidiary of the Guarantor as long as the Notes are outstanding and will advance the net proceeds of the Notes to the Guarantor. The Issuer has no material assets and will conduct no business, except relating to the offering, sale and issuance of indebtedness and the lending of the proceeds thereof to the Guarantor and any other activities in connection therewith.

The directors of the Issuer are Alexander Anthony Arena, Yuen Tin Fan, Francis and Wayne Michael Verge. Further information on the particulars and experience of the directors of the Guarantor is set forth in "Management." The Issuer does not have any executive officers.

The authorized share capital of the Issuer is US$50,000 divided into 50,000 ordinary shares of US$1.00 par value each, of which one share is issued and outstanding. No part of the equity securities of the Issuer is listed or dealt on any stock exchange and no listing or permission to deal in such securities is being or is proposed to be sought. The Issuer does not have any debt outstanding other than the Notes now being issued. The Issuer has no subsidiaries.

The Issuer has not audited or published, and does not propose to audit or publish, any of its accounts since it is not required to do so under the laws of the British Virgin Islands. However, the Issuer is required to keep such accounts and records as the directors consider necessary or desirable in order to reflect the financial position of the Issuer.

CAPITALIZATION

Capitalization of the Guarantor

The following table sets forth the consolidated capitalization of the Guarantor as at December 31, 2004, as adjusted to give effect to (i) the Notes offered hereby and (ii) the drawdown of HK$500 million (approximately US$64 million) under the Guarantor's five-year revolving credit facility entered into in December 2003. See "Description of Other Indebtedness." The authorized share capital of the Guarantor is HK$2,500,000,000, divided into 2,500,000,000 ordinary shares of HK$1.00 par value each, of which 2,163,783,209 shares were issued and outstanding as at December 31, 2004. Except as described herein, there has been no material change in the capitalization of the Guarantor since December 31, 2004.

	As at December 31, 2004					
	Actual		As Adjusted			
	(in millions)					
Long-term debt:[1]						
Bank loans	HK$	—	HK$	500	US$	64
7.75% Guaranteed Notes due 2011		7,713		7,713		993
6% Guaranteed Notes due 2013		3,869		3,869		498
The Notes offered hereby		—		3,885		500
Total long-term debt		11,582		15,967		2,055
Capital and reserves:						
Share capital		2,164		2,164		279
Reserves		1,924		1,924		248
Shareholders' funds		4,088		4,088		527
Total capitalization	HK$	15,670	HK$	20,055	US$	2,582

(1) The Guarantor has guaranteed obligations of other members of the PCCW Group (excluding subsidiaries of the Guarantor) in the aggregate principal amount of HK$9,313 million as at December 31, 2004. The Yen 30,000 million 3.65% Guaranteed Notes due 2031 issued by Profit Century Finance Limited, an indirect wholly owned subsidiary of PCCW, and guaranteed by the Guarantor, were repurchased and cancelled on June 30, 2005. See "Related Party Transactions" and Note 31 of the Audited Financial Statements.

Capitalization of the Issuer

The following table sets forth the capitalization of the Issuer as at July 12, 2005, adjusted to give effect to the Notes issued hereby. Except as described herein, there has been no material change in the capitalization of the Issuer since July 12, 2005.

	As at July 12, 2005	
	Actual	**As Adjusted**
Long-term debt:		
Notes being issued hereby	US$ —	US$ 500[1]
Capital and reserves:		
Share capital (one share of US$1.00, fully-paid)	1	1
Reserves	—	—
Shareholders' funds	1	1
Total capitalization	US$ 1	US$ 500[1]

(1) In millions.

SELECTED HISTORICAL FINANCIAL INFORMATION

The selected financial information presented in this Offering Circular should be read in conjunction with the Audited Financial Statements and the related notes thereto, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other historical financial information included elsewhere in this Offering Circular. The selected consolidated income statements, balance sheets and cash flows information for each of the three years ended December 31, 2002, 2003 and 2004 is derived from the Audited Financial Statements included elsewhere in this Offering Circular.

The Audited Financial Statements are prepared in accordance with Hong Kong GAAP. Hong Kong GAAP differs in significant respects from U.S. GAAP. See "Summary of Certain Differences between Hong Kong GAAP and U.S. GAAP."

Consolidated Income Statements:

	Year ended December 31,		
	2002[1]	2003[2]	2004[2]
	(HK$ millions)		
Turnover	15,126	14,118	12,923
Operating costs[3]	(9,035)	(8,212)	(8,123)
Restructuring costs	(411)	—	(13)
Impairment loss on fixed assets	—	(966)	—
Fixed assets written off	(40)	—	—
Other revenue and other net income	137	137	381
Profit from operations	5,777	5,077	5,168
Finance costs	(1,308)	(981)	(791)
Profit before taxation	4,469	4,096	4,377
Taxation	(924)	(1,054)	(910)
Profit for the year	3,545	3,042	3,467
Dividends	6,233	2,467	17,663
Other Information			
Adjusted EBITDA[4]	8,606	8,087	6,819
Adjusted EBITDA margin[5]	57%	57%	53%
Capital expenditure	1,226	1,638	1,460

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(1) During 2002, IMS became a wholly owned subsidiary of the Guarantor. Accordingly, the consolidated Audited Financial Statements include the results of IMS from April 1, 2002. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Overview — Acquisition of Retail Broadband and Narrowband Internet Access."

(2) During 2002, Cascade was formed to be a wholly owned subsidiary of the Guarantor and commenced operations on January 1, 2003. Subsequently, the Guarantor transferred its 100% interest in Cascade to another subsidiary of PCCW, and the consolidated Audited Financial Statements have not included the results of Cascade since March 20, 2004. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Overview — Formation and Development of Cascade" and "Related Party Transactions — PCCW Group and Pacific Century Group."

(3) Operating costs include depreciation, salaries and related costs, cost of services provided, subcontracting costs, management fees paid to HKT, rent, rates and utilities, amortization of goodwill and other operating costs.

(4) Adjusted EBITDA represents profit for the year before other income, other revenue, interest, taxes, depreciation, amortization and impairment loss, but excludes any exceptional profits or losses on the sale or termination of an operation, exceptional costs of reorganization or restructuring, exceptional profits or losses on the disposal of assets and other extraordinary items. Adjusted EBITDA is not a Hong Kong GAAP or U.S. GAAP measure. Adjusted EBITDA should not be construed as a substitute for operating profit, net income or cash flows from operating activities for purposes of analyzing the Guarantor's operating performance, financial position and cash flows. Adjusted EBITDA of the Guarantor as described in this Offering Circular is not necessarily comparable with similarly titled measures used by other companies.

(5) Adjusted EBITDA margin equals Adjusted EBITDA as a percentage of turnover.

Consolidated Balance Sheets:

	As at December 31[1],		
	2002	2003	2004
	(HK$ millions)		
Net current assets			
Current assets	5,252	6,132	4,796
Current liabilities	(4,704)	(3,992)	(4,284)
Net current assets	548	2,140	512
Non-current assets			
Fixed assets	13,775	12,313	11,809
Goodwill	480	428	376
Loans to ultimate holding company	—	—	4,476
Loans to intermediate holding company	33,986	16,705	—
Deferred tax assets	—	44	—
Total non-current assets	48,241	29,490	16,661
Total assets less current liabilities	48,789	31,630	17,173
Non-current liabilities			
Interest-bearing borrowings	(29,220)	(11,605)	(11,582)
Deferred tax liabilities	(1,457)	(1,410)	(1,375)
Defined benefit liability	(419)	(347)	(128)
Total non-current liabilities	(31,096)	(13,362)	(13,085)
Net assets and shareholders' funds	17,693	18,268	4,088

(1) The Guarantor has guaranteed obligations of other members of the PCCW Group (excluding subsidiaries of the Guarantor) in the aggregate principal amount of HK$9,313 million as at December 31, 2004. The Yen 30,000 million 3.65% Guaranteed Notes due 2031 issued by Profit Century Finance Limited, an indirect wholly owned subsidiary of PCCW, and guaranteed by the Guarantor, were repurchased and cancelled on June 30, 2005. See "Related Party Transactions" and Note 31 of the Audited Financial Statements.

Consolidated Cash Flows:

	Year ended December 31,		
	2002	2003	2004
	(HK$ millions)		
Cash generated from operations	7,744	6,159	6,549
Taxation	(1,050)	(1,222)	(1,152)
Net cash generated from/(used in) investing activities	1,517	15,974	(4,033)
Net cash used in financing activities	(10,431)	(20,982)	(2,072)
Decrease in cash and cash equivalents	(2,220)	(71)	(708)
Cash and cash equivalents as at the beginning of the year	3,276	1,056	985
Cash and cash equivalents as at the end of the year	1,056	985	277

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis is based on and should be read in conjunction with the Audited Financial Statements and related notes included elsewhere in this Offering Circular. The Audited Financial Statements have been prepared in Hong Kong dollars in accordance with Hong Kong GAAP and Hong Kong laws and regulations applicable thereto.

Overview

The Guarantor is the leading provider of fixed-line telecommunications services in Hong Kong. The Guarantor has the most extensive digital network in Hong Kong, and its broadband network coverage currently passes more than 95% of Hong Kong homes and all major business areas in Hong Kong utilizing fiber-to-the-building and DSL technology. The Guarantor provides a wide range of services including:

- Local Telephony Services
- Local Data and Broadband Services
- International Telecommunications Services
- Other Services

The Guarantor is an indirect wholly owned subsidiary of PCCW and forms the most significant part of PCCW's telecommunications services business. PCCW's other telecommunications services business also includes customer premises equipment sales and services, managed international network solutions, and most call center services provided to third parties that are carried out by other subsidiaries of PCCW.

Impact of the Liberalization of Hong Kong's Telecommunication Markets

The Guarantor's business is strongly influenced by the regulatory regime applicable to telecommunications service providers in Hong Kong and a number of structural changes that resulted from the liberalization of Hong Kong's telecommunications market.

International Competition. International services-based competition was introduced from January 1, 1999, and facilities-based competition was introduced from January 1, 2000. The liberalization in 2000 enabled licensed carriers to install their own international facilities and enabled service providers to purchase wholesale switched minutes and leased circuit capacity from international carriers other than HKTI. Together with further reductions in international accounting rates and global liberalization trends, international facilities-based competition has had the effect of reducing further the retail and wholesale prices for international calls and bandwidth on most routes. Consequently, the turnover for both outgoing and incoming services has been adversely affected.

Domestic Competition. Competition in the domestic fixed line market has intensified since 2000. This is primarily due to five factors:

- relative price differentials between the Guarantor's products and services and those of its competitors as well as the market credibility of the Guarantor's competitors;
- local network buildouts by the Guarantor's competitors;
- the continuation by the regulator of a local loop unbundling policy;
- until January 2005, the regulation of the Guarantor as a dominant service provider with the result that the Guarantor was unable to flexibly price its services; and
- increasing substitution of mobile service for fixed line service.

This situation has caused the Guarantor's share of the domestic fixed line market and margins to decrease, adversely affecting turnover from these services.

On January 14, 2005, the Guarantor exchanged its FTNS license for an FC license. The primary change is its move from an "ex ante" tariff regime (where TA prior approval of all tariff revisions by the Guarantor was required) to an "ex post" tariff regime (where the Guarantor gives the TA notice one day before it effectuates a tariff revision, such as a discount, promotion or services bundle). See "Business — Regulation."

During the past years, the Guarantor has sought to reform various policies of the Hong Kong Government that the Guarantor believes have unfairly restricted its ability to compete, in particular the compulsory provision of unbundled local loops to competitors of the Guarantor and the regulation of the Guarantor as a dominant service provider. See "Business — Regulation."

Development of Reach

On October 13, 2000, the Guarantor and Reach Networks, a wholly owned subsidiary of Reach, entered into a Hong Kong Domestic Connectivity Agreement and an International Services Agreement for the provision of domestic and international connectivity services in Hong Kong and between Hong Kong and other countries. In 2003, along with a refinancing of Reach's syndicated term loan facility, the terms of the International Services Agreement were amended so as to require the Guarantor to acquire 90% per annum of its total annual purchases of "Committed Services" (defined as international public switched telephone network terminating access, international transmission capacity and Internet gateway capacity) from Reach Networks at rates benchmarked at least annually to prevailing market prices until repayment of the amended syndicated term loan facility of Reach on December 31, 2010 or earlier. Reach Networks similarly had to acquire 90% per annum of its local connectivity services from the Guarantor under the amended Hong Kong Domestic Connectivity Agreement, similarly extended for the same period. On April 16, 2005, PCCW agreed with Telstra and Reach on a new operating model in which Reach would operate as an outsourcer of telecommunications network services for the PCCW Group and the Telstra Group. As a part of the arrangements implementing the new operating model for Reach, the International Services Agreement was terminated. The Guarantor will continue to provide local connectivity services to Reach Networks. See "Related Party Transactions — Reach."

Acquisition of Retail Broadband and Narrowband Internet Access

During 2002, PCCW transferred IMS to the Guarantor. IMS provides retail broadband and narrowband Internet access services and related multimedia services in Hong Kong. This transfer has facilitated the Guarantor's improved marketing of retail broadband access services and a more efficient cost structure. The consolidated Audited Financial Statements include the results of IMS from April 1, 2002. See Note 28 to the Audited Financial Statements.

Formation and Development of Cascade

During 2002, Cascade, a wholly owned subsidiary of the Guarantor, was formed. Cascade commenced operations on January 1, 2003 and provides network operations with support and maintenance services. On March 19, 2004, the Guarantor transferred its 100% interest in Cascade to another subsidiary of PCCW for a consideration of HK$215 million. See "Related Party Transactions." The Guarantor contracts certain services from Cascade and such expenses are recognized as other costs.

Results of Operations

During the years ended December 31, 2002, 2003 and 2004, the Guarantor continued to redirect its business investments and operations in response to the increasing liberalization of Hong Kong's telecommunications market as well as rapidly changing technology. In anticipation of the significant changes in the operating environment, the Guarantor focused on rebalancing its business to reduce reliance on IDD services and focus on growth through investments in value-added services, data transmission and broadband access lines, and on implementing efficiency improvements to maintain its competitiveness.

Local telephony services accounted for approximately 41% of overall turnover in the year ended December 31, 2004, down from approximately 43% in the year ended December 31, 2003. International telecommunications services accounted for approximately 12% of overall turnover in the year ended December 31, 2004, down from approximately 15% in the year ended December 31, 2003. However, turnover from local data and broadband services increased to approximately 35% of overall turnover in the year ended December 31, 2004 from approximately 33% in the year ended December 31, 2003.

The following table sets out the results for each of the years ended December 31, 2002, 2003 and 2004:

	Year ended December 31,		
	2002[(1)]	2003[(2)]	2004[(2)]
	(HK$ millions)		
Turnover:			
Local telephony services	6,864	6,024	5,301
Local data and broadband services	4,582	4,636	4,463
International telecommunications services	2,777	2,161	1,608
Other services	903	1,297	1,551
Total turnover	15,126	14,118	12,923
Operating Costs:			
Cost of services provided	(1,939)	(1,560)	(1,914)
Other costs[(3)]	(7,096)	(6,652)	(6,209)
Operating costs	(9,035)	(8,212)	(8,123)
Restructuring cost	(411)	—	(13)
Impairment loss on fixed assets	—	(966)	—
Fixed assets written off	(40)	—	—
Other net income	—	114	326
Other revenue	137	23	55
Profit from operations	5,777	5,077	5,168
Finance costs	(1,308)	(981)	(791)
Profit before taxation	4,469	4,096	4,377
Taxation	(924)	(1,054)	(910)
Profit for the year	3,545	3,042	3,467
Dividends	6,233	2,467	17,663
Operating margin[(4)]	38%	36%	40%
Adjusted EBITDA[(5)]	8,606	8,087	6,819
Adjusted EBITDA margin[(6)]	57%	57%	53%

(1) During 2002, IMS became a wholly owned subsidiary of the Guarantor. Accordingly, the consolidated Audited Financial Statements include the results of IMS from April 1, 2002. See "— Overview — Acquisition of Retail Broadband and Narrowband Internet Access."

(2) During 2002, Cascade was formed to be a wholly owned subsidiary of the Guarantor and commenced operations on January 1, 2003. Subsequently, the Guarantor transferred its 100% interest in Cascade to another subsidiary of PCCW, and the consolidated Audited Financial Statements have not included the results of Cascade since March 20, 2004. See "— Overview — Formation and Development of Cascade" and "Related Party Transactions — PCCW Group and Pacific Century Group."

(3) Other costs include depreciation, salaries and related costs, subcontracting costs, management fees paid to HKT, rent, rates and utilities, amortization of goodwill and other operating costs.

(4) Operating margin equals profit from operations as a percentage of turnover.

(5) Adjusted EBITDA represents profit for the year before other income, other revenue, interest, taxes, depreciation, amortization and impairment loss, but excludes any exceptional profits or losses on the sale or termination of an operation, exceptional costs of reorganization or restructuring, exceptional profits or losses on the disposal of assets and other extraordinary items. Adjusted EBITDA is not a Hong Kong GAAP or U.S. GAAP measure. Adjusted EBITDA should not be construed as a substitute for operating profit, net income or cash flows from operating activities for purposes of analyzing the Guarantor's operating performance, financial position and cash flows. Adjusted EBITDA of the Guarantor as described in this Offering Circular is not necessarily comparable with similarly titled measures used by other companies.

(6) Adjusted EBITDA margin equals Adjusted EBITDA as a percentage of turnover.

Critical Accounting Policies under Hong Kong GAAP

The preparation of the Audited Financial Statements requires its management to select and apply significant accounting policies and to make estimates and judgments that affect the Guarantor's reported financial condition and results of operations. Notwithstanding the presentation of the Guarantor's principal accounting policies in Note 2 to the Audited Financial Statements presented elsewhere herein, the Guarantor believes the following are some of its most critical accounting policies in presenting the Audited Financial Statements in accordance with Hong Kong GAAP.

Revenue Recognition

Telecommunications services revenues based on usage are recognized when the services are rendered. Telecommunications revenues for services provided for fixed periods are recognized on a straight-line basis over the respective periods. The Guarantor is required to exercise considerable judgment in revenue recognition particularly in the areas of customer discounts, billing reserves for pricing changes, customer disputes and revenue reserve for special customer agreements. Significant changes in management estimates may result in material revenue adjustments.

Depreciation and Amortization

The Guarantor has significant property, plant and equipment and intangibles comprising goodwill acquired through the purchases of various subsidiaries. The Guarantor is required to estimate the useful lives of property, plant and equipment and intangibles in order to ascertain the amount of depreciation and amortization charges for each reporting period. A significant amount of these assets have estimated useful lives that extend beyond ten years.

The useful lives are estimated at the time these purchases are made after considering the future technology changes, business developments and the Guarantor's strategies. Should there be unexpected adverse changes in the circumstances or events, the Guarantor would be required to assess the need to shorten the useful lives and/or make impairment provisions. Indications of these unexpected adverse changes include declines in projected operating results, negative industry or economic trends and rapid advancement in technology.

Impairment of Assets

At each balance sheet date, the Guarantor reviews internal and external sources of information to identify indications that fixed assets, investments in subsidiaries and goodwill may be impaired or an impairment loss previously recognized no longer exists or may have decreased. If such an indication exists, the asset's recoverable amount is estimated. An impairment loss is recognized in the income statement whenever the carrying amount of an asset exceeds its recoverable amounts.

The sources utilized to identify indications of impairment are often subjective in nature and require the Guarantor to use judgment in applying such information to its businesses. The Guarantor's interpretation of this information has a direct impact on whether an impairment assessment is performed as at any given balance sheet date. Such information is particularly significant as it relates to the Guarantor's telecommunications business in Hong Kong.

If an indication of impairment is identified, such information is further subjected to an exercise that requires the Guarantor to estimate recoverable value, representing the greater of the net selling price of such asset or the Guarantor's value-in-use. Depending on the Guarantor's assessment of the overall materiality of the asset under review and complexity of deriving reasonable estimates of the recoverable value, the Guarantor may perform such assessment utilizing internal resources or it may engage external advisors to counsel it in making this assessment. Regardless of the resources utilized, the Guarantor is required to make many assumptions to make this assessment, including the utilization of such asset, the cash flows to be generated, appropriate market discount rates, and the projected market and regulatory conditions. Changes in any of these assumptions could result in a material change to future estimates of the recoverable value of any asset.

Provisions

The Guarantor recognizes provisions when it has a present obligation (legal or constructive) as a result of a past event and the Guarantor believes it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The recording of provisions requires the application of judgments about the ultimate resolution of these obligations. As a result, provisions are reviewed at each balance sheet date and adjusted to reflect the Guarantor's current best estimate.

Retirement Scheme Costs

In computing retirement scheme costs, the Guarantor must make numerous assumptions about such things as employee mortality and turnover, expected salary and wage increases, discount rates, expected return on scheme assets and expected future economic cost increases. Two of these items, discount rate and expected rate of return on scheme assets, generally have the most significant impact on the level of cost.

Changes in any of the assumptions made in computing the retirement scheme costs could have an impact on various components that comprise these expenses. Factors to be considered include the strength or weakness of the investment markets, changes in the composition of the employee base, fluctuations in interest rates and significant employee hirings and downsizings.

Deferred Taxation

While deferred tax liabilities are provided in full on all taxable temporary differences, deferred tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be applied. In assessing the amount of deferred tax assets that needs to be recognized, the Guarantor considers future taxable income that will be available against which the asset can be utilized. In the event that changes in current tax regulations are enacted that would impact the timing or extent of the Guarantor's ability to utilize the tax benefits of net operating loss carryforwards in the future, adjustments to the recorded amount of net deferred tax assets and taxation expense would be made.

Recent Hong Kong GAAP Accounting Pronouncements

The Hong Kong Institute of Certified Public Accountants has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards (new HKFRSs) which are effective for accounting periods beginning on January 1, 2005. The Guarantor did not adopt these new HKFRSs in its financial statements prior to January 1, 2005. The adoption of the new HKFRSs in the Guarantor's financial statements for the year ending December 31, 2005 may result in changes to the preparation and presentation of the Guarantor's results in the future. The new standards require retrospective application other than those specifically allowed under the transitional provisions in the relevant standards. Accordingly, the Guarantor's financial statements for the year ended December 31, 2004 may have to be restated as required, in accordance with the relevant requirements.

The Guarantor is in the process of making an assessment of the impact of these new HKFRSs and has so far concluded that the more significant differences between new HKFRSs and current accounting policies that are expected to affect the Guarantor are described below.

Hong Kong Accounting Standard 17 (HKAS 17) on leases

In prior years, leases of land granted by the Hong Kong Government that are held by the Guarantor for own use were accounted for as fixed assets and depreciated over the remaining terms of the underlying leases. Following the adoption of HKAS 17 for the financial year beginning on January 1, 2005, the lease premium for land will be presented separately from fixed assets and continues to be depreciated over the remaining term of the underlying leases. HKAS 17 will be applied retrospectively and comparative information will be restated.

Hong Kong Accounting Standards 32 and 39 (HKAS 32 & HKAS 39) on financial instruments

In prior years, the Guarantor's borrowings were stated in the balance sheet at cost less unamortized prepaid loan facility fees and derivative financial instruments were not stated in the financial statements. Interest income or expense arising from the derivative financial instruments were netted off against the related interest income or expense applicable to the on-balance sheet items which these derivative financial instruments were hedging.

Following the adoption of HKAS 32 and 39 for the financial year beginning on January 1, 2005, the Guarantor's borrowings will be stated either at fair value with changes to be recognized in the income statement or at amortized cost using the effective interest method. The derivative financial instruments will be recognized as either assets or liabilities in the balance sheet at fair value and the change in fair value is recognized as follows:

- for a derivative designated as a fair value hedge, in the income statement together with the associated loss or gain on the hedged item;
- for a derivative designated as a cash flow hedge, initially in equity reserve and subsequently released into the income statement in line with the income of the hedged assets/liabilities; and
- for other derivatives, in the income statement.

HKAS 32 and 39 will be applied prospectively and no restatement of comparative information will be made in accordance with the transitional provisions of HKAS 32 and 39.

Hong Kong Accounting Standard 40 (HKAS 40) on investment property

One of the Guarantor's properties is partially owner-occupied and partially held to earn operating lease rentals. In prior years, the part occupied by the owner was treated as a depreciable asset and the part held for investment purposes was identified separately in the financial statements and stated at open market value. In accordance with HKAS 40, the portion of the property that is held for investment purposes is classified as an investment property only if that portion could be sold separately (or leased out separately under a finance lease) or the portion held for own use is an insignificant part of the property as a whole. Following the adoption of HKAS 40 for the financial period beginning on January 1, 2005, the portion of the Guarantor's property that is held for earning operating lease rentals will no longer be classified as an investment property as the above conditions set out in HKAS 40 are not met. Accordingly, the entire property of the group will be treated as a depreciable asset. HKAS 40 will be applied retrospectively in the Guarantor's financial statements. As a result, the investment properties revaluation reserve existing at the date of first adoption of HKAS 40 will be eliminated and the investment property will be restated at its depreciated cost.

Hong Kong Financial Reporting Standard 2 (HKFRS 2) on share-based payment

In prior years, no employee benefit cost or obligation in relation to share options granted by the ultimate holding company to the group's employees was recognized in the group's income statement. Following the adoption of HKFRS 2 for the financial period beginning on January 1, 2005, the fair value of the employee services rendered in exchange for the grant of share options will be recognized as an expense in the income statement. The total amount to be expensed over the vesting period of the share options will be determined by reference to the fair value of the options granted at the date of grant. In accordance with the transitional provision of HKFRS 2, the Guarantor will apply the new accounting policy to share options that were granted after November 7, 2002 and had not yet vested at January 1, 2005. The effect of adopting the new accounting policy relating to prior periods will be adjusted to the opening balances of retained profits and the comparative information will be restated.

Hong Kong Financial Reporting Standard 3 (HKFRS 3) on business combinations

In prior years, positive goodwill was amortized in the consolidated income statement on a straight-line basis over its estimated useful life. Following the adoption of HKFRS 3 for the financial period beginning on January 1, 2005, in respect of previously recognized positive goodwill, amortization will be discontinued as of January 1, 2005 and the goodwill will be tested for impairment in accordance with Hong Kong Accounting Standard 36 — Impairment of Assets.

Results of Operations for the Years Ended December 31, 2004 and December 31, 2003

Turnover

Total turnover was HK$12,923 million during the year ended December 31, 2004, as compared to HK$14,118 million during the year ended December 31, 2003, representing a decrease of approximately 8%. The decrease in turnover resulted from an approximately 26% decrease in international telecommunications services turnover, an approximately 12% decrease in local telephony services and an approximately 4% decrease in local data and broadband services. This decrease was partially offset by an approximately 20% increase in other services.

Local Telephony Services. Turnover from local telephony services consists of turnover from local exchange line services, value-added services and interconnection and network access services for traffic carried for other local operators and service providers. Interconnection fees include fees for the delivery of traffic, and fees for the physical interconnection of facilities as determined by OFTA, or by commercial agreements between the Guarantor and other local carriers.

Turnover from local telephony services decreased to HK$5,301 million during the year ended December 31, 2004 from HK$6,024 million during the year ended December 31, 2003, representing a decrease of approximately 12%. The decrease was primarily due to a decline in the number of direct exchange lines operated by the Guarantor and a lower interconnection fee turnover due to a rate reduction as determined by OFTA, which became effective in October 2003.

There are a number of challenging factors that have caused the Guarantor's market share to decline. These factors include increasing liberalization of the fixed line market since 1995, and further full liberalization since the beginning of 2003; competition from other fixed line operators; substitution by broadband access lines and wireless telecommunications services; and, until recently, the softening of the Hong Kong economy.

According to industry statistics provided by OFTA and the Guarantor's estimates, the total number of direct exchange lines in the fixed line market contracted by approximately 1.1% in 2004 as compared to 0.6% in 2003. At the end of 2004, the Guarantor operated approximately 2,567,000 direct exchange lines with an overall market share of approximately 68%, representing approximately 67% in the residential sector and approximately 69% in the business sector. As at December 31, 2003, the Guarantor had approximately 2,779,000 direct exchange lines with approximately 73% total market share, representing approximately 73% in each of the residential sector and the business sector. The total number of the Guarantor's residential exchange lines decreased to approximately 1,423,000 as at December 31, 2004 from approximately 1,543,000 as at December 31, 2003, and the total number of the Guarantor's business exchange lines in service decreased to approximately 1,144,000 as at December 31, 2004 from approximately 1,236,000 as at December 31, 2003.

Local Data and Broadband Services. Turnover from local data and broadband services consists of turnover from the provision of data and network services, wholesale broadband access lines, retail broadband and narrowband Internet access services utilizing the Guarantor's fiber optic network and DSL technology.

Turnover from local data and broadband services decreased to HK$4,463 million during the year ended December 31, 2004 from HK$4,636 million during the year ended December 31, 2003, representing a decrease of approximately 4%. This decrease was primarily due to severe pricing pressure in the provision of local area and wide area (LAN and WAN) corporate networks, and high-speed, high-volume data transmissions from mobile telephone operators and Internet service providers. This decrease was partially offset by an increase in turnover from broadband Internet access services as total broadband access lines grew by 13% to 796,000 as at December 31, 2004 from 703,000 as at December 31, 2003.

International Telecommunications Services. Turnover from international telecommunications services consists of turnover from retail outgoing IDD, retail IPLC, retail international data services and delivery fee revenue for the origination and termination of international calls on the Guarantor's network.

International telecommunications services turnover was HK$1,608 million during the year ended December 31, 2004, as compared to HK$2,161 million during the year ended December 31, 2003, representing a decrease of approximately 26%. The international telecommunications markets for both voice and data services continued to be intensely competitive in 2004. In 2004, the decreased retail prices of retail outgoing IDD minutes more than offset increased traffic volumes. Retail outgoing IDD minutes increased 13% to 1,383 million minutes in 2004 from 1,226 million minutes in 2003. Unit prices of retail outgoing IDD and other international data products in 2004 were lower than those in 2003, which was in line with the general global market trend. Delivery fee revenue also dropped primarily due to a rate reduction as determined by OFTA effective June 2004.

Other Services. Turnover from other services consists primarily of turnover from call center and technical, maintenance and other subcontracting services provided by the Guarantor to other subsidiaries of PCCW or third parties.

Turnover from other services was HK$1,551 million during the year ended December 31, 2004, as compared to HK$1,297 million during the year ended December 31, 2003, representing an increase of approximately 20%. This increase was primarily the result of increased technical, maintenance and other subcontracting services provided by the Guarantor to other subsidiaries of PCCW, including services provided in connection with the *now* Broadband TV service, which was launched in September 2003.

Operating Costs

Operating costs decreased slightly during the year ended December 31, 2004 to HK$8,123 million, as compared to HK$8,212 million during the year ended December 31, 2003, representing a decrease of approximately 1%. The decrease was primarily attributable to a decrease in salaries and related costs and other operating costs which was partially offset by an increase in cost of services provided and subcontracting costs.

Cost of Services Provided. Cost of services provided consists of voice and data disbursements, primarily to Reach and its affiliates, costs incurred in connection with the provision of subcontracting services and certain costs related to customer acquisitions and retentions. Cost of services provided was HK$1,914 million during the year ended December 31, 2004, as compared to HK$1,560 million during the year ended December 31, 2003, representing an increase of approximately 23%. This increase resulted primarily from an increase in the marketing and customer acquisition costs of new products and services, such as the *now* Broadband TV and New Generation Fixed Line Services (NGFLS).

Other Costs. Other costs consist primarily of depreciation and amortization, subcontracting costs, salaries and related costs, management fees paid to HKT, rent, rates and utility expenses and certain other operating expenses, including repair and maintenance of the network and publicity and promotion. Other costs were HK$6,209 million during the year ended December 31, 2004, compared to HK$6,652 million during the year ended December 31, 2003, representing a decrease of approximately 7%. The decrease resulted primarily from a decrease of approximately 33% in salaries and related costs, to HK$994 million in 2004 from HK$1,488 million in 2003 and a decrease of 37% in other operating costs, to HK$893 million in 2004 from HK$1,421 million in 2003. This decrease was partially offset by an increase in subcontracting costs to HK$1,242 million in 2004 from HK$374 million in 2003. Subcontracting costs increased as a result of fees paid to Cascade for services provided to the Guarantor after it was transferred to another subsidiary of PCCW in March 2004.

Operating Margin

Operating margin increased to approximately 40% during the year ended December 31, 2004, from approximately 36% during the year ended December 31, 2003.

Taxation

Effective April 1, 2003, the statutory profits tax rate applicable to companies in Hong Kong was increased from 16% to 17.5%. The overall effective tax rate of the Guarantor for 2004 was approximately 21%, resulting in a tax charge of HK$910 million. The overall effective tax rate of the Guarantor for 2003 was 26%, resulting in a tax charge of HK$1,054 million. The overall effective tax rate of the Guarantor was higher in 2003 mainly due to an adjustment to opening deferred tax balances to reflect the increase in the statutory profits tax rate in 2003.

The Guarantor has been in dispute with the IRD regarding the deductibility of interest payments and related financing expenses totaling HK$1,708 million in the previous years' tax computations. Subsequent to December 31, 2004, the Guarantor received additional assessments totaling HK$240 million as a result of disallowance by the IRD of the deductions in dispute. The directors of the Guarantor consider that their grounds for claiming the deductions are reasonable, and the Guarantor has lodged a formal objection to the IRD against the additional assessments and accordingly no provision for taxation has been made in the Guarantor's financial statements. See "Risk Factors — The Guarantor has been assessed taxes from previous years as a result of a dispute with the Inland Revenue Department."

Profit for the Year

Profit for the year was HK$3,467 million during the year ended December 31, 2004, as compared to HK$3,042 million during the year ended December 31, 2003, representing an increase of approximately 14%. The increase in profit was due to the factors discussed above and also reflected an impairment loss of HK$966 million recognized in 2003 for certain fixed assets that became obsolete or impaired due to technology and market changes in the sectors in which the Guarantor operates. No impairment loss was recognized in 2004.

Adjusted EBITDA

Adjusted EBITDA was HK$6,819 million during the year ended December 31, 2004 as compared to HK$8,087 million during the year ended December 31, 2003, representing a decrease of approximately 16%. The Adjusted EBITDA margin decreased to approximately 53% in 2004 from approximately 57% in 2003.

Results of Operations for the Years Ended December 31, 2003 and December 31, 2002

Turnover

Total turnover was HK$14,118 million during the year ended December 31, 2003, as compared to HK$15,126 million during the year ended December 31, 2002, representing a decrease of approximately 7%. The decrease in turnover resulted primarily from an approximately 22% decrease in international telecommunications services turnover and an approximately 12% decrease in local telephony services. This decrease was partially offset by an approximately 44% increase in other services and an approximately 1% increase in local data and broadband services.

Local Telephony Services. Turnover from local telephony services decreased to HK$6,024 million during the year ended December 31, 2003 from HK$6,864 million during the year ended December 31, 2002, representing a decrease of approximately 12%. This primarily reflected a reduction in the overall number of direct exchange lines operated by the Guarantor and lower interconnection fee turnover due to a rate reduction by OFTA in October 2003, partially offset by an increase in turnover from wholesaling local access lines to other fixed-line operators.

The decline in the number of direct exchange lines in service operated by the Guarantor during 2003 was due to a combination of factors including increasing competition from other fixed line operators, softening of the Hong Kong economy and users substituting exchange lines with broadband access lines and wireless telecommunications services.

According to industry statistics provided by OFTA, the overall fixed-line telecommunications market contracted by approximately 1% in 2003 and approximately 2% in 2002. Based on the Guarantor's estimates and OFTA's statistics, the Guarantor had approximately 73% of total market share as at December 31, 2003, representing approximately 73% in the residential sector and approximately 73% in the business sector. As at December 31, 2002, the Guarantor had approximately 82% total market share, representing approximately 84% in the residential sector and approximately 79% in the business sector. The total number of the Guarantor's exchange lines decreased by 11% to approximately 2,779,000 as at December 31, 2003 from approximately 3,138,000 as at December 31, 2002. The total number of the Guarantor's residential exchange lines decreased to approximately 1,543,000 as at December 31, 2003 from approximately 1,802,000 as at December 31, 2002 and the total number of the Guarantor's business exchange lines in service decreased to approximately 1,236,000 as at December 31, 2003 from approximately 1,336,000 as at December 31, 2002.

Local Data and Broadband Services. Turnover from local data and broadband services increased slightly to HK$4,636 million during the year ended December 31, 2003, from HK$4,582 million during the year ended December 31, 2002, representing an increase of approximately 1%. This was mainly the result of a significant increase in turnover from broadband Internet access services resulting from the transfer of IMS's retail consumer broadband and narrowband Internet access services and related multimedia services from PCCW to the Guarantor effective April 2002 as well as an increase in broadband access lines. This increase was partially offset by a decline in turnover from the provision of LAN and WAN corporate networks, high-speed, volume data transmissions from mobile phone operators and Internet service providers as a result of pricing pressure.

International Telecommunications Services. International telecommunications services turnover was HK$2,161 million during the year ended December 31, 2003, as compared to HK$2,777 million during the year ended December 31, 2002, representing a decrease of approximately 22%. The international telecommunications markets for both voice and data services continued to be intensely competitive in 2003, with decreased retail prices more than offsetting increased traffic volumes. The Guarantor's retail outgoing IDD minutes increased by approximately 18% in 2003 to 1,226 million minutes compared to 1,041 million minutes in 2002. Sales of IPLC bandwidth decreased significantly in 2003 compared to 2002. Unit prices of retail outgoing IDD, IPLC and other international data products in 2003 were lower than those in 2002, which was in line with the general global market trend. There was also a decrease in the Guarantor's delivery fee turnover as more international traffic was carried by mobile operators than over the Guarantor's network.

Other Services. Turnover from other services was HK$1,297 million during the year ended December 31, 2003, as compared to HK$903 million during the year ended December 31, 2002, representing an increase of approximately 44%. This increase was primarily the result of increased technical, maintenance and other subcontracting services provided by the Guarantor to other subsidiaries of PCCW, including services provided in connection with the *now* Broadband TV service, which was launched in September 2003.

Operating Costs

Operating costs were HK$8,212 million during the year ended December 31, 2003, as compared to HK$9,035 million during the year ended December 31, 2002, representing a decrease of approximately 9%. The decrease was attributable to an approximately 20% decrease in cost of services provided and an approximately 6% decrease in other costs.

Cost of Services Provided. Cost of services provided was HK$1,560 million during the year ended December 31, 2003, as compared to HK$1,939 million during the year ended December 31, 2002, representing a decrease of approximately 20%, primarily due to a decline in wholesale international voice and data disbursements. This decrease was partly offset by an increase in costs incurred in connection with the provision of subcontracting services and certain other costs relating to customer acquisition and retention.

Other Costs. Other costs were HK$6,652 million during the year ended December 31, 2003, as compared to HK$7,096 million during the year ended December 31, 2002, representing a decrease of approximately 6%. The decrease resulted primarily from a decrease of approximately 19% in salaries and related costs, to HK$1,488 million in 2003 from HK$1,829 million in 2002 and a decrease of 14% in depreciation to HK$2,129 million in 2003 from HK$2,476 million in 2002, partially offset by an increase in subcontracting costs to HK$374 million in 2003 from HK$56 million in 2002.

Operating Margin

Operating margin was approximately 36% during the year ended December 31, 2003 and 38% during the year ended December 31, 2002.

Taxation

Effective April 1, 2003, the statutory profits tax rate applicable to companies in Hong Kong was increased from 16% to 17.5%. The overall effective tax rate of the Guarantor during the year ended December 31, 2003 was 26%, resulting in a tax charge of HK$1,054 million. The overall effective tax rate of the Guarantor during the year ended December 31, 2002 was 21%, resulting in a tax charge of HK$924 million. The Guarantor's effective tax rate and tax charge increased in 2003 as compared with 2002 as a result of this increase in the statutory profits tax rate and an adjustment to opening deferred tax balances to reflect the increase in the statutory profits tax rate in 2003.

Profit for the Year

Profit for the year was HK$3,042 million during the year ended December 31, 2003, as compared to HK$3,545 million during the year ended December 31, 2002, representing a decrease of approximately 14%. The decrease in profit was due to the factors discussed above and an impairment loss of HK$966 million recognized in 2003 for certain fixed assets that became obsolete or impaired due to technology and market changes in the sectors in which the Guarantor operates.

Adjusted EBITDA

Adjusted EBITDA was HK$8,087 million during the year ended December 31, 2003, as compared to HK$8,606 million during the year ended December 31, 2002, representing a decrease of approximately 6%. The Adjusted EBITDA margin was 57% during each of the years ended December 31, 2003 and 2002.

Liquidity and Capital Resources

The Guarantor's principal source of funds has been cash flows from operations and borrowings. The Guarantor's principal uses of funds during the years ended December 31, 2002, 2003 and 2004 included capital expenditures related to the construction, maintenance and upgrading of its network, the payment of dividends to its parent companies and repayment of borrowings. See "— Capital Expenditures" for more detail on the Guarantor's capital expenditures.

Net cash flow from operating activities (cash generated from operations less taxes) for 2004 increased to HK$5,397 million from HK$4,937 million in 2003 despite a lower operating profit before changes in working capital in 2004 as compared with 2003. This increase reflected primarily a decrease in trade and other receivables (which includes amounts due from the Guarantor's parent companies and other PCCW subsidiaries) of HK$217 million in 2004, as compared with an increase in trade and other receivables of HK$851 million in 2003. This increase also reflected a decrease in trade and other payables of HK$458 million in 2004, as compared with a decrease in trade and other payables of HK$993 million in 2003. HKT manages certain treasury functions for the Guarantor. The decrease in trade and other receivables in 2004 reflected primarily the payment by HKT on behalf of the Guarantor of certain payroll and other expenses which were reflected as a reduction in receivables due from HKT. The decrease in trade and other payables resulted primarily from payments by the Guarantor to third parties for supplies and other items.

Net cash flow from operating activities for 2003 decreased to HK$4,937 million from HK$6,694 million in 2002. This decrease reflected primarily an increase in trade and other receivables of HK$851 million in 2003, compared with an increase in trade and other receivables of HK$306 million in 2002. This decrease also reflected a decrease in trade and other payables of HK$993 million in 2003, compared with a decrease in trade and other payables of HK$225 million in 2002. Trade and other receivables increased in 2003 due to lower payments made by HKT on behalf of the Guarantor, which resulted in increased receivables due from HKT. The decrease in trade and other payables in 2003 resulted primarily from payment by the Guarantor to third parties for supplies and other items.

The Guarantor entered into a term loan facility on January 19, 2001 and drew down approximately US$4,700 million on February 6, 2001. The proceeds of the drawdown were advanced to the Guarantor's parent companies for the purpose of allowing them to repay short-term borrowings incurred in connection with PCCW's acquisition of HKT in August 2000. Except for the interest bearing portion of US$342 million, which was fully repaid in 2002, the advances were unsecured, non-interest bearing and had no fixed term of repayment. On July 14, 2003, the Guarantor fully prepaid the remaining outstanding principal amount of this term loan facility.

Net cash used in investing activities for 2004 was HK$4,033 million compared to net cash generated from investing activities of HK$15,974 million in 2003. The change reflected a loan of HK$2,800 million by the Guarantor to its ultimate holding company in 2004 for working capital purposes, compared with a partial repayment by the Guarantor's parent companies in 2003 of HK$17,281 million.

Net cash generated from investing activities for 2003 increased to HK$15,974 million from HK$1,517 million in 2002, which primarily reflected the repayment by the Guarantor's parent companies in 2003 of the advances described above.

Net cash used in financing activities for 2004 was HK$2,072 million compared to HK$20,982 million for 2003. There were no net bank loan repayments in 2004. In contrast, in 2003, the Guarantor made substantial repayments of loans, including repayment of the term loan facility described above and loans from the Guarantor's ultimate holding company. These repayments were partly offset by proceeds from the issuance of the US$500 million 6% Guaranteed Notes due 2013 by one of the Guarantor's finance subsidiaries.

Net cash used in financing activities for 2003 increased to HK$20,982 million from HK$10,431 million for 2002, as the net bank loan repayment increased in 2003 compared with 2002. The dividends paid by the Guarantor to its parent companies were also higher in 2002 than in 2003.

As at December 31, 2004, the Guarantor had cash balances of HK$277 million and committed working capital facilities totaling HK$10,800 million. None of the committed working capital facilities were utilized as of December 31, 2004. In June 2005, a drawdown of HK$500 million was made by the Guarantor under its working capital facilities.

The Guarantor's dividend policy is based on a regular assessment of its financing needs, capital expenditure requirements and working capital requirements, as well as those of the PCCW Group.

For a description of certain other borrowings of the Guarantor, see "Description of Other Indebtedness."

PCCW's treasury department manages the Guarantor's overall treasury and funding policy. While cash is held in the Guarantor's accounts, PCCW's treasury department is responsible for the cash management for the Guarantor. Working capital arrangements with approved banks are monitored at the PCCW level. Long-term and short-term borrowing requirements are monitored and loan agreements are negotiated and finalized at the PCCW level.

Contingent Liabilities

The Guarantor had guaranteed obligations of other PCCW Group companies (excluding subsidiaries of the Guarantor) in the aggregate principal amount of HK$9,313 million as at December 31, 2004. See "Related Party Transactions" and Note 31 of the Audited Financial Statements. The Guarantor also had contingent liabilities in connection with performance guarantees issued by banks on behalf of third parties in the amount of HK$10 million as at December 31, 2004.

As at December 31, 2004, the Guarantor had given an unconditional and irrevocable guarantee to Hongkong International Theme Parks Limited (HKTPL) of all the obligations and liabilities of PCCW-HKT Business Services Limited, a subsidiary of PCCW, for the provision and implementation of certain telecommunication and other systems to HKTPL.

As at December 31, 2004, the Guarantor had also given IBM China/Hong Kong Limited unconditional and irrevocable guarantees of up to HK$379 million of the due and punctual payment by Unihub Limited and HKT, subsidiaries of PCCW, in connection with the liabilities arising from their purchases of IBM's services and products. The Guarantor provided another unconditional and irrevocable guarantee to IBM for the due and punctual performance by PCCW Powerbase Data Center Services (HK) Limited (Powerbase), a subsidiary of PCCW, for the provision of data center facilities services to IBM.

Contractual Obligations and Commercial Commitments

The following table summarizes contractual obligations as at December 31, 2004.

	Payments due by period				
Contractual obligations	**Total**	**Less than 1 year**	**1-3 years**	**4-5 years**	**After 5 years**
			(HK$ million)		
Swap contracts	26,889	—	15,224	—	11,665
Long-term bonds	5,813	—	—	—	5,813
Convertible bonds	3,500	—	3,500	—	—
Operating leases	5	4	1	—	—
Capital commitments	34	34	—	—	—
Total contractual cash obligations	36,241	38	18,725	—	17,478

On October 13, 2000, the Guarantor entered into agreements with Reach Networks relating to the supply of domestic connectivity services in Hong Kong by the Guarantor to Reach Networks and international connectivity services between Hong Kong and other countries by Reach Networks to the Guarantor. The agreement relating to the supply of international connectivity services was terminated on April 16, 2005. For further detail, see "Related Party Transactions — Reach."

Capital Expenditures

The following table summarizes the Guarantor's capital expenditure for the three years ended December 31, 2002, 2003 and 2004:

	Year ended December 31,		
	2002	**2003**	**2004**
		(HK$ millions)	
Exchange equipment	405	129	399
Transmission plant	78	236	333
Other plant and equipment	158	322	430
Projects under construction	585	951	298
Total	1,226	1,638	1,460

The Guarantor has substantially completed the expansion of its digital network and broadband core infrastructure. It has also established several new telephone exchange buildings in newly developed towns. In addition, the Guarantor has modernized its fully digital voice and data networks to support Internet Protocol (IP) and non-IP based services in preparation for the development and roll-out of sophisticated value-added services and products. Significant investments have also been made to build additional interconnection capacity to meet the rapidly growing demand for mobile service interconnection. The Guarantor's major capital expenditure for investments in the coming years will mainly be spent on upgrading and expanding its network coverage, meeting demand for the installation of local broadband access lines, ongoing maintenance of its network integrity, and building a platform for broadband and fast developing IP initiatives.

As at December 31, 2004, the Guarantor had capital expenditures contracted for of HK$34 million and capital expenditures authorized, but not contracted for, of HK$395 million.

The Guarantor expects to finance its capital expenditures from cash on hand, cash generated internally and, to the extent permitted under the terms of existing indebtedness, external borrowings.

Inflation/Deflation

Hong Kong experienced an economic downturn and asset deflation over the last several years until mid-2004. The Guarantor does not believe that the general deflationary environment in Hong Kong had or, if it returns, would have any material impact on its business. The annual deflation rate in Hong Kong was approximately 1.5% and 1.9% for the years ended December 2002 and 2003, respectively, and the annual inflation rate was 0.2% in 2004.

Market Risk

Market risk comprises both foreign currency exposure and interest rate exposure deriving from the Guarantor's operations and funding activities. As a matter of policy, market risks that are directly related to the Guarantor's operations and financing are continuously managed by PCCW. PCCW does not undertake any speculative trading activities that involve currency forwards, interest rate and currency swaps, forward rate agreements, options and other financial instruments. The Finance and Management Committee, a subcommittee of the Executive Committee of PCCW's board of directors, determines the appropriate risk management activities with the aim of prudently managing the market risk associated with transactions entered into in the normal course of its business. All treasury risk management activities are carried out in accordance with policies and guidelines approved by the Finance and Management Committee and the Executive Committee, which are reviewed on a regular basis.

In the normal course of business, PCCW uses interest rate swaps, cross currency swaps, forward contracts, forward rate agreements and other derivative contracts to limit the Guarantor's exposure to adverse fluctuations in interest rates and foreign currency exchange rates. These instruments are executed with creditworthy financial institutions, and all foreign currency contracts are denominated in currencies of major industrial countries.

BUSINESS

Overview

The Guarantor is the leading provider of fixed-line telecommunications services in Hong Kong. The Guarantor has the most extensive digital network in Hong Kong, and its broadband network coverage currently passes more than 95% of Hong Kong homes and all major business areas in Hong Kong utilizing fiber-to-the-building and DSL technology.

The Guarantor is focused on growth through investments in data transmission services, broadband access lines services and value-added services. It has also implemented efficiency improvements and improved marketing efforts to reduce costs and enhance customer service, considered a key feature that sets it apart from its competitors. It provides a wide range of services, including:

- *Local Telephony Services* — The Guarantor is the leading provider of fixed-line services in Hong Kong, with the most extensive digital network in Hong Kong and a broadband capability that covers almost all of Hong Kong's residential and commercial buildings.

- *Local Data and Broadband Services* — Within Hong Kong, the Guarantor provides a backbone for corporate data networks and provides high speed data services to other service operators, offering broadband-based IP-VPN, frame relay and ATM services that allow high volume transmissions of integrated data, voice and video traffic for corporate networks. The Guarantor also provides retail broadband and narrowband Internet access services.

- *International Telecommunications Services* — The Guarantor provides retail outgoing IDD, retail IPLCs and retail international data services and receives delivery fees for origination and termination of international calls on the Guarantor's network.

- *Other Services* — Consists primarily of call center and technical, maintenance and other subcontracting services provided by the Guarantor to other subsidiaries of PCCW or third parties.

The Guarantor is an indirect wholly owned subsidiary of PCCW and forms the most significant part of PCCW's telecommunications services business.

History and Development

The Guarantor was incorporated as a private limited company in Hong Kong in 1925 to acquire part of the business of China and Japan Telephone and Electric Company Limited, which had operated Hong Kong's first public telephone services since 1882. In the same year, the Guarantor was awarded the sole right to provide Hong Kong's local telephone services for 50 years. This right was subsequently extended to 1995.

Local Market Deregulation

Following the expiration of the Guarantor's monopoly on fixed-line telephone services in Hong Kong in 1995, the TA issued non-exclusive licenses to the Guarantor and three other companies to provide FTNS on a competitive basis. The FTNS licenses are valid until 2010 and are renewable for an additional period of up to 15 years at the discretion of the TA. In 2000, the TA awarded additional licenses for the provision of FTNS over hybrid coaxial cable networks or local fixed networks based on wireless technologies. Ten years after the first award of competitive FTNS licenses, the Guarantor maintains a leading competitive position in the local exchange line and local data services markets, including a market share of approximately 68% of exchange lines in service in Hong Kong as at December 31, 2004 based on the Guarantor's estimates and OFTA's statistics. Additionally, the Guarantor has established a strong wholesale business, providing a broad range of infrastructure and operating services, including wholesale broadband, data link and interconnection services, to other fixed, mobile, Internet and value-added service operators in Hong Kong. In January 2005, the

Guarantor exchanged its FTNS license for a new FC license. The primary change is the Guarantor's move from an "ex ante" tariff regime (where TA prior approval of all of the Guarantor's tariff revisions was required) to an "ex post" tariff regime (where the Guarantor gives the TA notice one day before it effectuates a tariff revision such as a discount, promotion or services bundle). The FC license does not contain any language that suggests the Guarantor is dominant in any market. Nevertheless, the Guarantor's new license does not grant it non-dominance status.

International Market Deregulation

In 1998, various members of the HKT Group, including the Guarantor and HKTI (now known as Reach Networks), entered into a Framework Agreement with the Hong Kong Government providing for the early termination of HKTI's exclusive international license as at March 31, 1998, the introduction of competition in the provision of international services commencing on January 1, 1999 and the introduction of competition in the ownership and operation of international facilities commencing on January 1, 2000. In return, the HKT Group received a package of compensatory measures, including the right for the Guarantor to increase its local exchange line tariffs in agreed phases. Price caps on the Guarantor's local business exchange line tariffs were removed on July 1, 1998 and price caps ceased to apply to the Guarantor's local residential exchange line tariffs from January 1, 2002.

Consequently, the Hong Kong telecommunications market has evolved from an environment in which fixed telecommunications networks and services were provided under an exclusive franchise by the Guarantor to a fully liberalized market, with multiple carriers operating local and international fixed and wireless telecommunications facilities and numerous competing service providers operating on a resale basis. Hong Kong is now a very competitive telecommunications market. See "— Regulation" and "— Competition."

The Guarantor faces retail market competition from a large number of service providers holding non-exclusive licenses for international voice, IDD, fax, data and value-added network services, international calling cards and virtual private network services. In particular, competition in the Hong Kong market for retail IDD calls has been intense with the issuance of ETS licences, resulting in a significant decline in average prices, stimulating growth in volumes for the overall market but an erosion in retail market share for the Guarantor.

Over the past several years, in the face of progressive deregulation and a highly competitive environment, the Guarantor has transitioned its business focus from a reliance on local telephone services and retail IDD services as the primary financial driver of its business to a more balanced portfolio of local and international voice, data, value-added and wholesale connectivity services. With its significant investments in an extensive broadband communications network, the Guarantor has benefited from the strong growth in demand for high speed data and Internet services to date.

PCCW's Acquisition of HKT and the Telstra Alliance

In August 2000, PCCW acquired HKT (then known as Cable & Wireless HKT Limited), which was a majority-owned subsidiary of Cable and Wireless plc. At the time of HKT's acquisition, HKT's communications-based businesses consisted of local and international voice and data communications services, mobile services and Internet and e-commerce services. As a result of the acquisition, the Guarantor became an indirect wholly owned subsidiary of PCCW.

In February 2001, PCCW formed a strategic alliance with Telstra which provided for, among other things, the formation of Reach. Reach is an equally-owned joint venture incorporating the international IP backbone business of each party. As a result, the Guarantor assumed responsibility for certain retail international data services and HKTI assumed responsibility for certain wholesale IDD services. Until recently, Reach Networks and the Guarantor operated under connectivity agreements in respect of Reach Networks' provision of international connectivity services between Hong Kong and other countries and the Guarantor's provision of domestic connectivity services in Hong Kong. On April 16, 2005, PCCW agreed with Telstra and Reach on a new operating model in which Reach would operate as an outsourcer of telecommunications network services for the PCCW Group and the Telstra Group. As a part of the arrangements implementing the new operating model for Reach, the international connectivity services agreement between the Guarantor and Reach Networks was terminated. The Guarantor will continue to provide local connectivity services to Reach Networks.

Competitive Strengths

The Guarantor believes that the following are its principal competitive strengths:

The Guarantor's network provides unmatched coverage and advanced technology to customers in Hong Kong

One of the Guarantor's key competitive advantages is its advanced telecommunications network. The Guarantor's network is the most extensive digital network in Hong Kong, with approximately 2.57 million exchange lines as at December 31, 2004 and a broadband network passing more than 95% of Hong Kong's homes and all major business areas in Hong Kong utilizing fiber-to-the-building and DSL technology. Moreover, the Guarantor's telecommunications infrastructure includes the vast majority of "last mile" access in Hong Kong, connecting residential and commercial building access lines to the core telephone network. This provides the Guarantor with significant economies of scale in network operations, as well as management and sales functions, relative to its competitors.

The Guarantor has an experienced management team with significant operational expertise

The Guarantor has long been the leading provider of fixed-line telecommunications services in Hong Kong. It has a management team with extensive and diverse experience in both the development and delivery of telecommunications services, as well as in transaction management and execution.

Despite operating in one of Asia's most deregulated telecommunications markets, the Guarantor has successfully expanded its offering of products and services while simultaneously improving the productivity of its network operations. The Guarantor believes that the synergies created by its management experience, technical expertise and advanced technology should enable it to move more quickly than its competitors to identify, adopt, acquire, develop and exploit emerging technologies. The Guarantor also believes that its management and operational expertise will make it a preferred partner for other telecommunications companies in Asia and elsewhere.

The Guarantor has a reputation for quality and strong customer relationships

The Guarantor believes that its products and services have a reputation for quality and reliability and enjoy a high level of brand recognition among its customers. The Guarantor's extensive and advanced networks, including its broadband network, allow it to provide a comprehensive set of high-quality services, encompassing voice, high-speed data, video services and interactive multimedia services to both residential and business customers. The Guarantor's investments in advanced network services and products have supported Hong Kong's development as one of the leading telecommunications centers in Asia. Quality and reliability are especially important to multinational corporations, banks and other corporate customers needing the Guarantor's services to support their critical operations.

Business Strategy

The Guarantor's strategy revolves around the following key initiatives:

Utilization of the Guarantor's broadband network platform

The Guarantor intends to exploit the extensive coverage of its fiber optic network to expand its implementation of advanced network services. Likewise, the Guarantor plans to leverage its network to generate higher network usage by providing a broadband platform for the further development and implementation of new growth businesses such as high-speed data and video services, interactive television and other multimedia applications and content services, high-speed Internet access services, IP integrated platforms (multiple services on the same customer line) and other newly developed and integrated services.

Implementation of advanced customer relationship management program

The Guarantor is in the process of enhancing its advanced CRM system to better monitor its customers' purchasing patterns, improve the quality of its services and address customer needs on a more individualized basis. The Guarantor believes that understanding customer needs and preferences will allow it to strengthen its relationships with existing customers and attract new ones. In conjunction with enhancing the CRM system, PCCW has established a global account sales force to cross-sell the Guarantor's products and services to its multinational company customer base by providing a single point of contact for sales and marketing purposes. This platform will allow for active cross-selling of the Guarantor's services to other customers of the PCCW Group of companies and will facilitate the provision of integrated services to these customers.

Broadening of products and services range and provision of integrated telecommunications solutions

The Guarantor plans to continue to innovate and broaden its product offering by focusing on data related products and value-added services with the goal of slowing customer churn and maintaining premium revenue per customer. The Guarantor intends to utilize its consultancy services and expanded product and service offerings to provide customized integrated packages of telecommunications and value-added services, such as managed network services and other operational services, tailored to particular customer needs. A key focus of this strategy will be the exploitation of the next generation of network products and services to bring the Internet to office and home devices and to enable the convergence of multiple platforms, such as unified messaging, video streaming and multi-channel digital broadcasting. The Guarantor expects the acquisition of a majority stake in SUNDAY by PCCW will allow the Guarantor to expand its product and service offerings into the mobile market and cross-sell such products and services so as to improve its ability to serve customer needs.

Focus on wholesale opportunities

The Guarantor plans to take advantage of network scale opportunities by providing wholesale services to resellers and other telecommunications and Internet service providers in order to generate increased network utilization. It will also look to target products and services for Internet service providers and pay television service providers, including higher speed Internet access services, digital video broadcasting and media streaming services.

Regional Expansion

The Guarantor's membership in the PCCW Group of companies provides the Guarantor with additional regional business and expansion opportunities. The Guarantor plans to use the experience and expertise that it has built-up through its many years of business in Hong Kong by offering network, operational and management expertise, as well as consultancy services, to clients and partners outside of Hong Kong, including in the Greater China region. In addition, the Guarantor may be able to take advantage of opportunities in the PRC created as a result of China Network Communications Group Corporation's (CNC) investment in PCCW.

Continuing focus on cost control and efficiency measures

The Guarantor has continued to focus on reducing costs and optimizing efficiency. During 2002, the Guarantor subcontracted a significant portion of its network maintenance function to 17 newly-established companies owned by staff previously employed by the Guarantor. Approximately 1,600 former employees joined these subcontracting companies in November 2002. In addition, approximately 3,000 of the Guarantor's employees joined a new wholly owned subsidiary, Cascade, on January 1, 2003. As part of the formation of Cascade, employees accepted new service contracts that generally reduced salaries slightly as well as realigned benefit packages. Finally, the Guarantor also reset staff levels in order to increase efficiency during 2002. In 2004, the Guarantor transferred its 100% interest in Cascade to another subsidiary of PCCW.

Local Network Infrastructure

Hong Kong has one of the most sophisticated and competitive telecommunications markets in the world in terms of overall scope, service penetration and customer choice. Because of the city's high population density and compactness, Hong Kong effectively utilizes practically all major types of technology in the development of its telecommunications networks, including point-to-point microwave, fiber-optics, multi-point distribution systems and traditional radio frequency distribution techniques. The Guarantor has been at the heart of this development with the deployment of its territory-wide broadband backbone and ancillary networks capable of delivering high quality voice and data services.

The Guarantor completed the digitalization of its network in 1993. Currently, all of the network transmission links for exchange junctions are digital and all exchange equipment incorporates digital technology. As a result, the Guarantor's network is capable of supporting a wide range of circuit and packet switched data services. These services enable a single line to be used for simultaneous voice and data communication and facilitate the provision of various customer services using voice, data, video services, Integrated Services Digital Network (ISDN) services and enhanced customer-calling features.

In early 1997, the Guarantor and its affiliates initiated their offering of ATM services in Hong Kong. ATM can manage the transmission of diverse kinds of traffic simultaneously within a network, including voice, data and video signals. In mid-1998, the Guarantor launched residential broadband access services and its broadband network coverage currently passes more than 95% of Hong Kong's homes and all major business areas in Hong Kong utilizing fiber-to-the-building and DSL technology.

As at December 31, 2004, the Guarantor's core telecommunications network includes:

- 2.57 million exchange lines, and approximately 796,000 broadband access lines;
- an extensive optical fiber network covering most of Hong Kong, consisting of 725,000 core kilometers of fiber;
- 236 advanced fiber telecom buildings, with high-bandwidth and resilient fiber optic cabling;
- 212 telephone switches; and
- transmission plant and exchange equipment, such as computer hardware and back-up power supplies.

The Guarantor is focused on providing a high level of service quality for its voice, data and broadband services, benchmarking its performance against the leading global operators. This is reflected in its 99.999% network availability during the year ended December 31, 2004, based on the Guarantor's internal quality assurance reports.

The Guarantor has commenced developing and migrating to a multi-service IP platform. This platform is aimed at facilitating the delivery of next-generation services that integrate voice, data, Internet, metro IP services and other high-bandwidth applications while providing significant cost advantages and scale efficiencies in service provision.

Products and Services

Local Telephony Services

Local telephony services accounted for approximately 41% of the Guarantor's turnover for the year ended December 31, 2004 and consisted of public-switched fixed line local telecommunications services, value-added services and wholesale interconnection services provided to other telecommunications carriers and service providers.

According to OFTA, as of January 2005, the fixed line telephone density in Hong Kong was 54.7 lines per 100 people, or 54.7%, which was among the highest in the world. OFTA reported there were approximately 3.8 million exchange lines in Hong Kong as at December 31, 2004, representing a decline of approximately 1.1% from the previous year. The decline in the number of direct exchange lines in service which the Guarantor operated during the year was due to a combination of factors including competition from other fixed-line operators and users substituting exchange lines with broadband access lines and wireless telecommunication services.

Exchange Line Services. The Guarantor provides retail public-switched fixed-line local telecommunications services to residential and business customers, for which it charges its retail customers a fixed monthly exchange line rental fee. Since January 2001, the tariffs for residential exchange lines and business exchange lines have been HK$110.00 and HK$128.80, respectively. These basic exchange line tariffs have remained at the same levels, although the Guarantor also offers various service packages incorporating value-added features at differing rates. In addition to charging a basic tariff, the Guarantor also charges customers for the installation and relocation of exchange lines.

As at December 31, 2004, based on the Guarantor's estimates and OFTA's statistics, the Guarantor's market share of exchange lines in service in Hong Kong was approximately 68%, representing approximately 67% of residential exchange lines and approximately 69% of business exchange lines. As at December 31, 2003, the Guarantor had approximately 73% total market share, representing approximately 73% of residential exchange lines and approximately 73% of business exchange lines.

The Guarantor's business exchange lines fall within two separate categories, business direct exchange lines and Integrated Digital Access (IDA) lines. Business direct exchange lines are traditional exchange lines provided for business use. IDA lines employ digital technology to provide multi-channel voice and voice band telecommunications between customers' equipment and the public switched telephone network. IDA lines are primarily employed by businesses to connect their private automated branch exchanges (PABXs) to the Guarantor's network, as well as by other telecommunications operators for interconnection purposes.

The following table indicates the number of exchange lines leased by the Guarantor as at December 31, 2002, 2003 and 2004, respectively:

	As at December 31,		
	2002	2003	2004
	(in thousands)		
Lines in Service			
Business lines, including IDA lines	1,336	1,236	1,144
Residential exchange lines	1,802	1,543	1,423
Total	3,138	2,779	2,567

Value-added Services. The Guarantor provides a number of value-added services to its business and residential customers in return for a monthly per-line or per-service fee or as part of a package subscription. Examples of the Guarantor's value-added services include:

- Caller Display, which shows the caller's telephone number on the screen of the telephone;
- Call Forwarding Services, which enable routing of calls to any other local fixed or mobile telephone number; and
- PhoneMail, which provides a mailbox service when the telephone line is busy or unattended.

In July 2003, the Guarantor launched NGFLS for business and residential customers, to help retain and win back customers and improve its churn rate. NGFLS utilizes a standard direct exchange line to provide access to a range of network-based applications. These services include:

- *Short Messaging Service (SMS)* — This enables the sending and receiving of text messages in either the English or Chinese language between fixed to fixed and mobile telephones. This NGFLS requires a SMS-capable telephone set.
- *Personal Assistant* — This service comprises a voice-activated phonebook, voicemail retriever that enables access to fixed and mobile telephone voicemail systems, reminder function and information retrieval.
- *Auto Receptionist* — This NGFLS, targeted at small and medium sized businesses, utilizes an Interactive Voice Response System (IVRS) to provide call routing and enquiry response services.

Approximately 746,000 residential exchange lines and 223,000 business exchange lines had signed up to NGFLS as at December 31, 2004. The average monthly net line loss has been significantly decreased since the new services were launched.

Wholesale Interconnection Services. The Guarantor receives interconnection payments from other service providers and local carriers for calls utilizing its network. Interconnection fees include fees for the delivery of traffic, as determined by OFTA, and fees for the physical interconnection of facilities and network sharing, as determined under commercial agreements between the Guarantor and other carriers. Currently, the primary sources of the Guarantor's interconnection turnover are:

- the per call/minute fees payable by other local carriers or service providers for the origination or termination of voice or dial up Internet traffic on its network;
- the origination, termination and transit of mobile voice traffic; and
- the termination of dial-up Internet traffic to Internet Service Providers.

Most of the retail public switched fixed-line telephone network traffic in Hong Kong is carried on the Guarantor's network by virtue of its extensive network coverage, significant ownership of "last mile" access, and large customer base.

Under the terms of its commercial interconnection agreements with other local fixed telecommunications network services operators, the Guarantor leases unbundled local access loops from its exchange sites to customer ends for which it receives per line charges. The Guarantor also charges other telecommunications operators for space in its local exchanges used to co-locate their equipment. See "— Regulation."

Local Data and Broadband Services

Local data and broadband services accounted for approximately 35% of the Guarantor's turnover for the year ended December 31, 2004, and consisted of local leased circuits, data services and the provision of broadband access lines utilizing the Guarantor's fiber optic and DSL network.

Local Leased Circuits. The Guarantor supplies local private leased telecommunications circuits to other service providers, allowing point-to-point connection for voice and data traffic between two or more separate points. A large number of local circuits are leased by the other fixed-line and mobile carriers to connect their network facilities, as well as by ISPs that need to connect to local and international Internet exchanges. The balance of the leased circuits is provided to corporate customers such as banks which require private network telecommunications facilities. The Guarantor also provides the local connections for its own and other carriers' international private telecommunications circuits. Lease rates for local telecommunications services are determined by levels of bandwidth, customization, service availability and customer support, as well as volume pricing discounts.

Data Services. The Guarantor provides customers with managed end-to-end data transmission facilities, including point-to-point, point-to-multipoint, or polling, and broadcast services within Hong Kong. The Guarantor's network also supports IP-VPN, frame relay and ATM data services that allow high volume transmissions or integrated data, voice and video traffic for corporate networks. In addition, the Guarantor offers a dedicated network for connecting multiple sites for data, Internet and intranet applications and provides managed router services to facilitate wide area network management services. Customers incur monthly charges for use of these services based on levels of bandwidth, customization, service availability and customer support, as well as volume pricing discounts.

Datapak Circuit Switched Service — ISDN. Datapak Circuit Switched Service is an ISDN service providing high bandwidth with the flexibility of both voice and data dial-up communication, enabling users to select various destinations for voice, data and video images. Applications include:

- *Video-conferencing*. The service cuts traveling time and expenses, while maintaining face-to-face contact by video. ISDN is an effective medium for international video-conferencing networks.

- *Dedicated Line Backup*. Where computer backup is required to a local or overseas host, ISDN provides high bandwidth on request, without the overhead of a permanent circuit. It also enables users to back up leased lines to ensure secure, high-speed communications.

- *High-speed computer links*. ISDN is appropriate for intermittent transmission of high-volume data. It is particularly suited to connection of geographically separated local-area networks.

- *Multimedia Communication*. Several applications combine data, text, voice and images.

Broadband Internet Access. The Guarantor is one of Hong Kong's leading broadband providers. Hong Kong had an estimated 1,484,486 registered broadband Internet-access customers from households and offices at December 31, 2004, based on statistics from OFTA. As at December 31, 2004, the Guarantor had approximately 796,000 retail and wholesale broadband customers. Broadband access lines are leased to other service providers, which package local-access lines with content services for their own customers. Usage-based, flat-rate and level-of-service broadband packages are tariffed and provided on a non-discriminatory basis.

The following table shows the number of the Guarantor's broadband access lines in service as at December 31, 2002, 2003 and 2004, respectively:

	As at December 31,		
	2002	2003	2004
	(in thousands)		
Total Broadband Access Lines Leased	559	703	796

NETVIGATOR. The Guarantor's retail Internet services in Hong Kong are offered through the Guarantor's "NETVIGATOR" brand, which had a consumer broadband customer base of approximately 660,000 as at December 31, 2004, representing an increase of approximately 28% from approximately 517,000 as at December 31, 2003.

The Guarantor also provides broadband Internet access at over 350 wireless hotspot locations in Hong Kong, such as cafes, restaurants, shopping malls, stations along the MTR Corporation's Airport Express route and throughout public areas at Hong Kong International Airport. In September 2003, the Guarantor launched NETVIGATOR *Inflight* service, offering customers access to email on their personal computers while on board Cathay Pacific flights. As at December 31, 2004, over 60 aircraft had been equipped to provide NETVIGATOR Inflight services. NETVIGATOR also offers various value-added services such as Parental Control, which filters undesirable Internet material and provides Internet access time-control for parents; NETSee, which enables video Internet communications and home-monitoring features; Mailguard, which blocks unwanted e-mails; and NetAlbum, which stores digital images and videos.

International Telecommunications Services

International telecommunications services accounted for approximately 12% of the Guarantor's turnover for the year ended December 31, 2004. These services consisted primarily of retail international services.

IDD Services. The Guarantor provides IDD calling services, operator assisted overseas calls and calling card services to both business and residential customers in Hong Kong. The Guarantor currently offers a choice of IDD calling services targeting different customer segments: its "001" premium service and its "0060" service. IDD services are charged on a per 6-second basis depending on the location called.

Competition in the IDD services market has increased significantly since the introduction of services-based competition and facilities-based competition in Hong Kong in 1999 and 2000, respectively. This has resulted in significant declines in prices and in the Guarantor's market share. There are now a large number of service providers holding non-exclusive licenses to provide international voice, fax, data and value-added network services, as well as international calling-cards and virtual private network services. In addition, licensed carriers can install their own facilities and service providers can purchase international transmission capacity, wholesale switched minutes and leased-circuit capacity from international carriers other than HKTI.

International Private Leased Circuits. The Guarantor supplies IPLC services to retail customers, allowing point-to-point connection for voice and data traffic between two or more points. The Guarantor leases the international capacity for its retail IPLCs from other providers, primarily Reach, which it then separately packages with its own local capacity to create a fully integrated international leased circuit. Customers incur monthly charges for use of these services based on levels of bandwidth, customization, service availability and customer support, as well as volume pricing discounts. See "— Regulation."

As a result of the introduction of the international facilities-based competition from January 2000, retail IPLC prices fell substantially. The Guarantor aims to increase its market penetration of end-to-end retail IPLC services. For example, the Guarantor intends to provide IP-based private network services and to continue to upgrade its customer care program to improve customer service and satisfaction.

Other Services

Other services accounted for approximately 12% of the Guarantor's turnover for the year ended December 31, 2004. The Guarantor provides a range of call center and technical, maintenance and other subcontracting services to other subsidiaries of PCCW or third parties. These services include installation and maintenance of customer access equipment and software for broadband service providers and call center services.

Sales and Marketing

The Guarantor markets its services through PCCW's global sales and marketing team. Dedicated sales units address the separate global business, Hong Kong corporate and residential customer market segments. A team of professional sales consultants in the global and Hong Kong corporate segments rely on the Guarantor's CRM system to target new products and services toward different customer groups, and cross-sell the Guarantor's services to the customers of PCCW's other divisions. The CRM system collects information about the Guarantor's customers' usage patterns, which can be used to market on a targeted basis. Industry specialization and individual client focus on larger clients allows for tailored solutions to a client's specialized needs.

As at December 31, 2004, the Guarantor marketed its services to approximately 2.2 million households through 16 PCCW retail shops and more than 1,000 business agents in Hong Kong. The team reaches these customers through telesales, roadshows and exhibitions, on-line sales and retail outlet partners. The Guarantor also utilizes an exclusive targeted loyalty program managed by PCCW with the objective of customer retention and rewarding customer loyalty. Discounts at shops and special promotions from other merchants were offered to approximately one million of the Guarantor's customers.

Investments

As at December 31, 2004, the Guarantor has invested approximately HK$21 billion, in aggregate, in its network infrastructure since April 1, 1996. Its investments in recent years have been focused primarily on the development and improvement of its broadband fiber optic and IP network systems. Additional expenditures relate to the maintenance of the Guarantor's existing fixed-line network and related infrastructure.

The Guarantor's major capital expenditure for investments in the coming years will mainly be spent on upgrading and expanding its network coverage, meeting demand for the installation of local broadband access lines, ongoing maintenance of its network integrity, and building a platform for broadband and fast-developing IP initiatives.

Competition

The implementation of the Hong Kong Government's policy to liberalize the telecommunications industry has resulted in intense competition in the markets for local and international services. Competition from providers of fixed exchange line services and resellers has materially increased in the past several years. Also, mobile telecommunications prices have declined sufficiently so that customers are more likely to substitute mobile telecommunications services for residential local fixed exchange services. The market for IDD services originating in Hong Kong is expected to remain extremely competitive. The presence of numerous ETS licensees has provided customers with greater choice with respect to IDD service providers. This has affected the Guarantor's market position in the retail IDD services market. In recent months, there has been a growth of VoIP services in the market. These services compete with the local fixed exchange line and IDD services. The Guarantor expects that this operating environment will continue to be a factor resulting in the continuation of the recent general trends in the business.

The Guarantor was the exclusive provider of local fixed exchange line services and facilities in Hong Kong until June 30, 1995. Currently, local fixed exchange line services and facilities are currently provided by the Guarantor and by several other competing local carriers: Hutchison Global Communications Limited, New World Telecommunications, Wharf and Hong Kong Broadband Network Limited (which also provides wireless local fixed exchange line services).

On January 1, 2003, full liberalization of the local and external FTNS markets took effect following a statement on the issue by the TA on January 11, 2002. Since January 1, 2003, several new operators have been granted local wireline-based FTNS licenses. Under the full liberalization policy, there is no pre-set limit on the number of licenses to be issued and there is no time limit for license applications. However, the TA will not consider granting any FC licenses to those applicants who intend to primarily rely on interconnection and wholesale services of other operators' infrastructure to roll out their network or provision of their services.

The Guarantor is required in certain situations to provide telecommunications services to service providers that compete directly with its operations. These services include interconnection and unbundled local loops.

Regulation

Telecommunications Regulatory Framework

The Telecommunications Ordinance provides the legislative framework for the provision of telecommunications services and facilities in Hong Kong. The TA is the principal telecommunications regulator in Hong Kong and is responsible for administering the Telecommunications Ordinance. OFTA was established in 1993 under the Telecommunications Ordinance to assist the TA in administering and enforcing the provisions of the Telecommunications Ordinance.

It is unlawful to establish or maintain any means of telecommunications, or possess, use or deal with telecommunications apparatus in Hong Kong without a license. The TA has the authority to grant licenses for all means of telecommunications services and facilities in Hong Kong, including the provision of fixed wireline, public mobile telephone, Internet and satellite services. It is also responsible for allocating spectrum, regulating interconnectivity between the various networks in Hong Kong and determining the terms of supply of unbundled network elements between carriers. The TA also has the power to make rules relating to the provision of telecommunications network services by licensees and the terms, conditions and rates for interconnection services among operators. Furthermore, the TA has the authority to require a licensee to comply with the terms of its license and any applicable legislation, and to suspend or revoke licenses to enforce the Telecommunications Ordinance or other rules or regulations to protect the public interest.

The Telecommunications Ordinance was amended, effective June 16, 2000, to broaden the application of a number of provisions, which previously applied only to holders of FTNS licenses, to cover all licensed telecommunications operators. These provisions include:

- interconnection and facilities sharing obligations;
- accounting and reporting requirements;
- tariffing requirements;

- prohibitions on anti-competitive practices, including abuse of dominant position; and
- prohibitions on misleading or deceptive conduct.

The amended Telecommunications Ordinance also increases the maximum penalty for breaches of the conditions to the license, the Telecommunications Ordinance or a Direction of OFTA to HK$1 million (for repeat offenses) and allows OFTA to refer cases to the courts, which will have the power to increase the penalty to the higher of HK$10 million or 10% of turnover for the relevant telecommunications market during the period of the breach.

The TA is required under the Telecommunications Ordinance to give reasons for its opinions, decisions and determinations (including those relating to the competition provisions). The TA may also issue guidelines to provide practical guidance with respect to provisions of the Telecommunications Ordinance and must conduct public consultation before issuing guidelines. The Telecommunications Ordinance contains a right of appeal from a decision of the TA relating to the competition provisions to the Competition Board. In addition, the amendments provide a right of private action in the event of a breach of the Telecommunications Ordinance or a condition to a license. A judicial review may be sought.

As a further step to monitor and regulate the telecommunications market, the Hong Kong Government enacted the 2003 Ordinance in July 2003, which deals specifically with merger and acquisition activities by carrier licensees in Hong Kong's telecommunications sector. The 2003 Ordinance gives the TA the power to review mergers and acquisitions and to direct a carrier licensee to take such actions as the TA sees fit so as to eliminate any anti-competitive effect when there are pre-defined changes in the ownership and control over a carrier licensee if the TA is of the opinion that such change has, or is likely to have, the effect of substantially lessening competition in a telecommunications market without any outweighing public benefits. The TA also has the right to impose additional conditions on the carrier licensee or may unwind the merger or acquisition in whole or in part. Failure to comply with the TA's direction would constitute a breach of the relevant provisions in the 2003 Ordinance. The TA may also impose a financial penalty on the carrier licensee in breach or suspend or revoke its carrier license. A carrier licensee or an interested party may, on a voluntary basis, seek prior approval from the TA for a proposed change in control. A de novo appeal to the Competition Board of the TA's decision is also part of the 2003 Ordinance.

Fixed Telecommunication Network Services

Local fixed exchange line services and facilities are currently provided by the Guarantor and by several other local carriers. The Guarantor's non-exclusive FTNS license permitted it to provide public fixed telecommunications network services, establish and maintain a telecommunications network and possess and use telecommunications installations in Hong Kong. On January 14, 2005 the Guarantor exchanged its FTNS license for a new FC licence. The new license reflects a substantial change in the regulation of the Guarantor and in particular the adoption of an ex post tariff regime where prior TA approval of the Guarantor's tariff revisions is no longer required. The Guarantor now notifies the TA of tariff revisions one day before they are effective in the market. The FC license also deleted any language relating to dominance regulation. The FC license may not be transferred without the prior written consent of OFTA and the Guarantor may not dispose of more than 15% of the assets that constitute its network without the prior written consent of OFTA. In addition, the license requires the Guarantor to comply generally with the Telecommunications Ordinance, which includes provisions relating to anti-competitive conduct.

The special conditions of the Guarantor's FC license include a Universal Service Obligation, requiring the Guarantor to provide, maintain and operate its fixed-line telecommunications network in a way which will ensure that good, efficient and continuous basic telephone service is reasonably available to all Hong Kong residents. The Guarantor receives a Universal Service Contribution (USC) from other telecommunications operators, in proportion to their respective external traffic minutes and as determined by OFTA from time to time, in order to offset the cost of providing such basic services to customers where such provision would otherwise be uneconomical. The aggregate amount of the USC to which the Guarantor is entitled has progressively declined following the liberalization of the international telecommunications markets and the increase in its exchange line tariffs implemented in accordance with the Framework Agreement.

Exchange line tariffs

Prior to the execution of the Framework Agreement, the Hong Kong Government subjected the Guarantor to strict price controls on its exchange line tariffs. The TA removed the caps on business exchange line tariffs effective July 1, 1998. In addition, the TA permitted the Guarantor to increase its residential line rental charge, subject to a price cap, over a period of three years ending January 1, 2001. The Guarantor increased its monthly charge for residential telephone lines from HK$68.90 to HK$90.00 effective September 1, 1999, and from HK$90 to HK$110 effective January 22, 2001. As at January 1, 2002, the price caps on maximum residential line tariffs expired. However, all tariff revisions required the TA's prior approval, including revisions for promotions, discounts and service bundles.

On August 8, 2003 and October 22, 2003, the Guarantor filed applications to OFTA to remove its dominant status in the business and residential exchange line markets, respectively. In relation to these applications, OFTA initiated two consultations in September 2003 and November 2003. Submissions were filed in January and March 2004.

On October 8, 2004, the TA released a consultation paper proposing that due to changed circumstances in the market, including increased competition, the Guarantor move from ex ante to ex post tariff regulation. Under the proposal, the Guarantor would not seek the TA's prior approval to revise its tariffs but would do so by way of a notification filing.

On January 13, 2005, the TA released the decision on moving the Guarantor to an ex post regime which would be implemented by issuing to the Guarantor a new FC license. The FC license would eliminate the prior approval requirement for tariff revisions, remove language relating to dominance, and remove language redundant with the Telecommunications Ordinance. Tariff notifications would be filed one day before the revisions became effective and would replace the previous prior approval process. Notifications cover discounts, services bundles, promotions, and other tariff changes. On January 14, 2005, the Guarantor exchanged its FTNS license for the new FC license.

External Fixed Telecommunications Network Services

On March 31, 1998, pursuant to the terms of the Framework Agreement, HKTI surrendered its exclusive license to provide all external telecommunications facilities in Hong Kong. In the second half of 1998, OFTA began issuing non-exclusive licenses to third parties to provide ETS utilizing IPLCs supplied by HKTI, effective January 1, 1999. The Hong Kong Government also announced that competition would be introduced in the market for external facilities from January 1, 2000. The licenses of the FTNS operators were amended on June 19, 1998 to include an authorization to provide external telecommunications services from January 1, 1999 and services via their own external telecommunications facilities from January 1, 2000.

Pursuant to the Framework Agreement, a tripartite FTNS license was issued to HKTI, the Guarantor and a subsidiary of HKT, allowing the parties to provide both external telecommunications services and facilities.

Upon the establishment of Reach and the acquisition of HKTI by Reach, the tripartite FTNS license held by the Guarantor, HKTI and a subsidiary of HKT, was individualized effective January 31, 2001 so that separate FTNS licenses were held by the Guarantor and HKTI, but not by the HKT subsidiary. The Guarantor's FTNS license authorized it to provide all local facilities and services and external telecommunications services on a wholesale and retail basis over external telecommunications circuits supplied to it by an authorized licensee. On June 17, 2004, the Guarantor was authorized to provide its own external facilities. These rights are now part of the Guarantor's FC license.

Local access charges and delivery fees for international services

Historically, international traffic routes were classified by OFTA as either "Category A" or "Category B" routes. Category A routes are those routes where there is demonstrable price competition for wholesale services. Category B routes were those routes that did not meet the conditions to be classified as Category A. On October 8, 2002, the Guarantor was declared non-dominant on all international routes for IDD traffic at the retail level. On December 30, 2002, the Guarantor was declared non-dominant on all international routes for IDD outbound traffic at the wholesale level. On August 25, 2003, the Guarantor was declared non-dominant on all international routes for IDD inbound traffic at the wholesale level.

Concurrently with the 1999 introduction of International Simple Resale (ISR), OFTA introduced a local access charge to complement the modified delivery fee system effective January 1, 1999. Local Access Charges (LAC) and Modified Delivery Fees (MDF) applied differently to Category A and Category B routes and differed as to whether the calls are incoming to Hong Kong or outbound from Hong Kong. These charges were designed to replace the then existing subsidy flows from external services to the domestic local services market. Under these charge arrangements, access fees flow from international service suppliers to domestic service suppliers upon whose network international calls either originate or terminate. The LAC is still a relevant charge.

The ETS operators are also required to pay LAC to the Guarantor and other FTNS or FC licensees for the delivery of traffic over the local network. Between July 2001 and May 2004, LACs at 12.1 cents and 12.6 cents per minute were charged for outgoing and incoming IDD calls, respectively. For IDD calls via a transit network, LAC was set at 10.6 cents per minute.

On May 4, 2004, OFTA issued a determination of revised LAC rates proposed to be effective June 1, 2004. The revised LAC rates were 8.6 cents and 8.8 cents per minute for outgoing and incoming IDD calls, respectively, and 7.6 cents per minute for IDD calls delivered via a transit network. On May 27, 2004, in response to an application by the Guarantor, the High Court granted an interim stay of OFTA's LAC determination, pending a judicial review. In June 2004, OFTA filed an application to the High Court to set aside the interim stay, which was denied. The Guarantor's substantive judicial review application was heard on the merits on September 13 and 14, 2004. On March 30, 2005, the High Court found that the TA lacked the power to make the LAC determination and, accordingly, the LAC determination was unlawful and has been quashed. The current LAC rates are therefore the ones determined in 2001 as noted above.

Retail international tariffs

The Guarantor is now classified as non-dominant in the provision of international services, in both IDD and bandwidth services. Nevertheless, like all non-dominant licensees, it must file maximum tariffs and abide by provisions prohibiting anti-competitive conduct in the Telecommunications Ordinance. As the Guarantor is classified as a non-dominant operator for these services and operates under maximum tariffs, the prior notification requirements of the new FC license do not apply.

Class license

In-building telecommunications systems have been authorized under a class license regime since 2002. Under this regime, a building's owner is automatically licensed to establish, maintain and operate an in-building telecommunications system within the common parts of a building and to provide telecommunications services within the building. No public telecommunications service can be provided. The Guarantor, as a fixed telecommunications operator, continues to enjoy the right to building access and to interconnect with in-building systems on a non-discriminatory basis.

The Wireless Local Area Network (wi-fi) class licensing regime has been in place since February 21, 2003, allowing operators meeting the license criteria to automatically provide wi-fi services that do not cross any public streets. As at November 1, 2004, there were 23 wi-fi class licensees. IMS holds one of these licenses, which has been effective since March 21, 2003.

Interconnection and Facilities Sharing

Under the Telecommunications Ordinance and the terms of their licenses, the Guarantor and the other local fixed-line carriers are required to interconnect their services and networks with each other and with those of mobile and international carriers. Interconnection is of two main types: Type I interconnection (i.e., interconnection between network gateways) and Type II interconnection (i.e., unbundling of local loops). The local fixed-line carriers are also required to share certain facilities where the sharing of those facilities is considered to be in the public interest. The TA may intervene if the parties cannot agree on the terms of interconnection or facilities sharing. The TA has powers under section 36B of the Telecommunications Ordinance to direct that interconnection be secured, under section 36A to determine the terms of interconnection and under section 36AA to direct the sharing of facilities. The TA has used these powers in the past and has indicated that it may use them in the future.

Pursuant to various TA policy statements and its license, the Guarantor entered into Type I interconnection agreements with each of the other FTNS licensees in 1995. Pursuant to these TA policy statements, the Guarantor also entered into Type II interconnection agreements with each of the other FTNS licensees, licensed in 1995, to provide them access to its narrowband copper local lines between the local exchange and customer sites for voice and premium services (transmission rates up to 144 kilobits per second). These unbundling arrangements allow customers to switch their direct network connection between the Guarantor and other fixed-line telecommunications licensees at the Guarantor exchanges. The ability to provide direct connection to customers utilizing the Guarantor's network enhances the potential for other FTNS licensees to provide services to more users.

On May 23, 2003, the Secretary for Commerce, Industry and Technology of the Hong Kong Government initiated a review of the policy on compulsory broadband and narrowband Type II interconnection due to the changing market landscape, the advent of new or improved technologies and the fact that seven years had passed since narrowband unbundling was implemented. On July 6, 2004, the Executive Council adopted a decision to phase out compulsory unbundled local loop by June 30, 2008. For buildings already connected by at least two self-built customer access networks, new customers could be added for two years (the transitional period) followed by a one-year grand-fathering period. For buildings not yet connected by at least two self-built customer access networks, the same timeframe would apply starting from the time the second network connection was established. The entire compulsory period will end on June 30, 2008, regardless of where a specific building is on this timeframe. Buildings meeting an essential facility test would remain subject to compulsory unbundling beyond mid-2008.

Broadband interconnection

On November 14, 2000, the TA issued a statement on the regulatory framework for broadband interconnection, including the principles underlying the determination of broadband unbundled local loop arrangements and interconnection charges. Following the approval of OFTA, on October 19, 2001, the Guarantor published a new wholesale tariff which sets out the terms and conditions upon which other FTNS licensees can interconnect with the Guarantor's copper local loops on a full or partial unbundled basis to provide broadband services. Prior to the filing and publication of that tariff, two other FTNS licensees (i.e., Wharf and New World Telecommunications) requested that OFTA make a determination regarding the terms, conditions and rates for interconnection to the Guarantor's broadband access line network. At the end of 2001, OFTA initiated two determination proceedings in response to these requests.

On May 15, 2002, the TA issued a direction to Wharf and the Guarantor directing the Guarantor, as an interim measure, to promptly implement broadband Type II interconnection upon request, and the Guarantor did so as per the terms of its tariff as amended in August 2002. Thereafter the Guarantor sought judicial review of the TA's direction. The hearing of the judicial review challenging the lawfulness of the TA's decision to direct broadband Type II interconnection with Wharf was conducted in March 2004. On June 30, 2004, the High Court found that the TA's direction was unlawful and, on October 4, 2004, ordered the direction to be quashed. Until compulsory local loop unbundling is phased out by mid-2008, any new directions by the TA to mandate the unbundling of the Guarantor's broadband network could subject it to additional competition.

As to the determination proceedings, OFTA's Interconnection Determination Committee released its preliminary analyses on February 24, 2003 and the Guarantor submitted further submissions responding to those preliminary analyses on May 7, 2003. The Guarantor has also filed a number of notices of appeal and judicial review applications relating to the preliminary analyses and the decisions by the TA not to stop the determination proceedings and not to withdraw the preliminary analyses. Leave to judicially review the decision of the TA not to stop the proceedings was granted and on May 23, 2003, an interim stay of the determinations proceedings was granted and the TA agreed not to act on the determination requests pending the outcome of the Hong Kong Government's review of the policy on broadband and narrowband Type II interconnection. This agreement was reflected in a court consent order made on June 12, 2003 which provided that the interim stay granted by the court on May 23, 2003 would continue in effect.

On July 6, 2004, the Executive Council released its decision to ultimately phase-out both narrowband and broadband compulsory unbundled local loop by June 30, 2008. One determination request has been dropped (New World Telecommunications), and the Guarantor has been involved in a series of bilateral negotiations with all of the relevant FTNS operators on broadband Type II interconnection. The Guarantor continues to offer broadband unbundled loops per its wholesale tariff, as amended, but not per any TA decisions. Until compulsory local loop unbundling is phased out by mid-2008, any new determinations on the terms and conditions of interconnection could subject the Guarantor to reduced margins on its narrowband and broadband services. On June 16, 2005, the TA inquired to the Guarantor and Wharf as to the state of the broadband negotiations and whether the TA's 2001 decision to accept Wharf's determination request should be vacated. The Guarantor submitted a reply on July 8, 2005.

Interconnection reviews

On March 18, 2002, OFTA published the Interconnection and Related Competition Issues Statement No. 7 (Second Revision), which concluded its review of the interconnection charging principles initially established in 1995. In Statement No. 7, OFTA reconfirmed that in future determinations for Type I and Type II interconnection it would continue to use an LRAIC approach and apply a current cost standard subject to the use of historical cost on certain items (land, building, copper infrastructure pre-1995) to the costing of network assets. On June 18, 2002, OFTA clarified that it would not refer to the costing methodology in Statement No. 7 when making broadband Type II interconnection determinations but would consider representations from parties concerned. OFTA also indicated on June 18, 2002 that it would consider in due course whether there was a need to further revise Statement No. 7 to make it applicable to both broadband and narrowband interconnections. This potential revision may result in interconnection charge levels less than those currently in existence and may adversely affect the Guarantor's business, results of operations or financial condition.

On November 12, 2004, OFTA announced that it would review the existing charging methodology, including the continued use of the fully distributed cost (FDC), standard, for mobile and value added service interconnection to the Guarantor's FTNS network. One option would be to change the FDC standard to the LRAIC standard in line with Type I and Type II interconnection. OFTA also indicated on November 12, 2004 that it would conduct a more comprehensive review of charging arrangements for interconnection between fixed and mobile carriers in the light of fixed and mobile convergence. These reviews may result in interconnection charge levels less than those currently in existence and may adversely affect the Guarantor's business, results of operations or financial condition.

VoIP services

On October 4, 2004, OFTA initiated a consultation on how VoIP services should be regulated. The consultation paper raised issues concerning the licensing of VoIP services and the manner in which such services could be provided. It also dealt with the allocation of telephone numbers and number portability rights, the need to provide any-to-any connectivity, network interconnection and Calling Line Identification, the payment of interconnection charges, and a range of consumer welfare issues. On June 20, 2005, the TA released its policy statement on the regulation of VoIP services in Hong Kong. The TA adopted a two tier licensing regime for VoIP providers and indicated that the first tier providers would have similar rights and obligations as the current FTNS/FC licensees as they would be providing a substitutable voice service. The second tier providers would have fewer rights and obligations, as they would be offering services that would not be substitutable for existing voice services. Additional consultations will be held on service quality and numbering issues, although the first tier VoIP service providers would have access to eight digit numbers and number porting rights and enjoy interconnection rights as well. The outcomes of the additional consultations are expected to be announced by OFTA by year end 2005. Depending on the outcome of commercial negotiation and the additional consultations on VoIP, such services could pose a serious competitive threat to the Guarantor's fixed line and IDD business, resulting in reduced revenues and margins.

Other Telecommunications Services

The conditions of the Guarantor's new FC license, the provisions of the Telecommunications Ordinance and Statements or Directions from the TA apply to all of the Guarantor's telecommunications services, including local data services and local leased circuits. These conditions include tariff notification requirements and restrictions on anti-competitive practices.

International Telecommunications Networks

Subject to the overseas regulatory requirements, the construction and operation of telecommunications networks and the provision of telecommunications services in foreign countries may require a variety of permits, licenses and authorizations in the ordinary course of business. In addition to telecommunications licenses and authorizations, the Guarantor may be required to obtain environmental, construction, zoning and other permits, licenses and authorizations. The construction and operation of telecommunications facilities and the provision of telecommunications services may be subject to regulation in other countries at the national, state, provincial and local levels.

The Internet and Electronic Commerce

The laws relating to the provision of Internet services in the Asia-Pacific region vary substantially from country to country and are undergoing rapid development and change. In countries such as New Zealand, South Korea, Taiwan, Japan, Philippines, Malaysia and the PRC, the regulation of content, intellectual property rights, operation and ownership of telecommunications facilities and the provision of Internet and related services are subject to varying degrees of regulation. Regulatory schemes in each of these countries distinguish among the various types of content and information services, Internet and telecommunication services and other value added services. Some or all of the Guarantor's services may fall under a formal licensing system or may be subject to foreign ownership restrictions, content-based regulations or other legal restrictions. As the Guarantor continues to expand into international markets, these laws will have an increasing impact on its operations. The Guarantor does not know whether new or existing laws or regulations could have a material adverse effect on the Guarantor or its ability to offer some or all of its services in any country.

Internet Service Providers—Licensing

Internet access services are "public non-exclusive telecommunication services" which require a Public Non-Exclusive Telecommunications Service (PNETS) license issued by OFTA. PNETS licenses are renewable annually on payment of a nominal fee to OFTA, subject to any terms or conditions specified by OFTA. There were 186 PNETS licenses for the operation of Internet access services as at April 3, 2005. The licenses are not transferable without OFTA's prior written consent. Under the Telecommunications Ordinance, OFTA may suspend, cancel or withdraw a telecommunications license upon a breach by the licensee of the Telecommunications Ordinance or the terms and conditions of its license. In addition, the Chief Executive in Council may suspend or cancel a telecommunications license at any time if he considers that it is in the public interest to do so.

Telecommunications Regulations in the PRC

On April 1, 2002, the PRC issued a catalogue and regulations for guiding foreign investment, which lists the industries in which foreign investment is encouraged, restricted or prohibited. Industries which are not listed shall firstly be reviewed with reference to items set out in this catalogue. If no similar industry can be found, specific opinion on the permissibility of foreign investment in such industry must be obtained from the Ministry of Commerce. Telecommunications services have been moved from the prohibited category to the restricted category, which means that foreign companies will have a limited ability to invest in such industries subject to satisfaction of certain qualification requirements and compliance with application procedures of the Ministry of Information Industry and other governmental agencies.

A number of new rules and regulations have been issued by the Ministry of Information Industry with the intention to set up a proper legal framework governing the telecommunication industry, among which the Telecom Business Operation License Administration Rules and Telecom Business Classification Catalogue are of particular significance. Effective January 1, 2002, the Telecom Business Operation License Administration Rules set out the qualification requirements applicable to any telecommunications business operator conducting telecommunications business in the PRC and relevant license application and administration procedures. To further regulate the telecommunication business, the new Telecom Business Classification Catalogue, effective April 1, 2003 and slightly adjusted in January 2004, divides each of the basic telecommunications services and value-added telecommunications services into category I and II, respectively, for ease of supervision and administration. Telecommunications services which have a close relationship with national security and/or are of important economic significance are allocated to category I while those having relatively lower impact on the market fall into category II.

On June 15, 2004, the State Administration of Radio Film and Television passed the Administrative Rules for Broadcasting Audio and Video Programs on Internet-like Information Networks which was effective October 11, 2004. Operators may broadcast television, radio and other audio and video programs on the Internet subject to licensing. It is expected that certain mainland operators will receive licences and commence to provide such services on the Internet in 2005.

World Trade Organization (WTO)

In accordance with the above catalogue and regulations, basic telecommunications services (which include fixed-line and mobile voice and data services, and domestic and international services) will be gradually opened to foreign participation up to a maximum of 49%. Value-added telecommunications services (which include paging services, Internet access, Internet content provision and Internet data centers) will be gradually opened to foreign participation up to a maximum of 50%. Additionally, geographical restrictions are imposed upon such activities for the first six years from the PRC's accession to the WTO.

However, even with the above new regulations, there are still ambiguities in these laws and regulations and uncertainties as to interpretation. Therefore, it is possible that interpretation and enforcement of such laws and regulations may change.

Internet Content

There is currently a small but growing body of laws and regulations in various jurisdictions directly applicable to Internet content. Due to the increasing popularity and use of the Internet, it is likely that a growing number of laws and regulations will be adopted in various jurisdictions with respect to user privacy, freedom of expression, intellectual property rights and information security. Some governments, including those of the PRC, Malaysia and Singapore, block websites whose content breaches their standards. Problematic content generally consists of political speech, pornography and any content that may be deemed to have the effect of harming the society or the culture of a country, as such concepts are defined by the regulators.

Property, Plant and Equipment

The Guarantor's principal plant and equipment consist of transmission plants and exchange equipment (including switches, computer hardware, back-up power, plant etc.) and connecting lines (including cable ducting, copper and fiber optic cabling and poles). Leasehold land and buildings principally consist of local telephone exchanges, which in certain cases include engineering facilities or administrative offices and technical and administration centers. Nearly all of the leases relating to such exchanges and centers are special purpose leases granted by the Hong Kong Government, which contain restrictions on their use for other purposes and on their transfer. The vast majority of these leases do not expire before 2025.

The net book value of the Guarantor's fixed assets as at December 31, 2004 was as follows:

	Net Book Value
	(HK$ millions)
Plant and Equipment:	
Transmission plant	4,497
Exchange equipment	4,274
Other plant and equipment	1,538
Leasehold land and buildings	1,084
Projects under construction	304
Other:	
Investment properties	112
Total	11,809

Insurance

The Guarantor has insurance policies covering fire, flood, other material damage to property and general liability under material damage to property, business interruption and public liability provisions.

The Guarantor believes that its properties are covered with adequate insurance provided by reputable insurance companies and with commercially reasonable deductibles and limits on coverage. Notwithstanding the Guarantor's coverage, damage to its buildings, facilities, equipment, machinery or other properties as a result of occurrences such as fire, flood, water damage, explosion, power loss, telecommunications failure, intentional unlawful act, human error, typhoons and other natural disasters could nevertheless have a material adverse effect on the Guarantor's financial condition and results of operations.

Employees

The Guarantor's future success will depend, in large part, on its ability to continue to attract, train, retain and motivate highly qualified technical and management personnel, particularly highly-skilled technical personnel and engineers involved in new product development, for whom market competition for such talent is intense.

As at December 31, 2004, the Guarantor had approximately 2,919 employees. The majority of these employees work in Hong Kong, although the Guarantor does have some employees in various countries within the Asia-Pacific region.

A Joint Staff Council meets regularly to consult with employee representatives on various matters including the affairs of the Guarantor.

The Guarantor's employees are not represented by any collective bargaining unit, and it has never experienced a work stoppage. The Guarantor does not recognize any labor unions, although it believes that some of its employees are members of unions.

Intellectual Property

The Guarantor relies on a combination of trademarks, service marks, domain name registrations, copyright protection and contractual restrictions to establish and protect its brand name and logos, marketing designs and Internet domain names. Approximately 70 registered trademarks and four pending trademark applications used by the Guarantor are owned by PCCW-HKT DataCom Services Limited, an indirect wholly owned subsidiary of PCCW. In addition, five registered trademarks and one pending trademark application used by the Guarantor are co-owned by PCCW-HKT DataCom Services Limited and EPS Company (Hong Kong) Limited. The trademarks are licensed on a non-exclusive basis to the Guarantor. Other than licenses described in "— Regulation," the Guarantor is not substantially dependent upon any patents or licenses, industrial, commercial or financial contracts or new manufacturing processes.

Environmental Issues

The Guarantor's operations are subject to various environmental laws. Compliance with such laws has not, and in the Guarantor's opinion, is not expected to have, a material adverse effect upon the Guarantor's capital expenditures, earnings or competitive position.

Litigation

Reach Networks has instituted legal proceedings against Wharf to recover international delivery fees mistakenly paid or payable to Wharf during the period from 1996 to 1998. The amount claimed is around HK$157 million plus interest. Wharf has filed a counterclaim against Reach Networks for HK$78.5 million. Reach Networks' action may be successful or unsuccessful and no assurance can be given that any recovery will be possible. Pursuant to the agreements for the transfer of PCCW's IP backbone operations to Reach, as part of PCCW's joint venture with Telstra, PCCW or its nominee retains the right to any proceeds if these proceedings are successful, and PCCW or its nominee will be responsible for the conduct of these proceedings and all liabilities, costs and expenses incurred in connection with these proceedings. The rights and obligations of PCCW were novated to the Guarantor on June 17, 2004.

On December 7, 2004, the Guarantor commenced legal proceedings in Hong Kong against Wharf seeking, amongst other things, a declaration that Wharf was not entitled to a repayment of sums totaling approximately HK$61.5 million owed in respect of an agreement for narrowband type II interconnection charges (the LAL Agreement). The Guarantor also seeks damages in respect of amounts which have been, and continue to be, withheld by Wharf each month under the LAL Agreement. Proceedings are at a relatively early stage and are not expected to be completed within 2005.

Except as set forth above, the Guarantor is not a defendant in any material litigation or arbitration of material importance, and no material litigation or claim is known by the board of directors of the Guarantor to be threatened against it.

Due to the nature of the Guarantor's business, it initiates numerous actions against numerous defendants. In most cases, it seeks damages that are not individually material.

MANAGEMENT

The following individuals have been appointed to serve as the directors of the Guarantor and the executive management of PCCW responsible for the operations of the Guarantor:

Name	Position
Directors	
Li Tzar Kai, Richard	Director
So Chak Kwong, Jack	Director
Yuen Tin Fan, Francis	Director
Arena, Alexander Anthony	Director
Executive Management	
Arena, Alexander Anthony	Executive Director
Chan Kee Sun, Tom	President, Consumer Sales & Channel
Chow Ding Man, Gary	Acting Head of Commercial Group
Chung Wai Cheong, Tommy	President, Global Sales & Products
Hui Hon Hing, Susanna	Director of Finance
Leung Tak Sing, Dominic	Executive Vice President, Consumer Marketing & Business Management

Board of directors

Li Tzar Kai, Richard

Mr. Li is chairman of PCCW and chairman of PCCW's Executive Committee. He is also chairman and chief executive of the Pacific Century Group, chairman of Pacific Century Premium Developments Limited, chairman of Pacific Century Premium Developments Limited's Executive Committee and chairman of Singapore-based Pacific Century Regional Developments Limited.

Mr. Li is a governor of the World Economic Forum for Information Technologies and Telecommunications and a member of the Center for Strategic and International Studies' International Councillors' Group in Washington, DC.

Mr. Li is also a member of the Global Information Infrastructure Commission and a member of the Panel of Advisors to the United Nations Information and Communication Technologies Task Force.

So Chak Kwong, Jack

Mr. So joined PCCW in 2003 as deputy chairman and group managing director.

After beginning his career with the Hong Kong Government, Mr. So joined the private sector in 1978 and held various posts in securities, banking and property.

Before taking up his post at PCCW, Mr. So was chairman and chief executive of Mass Transit Railway Corporation Limited, an appointment he accepted in 1995.

He served as executive director of the Hong Kong Trade Development Council from 1985 to 1992.

Mr. So is a non-executive director of The Hongkong and Shanghai Banking Corporation Limited and Cathay Pacific Airways Limited. He also sits on a number of other committees and organizations, including The University of Hong Kong Council, the Hong Kong General Chamber of Commerce and the Hong Kong — United States Business Council.

Yuen Tin Fan, Francis

Mr. Yuen joined the Pacific Century Group in 1996 as deputy chairman and is currently a deputy chairman of PCCW. He is also a member of PCCW's Executive Committee, chairman of Pacific Century Insurance Holdings Limited and deputy chairman of Pacific Century Premium Developments Limited. In addition, Mr. Yuen is deputy chairman of Pacific Century Premium Developments Limited's Executive Committee. He is also an executive director and deputy chairman of Pacific Century Regional Developments Limited.

From 1988 to 1991, he was chief executive of The Stock Exchange of Hong Kong Limited. Mr. Yuen was also a founding director of Hong Kong Securities Clearing Company Limited. He served from 1992 to 1994 as a member of the International Markets Advisory Board of NASDAQ in the United States.

He served as managing director of Citicorp Scrimgeour Vickers Hong Kong Limited in October 1986, and was appointed to the firm's main board in London in 1987. Mr. Yuen worked for Wardley, a merchant bank, from 1977 to 1985.

Mr. Yuen is chairman of the Board of Trustees of the Hong Kong Centre for Economic Research, a member of the Shanghai People's Political Consultative Committee and a member of the Board of Trustees of Shanghai's Fudan University.

He received a Bachelor of Arts degree in economics from the University of Chicago and is currently a member of the Board of Trustees of the university.

Arena, Alexander Anthony

Mr. Arena oversees PCCW's Consumer Group and Commercial Group. Mr. Arena is an executive director of PCCW, deputy chairman of PCCW's Executive Committee, group chief financial officer of PCCW, a director of Pacific Century Regional Developments Limited, a director of Pacific Century Insurance Holdings Limited and an executive director and Executive Committee member of Pacific Century Premium Developments Limited. He was appointed a director of SUNDAY effective July 8, 2005. He joined the Pacific Century Group in 1998.

Prior to joining the Pacific Century Group, Mr. Arena was a Special Policy Adviser to the Hong Kong Government from 1997 to 1998. From 1993 to 1997, he was director-general of telecommunications at the Office of the Telecommunications Authority of Hong Kong, as well as a member of the Broadcasting Authority.

Before his appointment as director-general, Mr. Arena was recruited to plan a reform program for the liberalization of Hong Kong's telecommunications sector. Prior to his appointment to the Hong Kong Government, he was an inaugural member of the Australian Telecommunications Authority, where he served for four years.

Mr. Arena has had an extensive career in public administration, specializing in high technology and infrastructure industries. From a practising radio/communications engineer to a public policy maker, his experience spans such diverse areas as the commercialization of government-owned business enterprises and deregulation in the aviation, transport, telecommunications and postal industries.

Mr. Arena graduated from the University of New South Wales, Australia, with a bachelor's degree in electrical engineering. He completed a MBA at Melbourne University, Australia, and is a Fellow of the Hong Kong Institution of Engineers.

Executive Management

Arena, Alexander Anthony

Please see above.

Chan Kee Sun, Tom

Mr. Chan is the President of Consumer Sales & Channel of PCCW, responsible for all PCCW's consumer sales teams, covering telesales, shops, direct sales, partnership sales and consumer roadshows. He joined the HKT Group in September 1988. He was appointed a director of SUNDAY effective July 8, 2005.

Mr. Chan has over 16 years of experience with the HKT Group/the PCCW Group in different managerial and executive roles, covering finance, regulatory, carrier business, marketing and sales. He holds an honors degree in Accountancy and Economics from the University of Cardiff (UK) and he is a Certified Public Accountant and a Fellow of both the Association of Chartered Certified Accountants and the Chartered Institute of Marketing.

Chow Ding Man, Gary

Mr. Chow joined the HKT Group in February 1986 as a sales executive. He worked in various management positions within the HKT Group/the PCCW Group and is currently the Acting Head of Commercial Group of PCCW. He oversees the operation of the Commercial Business and Contact Center Business. He was appointed a director of SUNDAY effective July 8, 2005.

Mr. Chow graduated from the University of Hong Kong with a bachelor's degree in biology. He has 19 years of experience in business operations and management and an in-depth knowledge of the communications business in Hong Kong.

Chung Wai Cheong, Tommy

Mr. Chung is the President of Global Sales & Products of PCCW, responsible for managing PCCW's sales and product development operations around the globe.

Mr. Chung joined the HKT Group in February 1994. Since then, he has held a number of management positions within the HKT Group/the PCCW Group. Prior to joining the HKT Group, Mr. Chung had worked in several technology companies in Europe, Singapore and Hong Kong, leading developments in IT consultancy, sales and marketing, and industry business management.

Mr. Chung is a graduate of the University of Hong Kong with BSc (Engineering), M Phil and MBA Degrees.

Hui Hon Hing, Susanna

Ms. Hui joined the HKT Group in 1999 and is now PCCW's Director of Finance, responsible for the telecommunications services sector and regulatory accounting. She was appointed a director of SUNDAY effective July 8, 2005.

Ms. Hui is a qualified accountant and is a member of both the Hong Kong and the American Institute of Certified Public Accountants. She graduated from the University of Hong Kong with first class honors and held various senior positions with banks and listed companies prior to joining the HKT Group.

Leung Tak Sing, Dominic

Mr. Leung is the Executive Vice President of PCCW's Consumer Marketing & Business Management, responsible for marketing, product development and management of the Consumer IDD, Local Telephone Services and Broadband Services. Recently, he led the launch of PCCW's pay TV service — *now* Broadband TV.

Mr. Leung joined the HKT Group in 1981 and has over 20 years of experience in the IT and telecommunications industry. He graduated from the University of Toronto with a bachelor of arts degree in 1979, and from the University of Windsor, also in Canada, with a bachelor of commerce in 1980.

Share Ownership

The Guarantor is an indirect wholly owned subsidiary of PCCW. As at June 28, 2005, Li Tzar Kai, Richard, the chairman of PCCW, was deemed to be interested in approximately 26.62% of PCCW's issued share capital under the HKSFO. Except for Li Tzar Kai, Richard, none of the directors of the Guarantor or the executive management of PCCW responsible for the operations of the Guarantor holds more than 1% of the shares of PCCW.

RELATED PARTY TRANSACTIONS

The Guarantor engages in certain transactions with affiliates and other related parties. These arrangements are entered into on an arm's-length basis and in accordance with applicable regulations.

PCCW Group and Pacific Century Group

The Guarantor had guaranteed obligations of other PCCW Group companies (excluding subsidiaries of the Guarantor) in the aggregate principal amount of HK$9,313 million as at December 31, 2004. See Note 31 of the Audited Financial Statements.

PCCW extended a subordinated loan facility to the Guarantor in the amount of US$260 million on October 18, 2001 and in the amount of US$450 million on January 29, 2002. The subordinated loans bore interest at the London Interbank Offered Rate (LIBOR) plus 2% and at 1% respectively, and were both repaid on December 19, 2003.

On October 26, 2001, Profit Century Finance Limited, an indirect wholly owned subsidiary of PCCW, completed the placement of Yen 30,000 million 3.65% Guaranteed Notes due 2031 (the Yen Notes). The Yen Notes were unconditionally and irrevocably guaranteed by the Guarantor. The Yen Notes were repurchased and cancelled on June 30, 2005.

On January 29, 2002, PCCW Capital No. 2 Limited, an indirect wholly owned subsidiary of PCCW, issued US$450 million 1% Guaranteed Convertible Bonds due 2007, which are unconditionally and irrevocably guaranteed on a joint and several basis by PCCW and the Guarantor. The convertible bonds due 2007 are convertible, at the option of their holders, up to and including January 15, 2007 into ordinary shares of PCCW at an initial conversion price of HK$13.5836 per share (after adjustments in connection with a share placement in July 2003) and with a fixed exchange rate on conversion of US$1.00 = HK$7.80.

In 2001, the Guarantor advanced US$4,700 million to its parent companies to repay indebtedness incurred in connection with PCCW's acquisition of HKT. The advances were unsecured and bore no fixed term of repayment. The advances were fully repaid in 2004.

During 2004, the Guarantor advanced HK$4,476 million to PCCW for general working capital purposes. The advances have no fixed term of repayment. The advances are non-interest bearing except for HK$2,800 million, which bears interest at the Hong Kong Interbank Offered Rate (HIBOR) plus 0.79% per annum.

On January 24, 2003, PCCW Capital No. 3 Limited, an indirect wholly owned subsidiary of PCCW, issued and sold by way of a private placement US$456 million 7.88% guaranteed notes due 2013 to raise funds for general corporate purposes. The notes were unconditionally and irrevocably guaranteed by PCCW until May 12, 2004. On May 12, 2004, the noteholders approved the novation of the guarantee to the Guarantor and amendments to certain terms of the notes.

During 2002, Cascade, a wholly owned subsidiary of the Guarantor, was formed. Cascade commenced operations on January 1, 2003 and provides technical support and maintenance services to PCCW Group companies, including the Guarantor, and third parties. On March 19, 2004, the Guarantor transferred its 100% interest in Cascade to another subsidiary of PCCW for a consideration of HK$215 million.

On May 10, 2004, the Guarantor entered into a transaction with Talent Master Investments Limited (Talent Master), an indirect wholly owned subsidiary of Pacific Century Premium Developments Limited, in which the Guarantor sold certain property to Talent Master for HK$158 million and leases back a portion of the property for a monthly rental of HK$248,050.

In 2004, PCCW effected a capital reduction, which represented the completion of a necessary technical formality, in order to permit the payment of dividends, as and when PCCW's directors consider it appropriate. In connection with PCCW's capital reduction, the Guarantor entered into a guarantee facility with Standard Chartered Bank (HK) Ltd for the benefit of PCCW. The purpose of this facility is to guarantee payment to certain creditors of PCCW as of the time of the capital reduction. As of the date hereof, no guarantees have been issued under this facility. In connection with the capital reduction, the Guarantor also entered into a subordination deed under which the Guarantor agreed to subordinate amounts owing to it by PCCW, including the HK$4,476 million advances described above, to those of certain creditors of PCCW as of the time of the capital reduction.

On February 27, 2004, the Guarantor gave an unconditional and irrevocable guarantee to HKTPL of all the obligations and liabilities of PCCW-HKT Business Services Limited, a subsidiary of PCCW, for the provision and implementation of certain telecommunication and other systems to HKTPL.

On June 24, 2004, the Guarantor gave IBM China/Hong Kong Limited unconditional and irrevocable guarantees on the due and punctual payment by Unihub Limited and HKT, subsidiaries of PCCW, in connection with the liabilities arising from their purchases of IBM's services and products. As of December 31, 2004, the guaranteed amount was up to HK$379 million. The Guarantor also provided another unconditional and irrevocable guarantee to IBM for the due and punctual performance by Powerbase, a subsidiary of PCCW, for the provision of data center facilities services to IBM.

During 2005, IMS transferred now.com.hk to another subsidiary of PCCW for a consideration of approximately HK$54 million.

The Guarantor also receives services from, and provides services to, other affiliates of the PCCW Group and the Pacific Century Group in the ordinary course of business on an arm's-length basis.

Reach

On October 13, 2000, the Guarantor and Reach Networks (then known as HKTI and an indirect wholly owned subsidiary of PCCW) entered into a Hong Kong Domestic Connectivity Agreement and an International Services Agreement for the provision of domestic and international connectivity services in Hong Kong and between Hong Kong and other countries. The agreements were entered into in connection with the formation of Reach. Reach is a joint venture that resulted from the strategic alliance between PCCW and Telstra. After the formation of Reach, Reach Networks became a subsidiary of Reach.

Pursuant to the original terms of the International Services Agreement, for the first five years of operations subsequent to the formation of Reach in February 2001, the Guarantor was required to acquire 90%, 90%, 80%, 70% and 60% per annum, respectively, of its total annual purchases of "Committed Services" (being international public switched telephone network terminating access, international transmission capacity and Internet gateway access services) from Reach Networks. The Hong Kong Domestic Connectivity Agreement contemplates a reciprocal arrangement, whereby the Guarantor will provide local connectivity services to Reach Networks under similar terms and conditions. With effect from April 25, 2003, the International Services Agreement was amended to provide that the Guarantor had to acquire 90% per annum of its total annual purchases of Committed Services from Reach Networks at rates benchmarked at least annually to prevailing market prices until repayment of the debt under the amended syndicated term loan facility of Reach (Reach Term Facility) on December 31, 2010 or earlier. Reach Networks similarly had to acquire 90% per annum of its local connectivity services from the Guarantor under the amended Hong Kong Domestic Connectivity Agreement, similarly extended for the same period.

On April 15, 2003, PCCW, the Guarantor and Telstra entered into a capacity prepayment agreement with Reach and certain of its subsidiaries whereby PCCW and Telstra agreed to pre-purchase services, including "Committed Services", in accordance with the terms of existing connectivity agreements with Reach Networks, and to each make a payment of US$143 million (approximately HK$1,115 million) (in aggregate US$286 million (approximately HK$2,231 million)) for the pre-purchase of capacity to be used in the future. The payments (which will be compounded to reflect the time value of money) were to be applied against the cost of the services and capacity supplied to Telstra and PCCW by Reach and its subsidiaries (the Reach Group) as and when the Reach Group has available surplus cash in accordance with a prescribed formula.

On June 17, 2004, PCCW and Telstra agreed to purchase from the syndicate of banks the entire outstanding portion of US$1,200 million of the debt under the Reach Term Facility for approximately US$310.9 million (approximately HK$2,425 million). PCCW and Telstra paid equal proportions of approximately US$155.45 million (approximately HK$1,213 million) to purchase this debt on June 18, 2004. This loan receivable from Reach Networks is secured and will be repayable in a single payment on December 31, 2010. Interest on the purchased debt was suspended for six months from June 18, 2004 and agreed to be at LIBOR plus 250 basis points following such period. The capacity prepayment agreement was amended and restated in connection with this purchase of Reach's debt.

On April 16, 2005, PCCW agreed with Telstra and Reach on a new operating model under which Reach would operate as an outsourcer of telecommunications network services for the PCCW Group and the Telstra Group.

To implement this new operating model, a capacity allocation agreement (the Capacity Allocation Agreement) was entered into by PCCW, PCCW Communications (Singapore) Pte Ltd (PCCW Communications), an indirect wholly owned subsidiary of PCCW, Telstra and Reach Global Networks Limited (Reach Global), a wholly owned subsidiary of Reach. Pursuant to the Capacity Allocation Agreement, PCCW Communications and Telstra each agreed to acquire indefeasible rights to use the Reach Group's international undersea cable capacity. Each of PCCW Communications and Telstra paid Reach Global US$157 million for such capacity, which in PCCW's case, was settled by way of set-off against the equivalent amount outstanding under the shareholder loan made by PCCW to Reach, and not by way of new cash injections.

PCCW Communications and Telstra also agreed to each assume one half of Reach's committed future expenditure in order to support growth in their own retail services. PCCW Communications' share of this expenditure over the 17-year period from March 2005 to 2022 is expected to be approximately US$106 million. PCCW Communications and Telstra will only assume any additional future capital expenditure if such expenditure is approved by both PCCW Communications and Telstra. The obligations of PCCW Communications under the Capacity Allocation Agreement are guaranteed by PCCW.

Certain members of the PCCW Group (including the Guarantor), the Telstra Group and the Reach Group also entered into a debt and asset restructure deed (the Reach Debt and Asset Restructure Deed) whereby the consideration of US$157 million payable by each of PCCW Communications and Telstra under the Capacity Allocation Agreement was set-off against, in PCCW's case, the equivalent amount outstanding under the shareholder loan by PCCW. In addition, interest of US$6 million due by Reach to PCCW was waived, and US$445 million of the remaining balance of the shareholder loan by PCCW was capitalized by way of the issue of shares in Reach to Pacific Century Cable Holdings Limited (PCCHL), a wholly owned subsidiary of PCCW and holder of PCCW's interest in Reach since Reach's formation. After the issue of Reach shares, PCCHL continues to hold 50% of the issued share capital of Reach. Following the set-off and capitalization referred to above, Reach's aggregate indebtedness to PCCW was reduced to US$155 million. The PCCW Group and Telstra jointly have charges over Reach's assets in relation to this outstanding amount and Telstra's outstanding amount.

Further, pursuant to a network services agreement (the Reach Network Services Agreement) Reach will provide to the PCCW Group (including the Guarantor) and the Telstra Group certain outsourcing services in relation to the international undersea cable capacity allocated by way of the grant of indefeasible rights to use as described above.

Reach has ceased to pursue sales of data services to third parties, and data services will be sold to third parties directly by the PCCW Group and the Telstra Group. Reach will continue to provide voice and satellite services to the PCCW Group and the Telstra Group, as well as to third parties.

All definitive agreements relating to the arrangements for the new operating model for Reach described above were entered into on April 16, 2005, but the effective date of such arrangements was March 1, 2005.

As part of the arrangements relating to the establishment of the new operating model for Reach, the International Services Agreement was terminated pursuant to the provisions of the Reach Network Services Agreement, and the PCCW Group's obligations under the Capacity Prepayment Agreement have been satisfied under the Reach Debt and Asset Restructure Deed. The Guarantor will continue to provide local connectivity services to Reach Networks.

Hutchison

Li Tzar Kai, Richard, a director of the Guarantor and PCCW, is the son of Li Ka-shing, who is the chairman and an executive director of Hutchison Whampoa Limited (HWL) and its associated company, Cheung Kong (Holdings) Limited (together with their subsidiaries and affiliates, the Hutchison Whampoa Group). Li Tzar Kai, Richard has a personal interest in 110,000 shares in the Hutchison Whampoa Group (representing less than 0.01% of the outstanding shares of HWL) and he is also one of the discretionary beneficiaries of certain discretionary trusts which hold units in unit trusts which in turn are interested in certain shares of HWL. Since April 1, 2003 Li Tzar Kai, Richard has held one-third of the issued share capitals of two companies, which own all the shares in the trustee companies which act as trustees of such discretionary trusts and unit trusts. These trustee companies perform their functions as trustees independently without any reference to Li Tzar Kai, Richard. Notwithstanding the above, and in view of his small personal shareholding, his being a discretionary beneficiary and that the trustee companies act independently of him, the Guarantor considers that Li Tzar Kai, Richard is not able to exert control or influence over the Hutchison Whampoa Group.

Additionally, the Hutchison Whampoa Group held 36,726,857, or approximately 0.5%, of the ordinary shares of PCCW as at June 28, 2005. In addition, a wholly owned subsidiary of Cheung Kong (Holdings) Limited and a private company controlled by Li Ka-shing held respectively 19,854,000 shares of SUNDAY (representing approximately 0.66% of the existing issued share capital of SUNDAY) and 5,127,000 shares of SUNDAY (representing approximately 0.17% of the existing issued share capital of SUNDAY).

Li Tzar Kai, Richard was a director of HWL and certain of its subsidiaries until August 16, 2000, the day before the acquisition of HKT became effective. His resignation was effected in order to avoid the potential for conflicts of interest between HKT's and Hutchison Whampoa Group's competing businesses in Hong Kong.

Certain businesses of the Hutchison Whampoa Group compete with certain aspects of the Guarantor's telecommunications businesses. In particular, the Guarantor and Reach each compete with, and interconnect their networks with, certain HWL subsidiaries, including Hutchison Global Communications Limited and Hutchison Telephone Company Limited, which are fixed network and mobile communications operators, respectively, in Hong Kong. Such interconnection arrangements are established in the ordinary course of the Guarantor's businesses, on the basis of arm's length commercial agreements and in accordance with applicable telecommunications regulations in Hong Kong, as determined by the TA. The Guarantor is required under the terms of its FC license to interconnect its network with other licensees on a non-discriminatory basis.

PCCW established a Regulatory Compliance Committee in consultation with the TA and the Broadcasting Authority comprising executive and non-executive directors, but excluding Li Tzar Kai, Richard, to review and monitor dealings with the Hutchison Whampoa Group to ensure that all dealings between PCCW and the Hutchison Whampoa Group are on arm's-length terms.

In light of the foregoing, the Guarantor does not consider Li Ka-shing and the companies he controls, including the Hutchison Whampoa Group, to be related parties of the Guarantor, and any transactions with the Hutchison Whampoa Group are not being reported as related party transactions.

PCCW OVERVIEW

The following information concerning PCCW is provided purely as background information. Payments of principal, interest and other amounts on the Notes are not guaranteed by PCCW or any of its subsidiaries other than the Guarantor.

Overview

PCCW is one of Asia's leading integrated communications companies and Hong Kong's largest provider of telecommunications services. It is involved in selected real estate ventures in Hong Kong and the PRC through its majority owned subsidiary, Pacific Century Premium Developments Limited. Its shares are listed on The Stock Exchange of Hong Kong Limited (the SEHK) under the symbol 0008, and its American Depositary Shares (ADSs) are listed on the New York Stock Exchange, Inc. (the NYSE) under the symbol PCW.

Founded as Ring Holdings Limited in 1979 and subsequently changed its name to Tricom Holdings Limited, the company changed its name to Pacific Century CyberWorks Limited at the time that Pacific Century Group, a group of companies controlled by Li Tzar Kai, Richard, or over which Mr. Li Tzar Kai, Richard has significant influence, acquired a substantial interest.

In August 2000, PCCW acquired HKT, previously known as Hong Kong Telecommunications Limited, Hong Kong's leading provider of telecommunications services. At the time of HKT's acquisition, HKT's communications-based businesses consisted of local and international voice and data communications services, mobile services and Internet and e-commerce services. HKT's ordinary shares were listed on the SEHK and in the form of ADSs on the NYSE. HKT is now an indirect wholly owned subsidiary of PCCW. The Guarantor forms the most significant part of PCCW's telecommunications services business. On August 9, 2002, Pacific Century CyberWorks Limited changed its name to PCCW Limited in order to align the legal name with its logo and brand. The Chinese name remains unchanged.

PCCW's other telecommunications services business also includes customer premises equipment sales and services, managed international network solutions, and most call center services provided to third parties that are carried out by other subsidiaries of PCCW and are not accounted for in the Guarantor's results.

PCCW's operations are currently conducted under the following business segments:

- **Telecommunications Services** is principally comprised of the Guarantor's telecommunications services business, including retail broadband and narrowband Internet access and related multimedia services, which became a part of telecommunications services during 2002. PCCW also has businesses providing network and other value-added services including *now* Broadband TV, call center services, customer premises equipment sales and managed international network solutions.

- **Business eSolutions** provides systems and Internet infrastructure services to support enterprise customer requirements across Asia. Its service scope includes business consulting, systems integration, web design, applications development, on-line security and payment platforms, retail business broadband access, business Internet portals, on-line marketplaces, and logistics and fulfillment services. The segment also includes IT businesses provided by Unihub China Information Technology Company Limited, PCCW Group's subsidiary co-owned with China Telecommunications Corporation. PCCW also operates PCCW Directories Limited, a telephone directory advertising business in Hong Kong and one of the market leaders in directory publications in Asia.

- **Infrastructure** holds PCCW's investment property development and management businesses based in Hong Kong and the PRC, including its interest in the technology-promoting Cyberport project in Hong Kong. PCCW principally holds its infrastructure investments through Pacific Century Premium Developments Limited, a company listed on the SEHK in which PCCW had a 61.66% interest as at June 28, 2005.

- **Mobile Telecommunications Services** is comprised of SUNDAY. On June 22, 2005, PCCW Mobile Holding No. 2 Limited (PCCW Mobile No. 2), an indirect wholly owned subsidiary of PCCW, completed its acquisition of a 59.87% interest in SUNDAY. SUNDAY is a developer and provider of wireless communications and data services in Hong Kong, and a 3G license holder. SUNDAY's ordinary shares are listed on the SEHK, and its American depositary shares are listed on the NASDAQ National Market. On July 8, 2005, Citigroup Global Markets Asia Limited for and on behalf of PCCW Mobile No. 2 commenced a mandatory unconditional cash offer to acquire all the issued shares in the capital of SUNDAY other than those already owned by PCCW Mobile No. 2. Unless the offer is revised or extended, it will close on July 29, 2005.

- **Others** include PCCW's overseas and other investments.

On April 1, 2005, China Netcom Corporation (BVI) Limited, an indirect wholly owned subsidiary of CNC, subscribed for 1,343,571,766 new ordinary shares of PCCW, representing approximately 20% of PCCW's enlarged issued share capital. The proceeds of the subscription were approximately HK$7,927 million (before deduction of expenses). Under the terms of the subscription agreement (the CNC Subscription Agreement), CNC has been granted certain rights, including the right to nominate three directors of PCCW and anti-dilution rights.

Major Shareholders

The following table below sets forth information with respect to persons who were beneficial owners of more than 5% of PCCW's outstanding ordinary shares as at June 28, 2005 based on Rule 13d-3 of the Exchange Act, to the extent that such information has been made available to the Guarantor by PCCW or can be ascertained from public filings.

Name of shareholder	Notes	Number of shares	%
OS Holdings Limited	1	1,549,938,605	23.07
The Starlite Unit Trust	1	1,549,938,605	23.07
The Ocean Unit Trust	1	1,549,938,605	23.07
Ocean Star Management Limited	1	1,549,938,605	23.07
Ocean Star Investment Management Limited	1	1,549,938,605	23.07
Pacific Century Group Holdings Limited	1	1,549,938,605	23.07
Pacific Century Regional Developments Limited	2	1,528,781,171	22.76
Pacific Century International Limited	3	1,528,781,171	22.76
Pacific Century Group (Cayman Islands) Limited	4	1,528,781,171	22.76
Anglang Investments Limited	5	1,528,781,171	22.76
CNC	6	1,343,571,766	20.00

(1) Pacific Century Group Holdings Limited (PCGH) directly owns 20,354,286 shares. PCGH may be deemed to beneficially own the 1,526,773,301 shares directly owned by Pacific Century Regional Developments Limited (PCRD), the 803,148 shares that the PCCW Capital Limited's 3.5% guaranteed convertible bonds due 2005 held by PCGH are convertible into and the 2,007,870 shares that Pacific Century Insurance Company Limited (PCI) may be deemed to beneficially own due to PCGH's indirect interest in PCI. As a result, PCGH may be deemed to beneficially own a total of 1,549,938,605 shares.

On April 18, 2004, Li Tzar Kai, Richard transferred all of the issued share capital of PCGH to Ocean Star Management Limited as trustee of The Ocean Unit Trust and The Starlite Unit Trust. All of Ocean Star Management Limited's issued share capital is held by OS Holdings Limited.

(2) PCRD directly owns 1,526,094,301 shares and 679,000 shares in the form of 67,900 ADSs. PCRD may be deemed to beneficially own the 2,007,870 shares that PCI may be deemed to beneficially own due to PCRD's indirect interest in PCI. As a result, PCRD may be deemed to beneficially own a total of 1,528,781,171 shares.

(3) Pacific Century International Limited (PCIL) does not directly own any shares. PCIL may be deemed to beneficially own the 1,526,773,301 shares directly owned by PCRD and the 2,007,870 shares that PCI may be deemed to beneficially own due to PCIL's indirect interest in PCRD and PCI. As a result, PCIL may be deemed to beneficially own a total of 1,528,781,171 shares.

(4) Pacific Century Group (Cayman Islands) Limited (PCGCI) does not directly own any shares. PCGCI may be deemed to beneficially own the 1,526,773,301 shares directly owned by PCRD and the 2,007,870 shares that PCI may be deemed to beneficially own due to PCGCI's interest in PCRD and PCGCI's indirect interest in PCI. As a result, PCGCI may be deemed to beneficially own a total of 1,528,781,171 shares.

(5) Anglang Investments Limited (Anglang) does not directly own any shares. Anglang may be deemed to beneficially own the 1,526,773,301 shares directly owned by PCRD and the 2,007,870 shares that PCI may be deemed to beneficially own due to Anglang's interest in PCRD and Anglang's indirect interest in PCI. As a result, Anglang may be deemed to beneficially own a total of 1,528,781,171 shares.

(6) CNC indirectly holds these shares through its indirect wholly owned subsidiary, China Netcom Corporation (BVI) Limited. These shares were acquired pursuant to the CNC Subscription Agreement. CNC is a state-owned enterprise established under the laws of the PRC.

Save as disclosed above, the Guarantor is not aware of any other beneficial owners of more than 5% of PCCW's outstanding ordinary shares. PCCW's major shareholders have voting rights that are identical to all the other shareholders.

DESCRIPTION OF THE NOTES AND GUARANTEE

The Notes will be issued pursuant to an Indenture (the Indenture) to be dated as at July 20, 2005 among the Issuer, the Guarantor and HSBC Bank USA, National Association as trustee (the Trustee). A copy of the Indenture will be available for inspection at the registered office of the Trustee. The following summaries of certain provisions of the Notes and the Indenture do not purport to be complete and are subject to, and are qualified in their entirety by reference to, the detailed provisions of the Notes and the Indenture. Capitalized terms used in this section and not otherwise defined shall have the meanings given to such terms in the Notes and the Indenture.

General

The Notes will be the direct, unconditional, unsubordinated and unsecured obligations of the Issuer, and rank *pari passu* in right of payment with all other unsecured and unsubordinated obligations of the Issuer (other than obligations preferred by applicable law) and senior in priority of payment and in all other respects to all other Indebtedness of the Issuer that is designated as subordinate or junior in right of payment to the Notes. The Notes will be issued in registered form.

The Notes will be issued in an initial aggregate principal amount of US$500,000,000 and will mature on July 20, 2015 unless earlier redeemed pursuant to the terms thereof and of the Indenture. The Notes will bear interest at the rate of 5.25% per annum. The Notes will bear interest from July 20, 2005 or from the most recent Interest Payment Date (as defined below) to which interest has been paid or provided for payable semi-annually on January 20 and July 20 in each year (each, an Interest Payment Date), commencing on January 20, 2006 to the persons in whose names the Notes are registered at the close of business on the preceding January 6 and July 6, respectively (each an Interest Record Date). At maturity, the Notes are payable at 100% of the principal amount thereof plus accrued interest thereon. In any case where the payment of principal of or interest on the Notes is due on a date that is not a Business Day, then payment of principal of or interest on the Notes shall be made on the next succeeding Business Day and no interest shall accrue with respect to such payment for the period from and after such date that is not a Business Day to such next succeeding Business Day. Interest shall be calculated on the basis of a 360-day year consisting of twelve 30-day months. The Notes will not be entitled to the benefit of any sinking fund. The Notes shall be denominated in minimum principal amounts of US$100,000 and in integral multiples of US$1,000 above that amount.

The Notes are unconditionally guaranteed as to the payment of the principal and interest in respect thereof and all other amounts payable under the Notes by the Issuer as evidenced by the guarantee set forth in the Indenture and noted on the Notes (the Guarantee). The Guarantee is a direct, unconditional, unsubordinated and unsecured obligation of the Guarantor and will rank *pari passu* in right of payment with all other unsecured and unsubordinated obligations of the Guarantor (other than obligations preferred by applicable law) and senior in priority of payment and in all other respects to all other Indebtedness of the Guarantor that is designated as subordinate or junior in right of payment to the Guarantee.

The principal of, interest on, and all other amounts payable under the Notes will be payable, and the Notes may be exchanged or transferred, at the office or agency of the Issuer in the Borough of Manhattan, The City of New York (which initially will be the corporate trust office of the Trustee at 452 Fifth Avenue, New York, New York 10018). The principal of and interest on the Notes will be payable in U.S. dollars (or in such other coin or currency of the United States of America as at the time of payment is legal tender for the payment of public and private debts) in immediately available funds. Payments of interest and principal with respect to interests in the global notes will be credited to the respective accounts of the holders of such interests with DTC, Euroclear or Clearstream, as the case may be. See "— Notes; Delivery and Form."

Guarantee

Under the Indenture, the Guarantor will irrevocably and unconditionally guarantee the due and punctual payment of the principal of and interest on, and all other amounts payable under (including any Additional Amounts payable in respect thereof), the Notes when and as the same shall become due and payable, whether on the Stated Maturity (as defined below), upon acceleration, by call for redemption or otherwise. The Guarantor has (i) agreed that its obligations under the Guarantee will be as if it were principal obligor and not merely surety, and will be enforceable irrespective of any invalidity, irregularity or unenforceability of the Notes or the Indenture and (ii) waived its right to require the Trustee to pursue or exhaust its legal or equitable remedies against the Issuer prior to exercising its rights under the Guarantee. The Guarantee will not be discharged with respect to any Note except by payment in full of the principal thereof, interest thereon and all other amounts payable thereunder (including any Additional Amounts payable in respect thereof). Moreover, if at any time any amount paid under a Note is rescinded or must otherwise be restored, the rights of the holders of the Notes under the Guarantee will be reinstated with respect to such payments as though such payments had not been made.

Further Issues

The Issuer and the Guarantor may, from time to time, without the consent of the holders of the Notes, create and issue further securities having the same terms and conditions as the Notes in all respects (or in all respects except for issue date, issue price, and the first payment of interest on them and, to the extent necessary, certain temporary securities law transfer restrictions) (a Further Issue). Additional Notes issued in this manner will be consolidated with the previously outstanding Notes.

The Issuer and the Guarantor may offer additional debt securities with original issue discount (OID) for U.S. federal income tax purposes as part of a Further Issue. Purchasers of debt securities after the date of any Further Issue will not be able to differentiate between debt securities sold as part of the Further Issue and previously issued Notes. If the Issuer were to issue further debt securities with OID, purchasers of debt securities after such a Further Issue may be required to accrue OID (or greater amounts of OID than they would otherwise have accrued) with respect to their Notes. This may affect the price of outstanding Notes following a Further Issue. Purchasers are advised to consult their own tax advisors with respect to the implications of any future decision by the Issuer to undertake a Further Issue of debt securities with OID.

Payment of Additional Amounts

All payments of principal and interest made by the Issuer in respect of the Notes and made by the Guarantor in respect of the Intercompany Loan, and all payments pursuant to the Guarantee, shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or within the British Virgin Islands or Hong Kong or any authority therein or thereof having power to tax (Taxes), unless such withholding or deduction of such Taxes is required by law or by the interpretation or administration thereof. In that event, the Issuer or the Guarantor, as applicable, shall pay such additional amounts (Additional Amounts) as will result in receipt by the holders of the Notes or the Issuer in respect of the Intercompany Loan, as the case may be, of such amounts as would have been payable to such holders or the Issuer, as the case may be, had no such withholding or deduction of such Taxes been required, except that no such Additional Amounts shall be payable:

(a) in respect of any such Taxes that would not have been imposed, deducted or withheld but for the existence of any connection between the holder or beneficial owner of a Note or the Guarantee, as the case may be, and the British Virgin Islands or Hong Kong or any political subdivision or any authority thereof or therein or any territory or possession thereof or area subject to its jurisdiction, as the case may be, otherwise than merely holding such Note or the Guarantee or receiving principal or interest in respect thereof;

(b) in respect of any Note or the Guarantee presented for payment (where presentation is required) more than 30 days after the relevant date, except to the extent that the holder thereof would have been entitled to such Additional Amounts on presenting the same for payment on the last day of such 30-day period. For this purpose, the "relevant date" in relation to any Note or the Guarantee means (i) the due date for payment thereof and (ii) if the full amount payable on such due date has not been received in The City of New York by the Trustee on or prior to such due date, the first date on which such full amount has been so received and notice to that effect has been given to the holders of the Notes;

(c) in respect of any such Taxes withheld or deducted from any payment under or with respect to any Note or the Guarantee: (i) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any Directive implementing the conclusions of the ECOFIN Council meeting of November 26-27, 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive or (ii) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another paying agent in a Member State of the European Union;

(d) in respect of any such Taxes payable otherwise than by deduction or withholding from payments under or with respect to any Note or the Guarantee;

(e) in respect of any such Taxes that would not have been so imposed, deducted or withheld if the holder or beneficial owner of a Note or the Guarantee or the beneficial owner of any payment on such Note or the Guarantee had (i) made a declaration of non-residence or any other claim or filing for exemption to which it is entitled or (ii) complied with any certification, identification, information, documentation or other reporting requirement concerning the nationality, residence, identity or connection with the British Virgin Islands or Hong Kong of such holder or beneficial owner of such Note or the Guarantee (provided that (x) such declaration of non-residence or other claim or filing for exemption or such compliance is required by the applicable law of the British Virgin Islands or Hong Kong as a precondition to exemption from, or reduction in the rate of the imposition, deduction or withholding of, such Taxes and (y) at least 30 days prior to the first payment date with respect to which such declaration of non-residence or other claim or filing for exemption or such compliance is required under the applicable law of the British Virgin Islands or Hong Kong, the holder of such Note or the Guarantee at that time has been notified by the Issuer, the Guarantor or any other person through whom payment may be made that a declaration of non-residence or other claim or filing for exemption or such compliance is required to be made);

(f) in respect of any payment under or with respect to a Note or the Guarantee to any holder that is a fiduciary or partnership or any person other than the sole beneficial owner of such payment, Note or Guarantee, to the extent that a beneficiary or settlor with respect to such fiduciary, a member of such a partnership or the beneficial owner of such payment, Note or Guarantee would not have been entitled to such Additional Amounts had such beneficiary, settlor, member or beneficial owner been the actual holder of such Note or Guarantee;

(g) in respect of any estate, inheritance, gift, sales, excise, transfer or personal property tax or similar tax, assessment or governmental charge; or

(h) any combination of items (a) through (g) above.

Whenever there is mentioned, in any context, the payment of principal or interest in respect of any Note, the Intercompany Loan, or the Guarantee, such mention shall be deemed to include the payment of Additional Amounts provided for in the Indenture or the Intercompany Loan, as the case may be, to the extent that, in such context, Additional Amounts are, were or would be payable in respect thereof pursuant to the Indenture or the Intercompany Loan, as the case may be.

The foregoing provisions shall apply in the same manner with respect to the jurisdiction in which any successor Person to the Issuer or the Guarantor is organized or any authority therein or thereof having the power to tax (a Successor Jurisdiction), substituting such Successor Jurisdiction for the British Virgin Islands or Hong Kong, as the case may be.

Optional Tax Redemption

The Notes are not redeemable prior to maturity; provided that the Notes may be redeemed at any time, at the option of the Issuer, as a whole but not in part, upon notice as described below, at a redemption price equal to 100% of the principal amount thereof, together with accrued and unpaid interest to the date fixed for redemption, if any, if (i) as a result of any change in, or amendment to, the laws (or any regulations or rulings promulgated thereunder) of the British Virgin Islands or Hong Kong, as the case may be, (or, in the case of Additional Amounts payable by a successor Person to the Issuer or the Guarantor, the applicable Successor Jurisdiction) or any political subdivision or taxing authority thereof or therein having power to tax, or any change in or amendment to, any official position regarding the application or interpretation of such laws, regulations or rulings (including a holding by a court of competent jurisdiction), which change, amendment, application or interpretation becomes effective on or after the date of the Indenture (or, in the case of Additional Amounts payable by a successor Person to the Issuer or the Guarantor, the date on which such successor Person to the Issuer or the Guarantor, as the case may be, became such pursuant to the applicable provisions of the Indenture), either (x) the Issuer, the Guarantor or any such successor Person to the Issuer or the Guarantor, as the case may be, is, or would be, obligated to pay Additional Amounts upon the next payment of principal or interest in respect of the Notes or the Guarantee or (y) the Guarantor or any such successor Person to the Guarantor is, or would be, obligated to pay Additional Amounts upon the next payment of principal or interest in respect of the Intercompany Loan and (ii) such obligation cannot be avoided by the Issuer, the Guarantor or any such successor Person to the Issuer or the Guarantor, as the case may be, taking reasonable measures available to it. Prior to the giving of any notice of redemption of the Notes pursuant to the foregoing, the Issuer or any such successor Person to the Issuer shall deliver to the Trustee a notice of such redemption election, an opinion of independent legal counsel of recognized standing to the Issuer, the Guarantor or any such successor Person to the Issuer or the Guarantor, as the case may be, to the effect that the Issuer, the Guarantor or any such successor Person to the Issuer or the Guarantor, as the case may be, is, or would become, obligated to pay such Additional Amounts as described in clause (i) as the result of such change or amendment, and an Officers' Certificate (as defined in the Indenture) of the Issuer, the Guarantor or any such successor Person to the Issuer or the Guarantor, as the case may be, stating that such amendment or change has occurred, describing the facts leading thereto and stating that such requirement cannot be avoided by the Issuer, the Guarantor or any such successor Person to the Issuer or the Guarantor, as the case may be, taking reasonable measures available to it.

Notice of redemption of the Notes as provided above shall be given not less than 30 nor more than 60 days prior to the date fixed for redemption; *provided* that no such notice of redemption shall be given earlier than 60 days prior to the earliest date on which the Issuer, the Guarantor or any such successor Person to the Issuer or the Guarantor, as the case may be, would be required to pay Additional Amounts if a payment in respect of the Notes or in respect of the Intercompany Loan, as the case may be, was then due. Notice having been given, the Notes shall become due and payable on the date fixed for redemption and will be paid at the redemption price, together with accrued and unpaid interest to the date fixed for redemption, at the place or places of payment and in the manner specified in the Notes. From and after the redemption date, if moneys for the redemption of the Notes shall have been made available as provided in the Indenture for redemption on the redemption date, the Notes shall cease to bear interest, and the only right of the holders of the Notes shall be to receive payment of the redemption price and interest accrued to the date of redemption.

Repurchase

The Issuer, the Guarantor and any of the Guarantor's Subsidiaries may, in accordance with all applicable laws and regulations, at any time purchase the Notes in the open market or otherwise at any price. If purchases are made by tender, such tender must be made available to all holders of the Notes alike. Any Notes the Issuer, the Guarantor or any of the Guarantor's Subsidiaries repurchases may be held, cancelled or sold.

Modification and Waiver

The Indenture contains provisions permitting the Issuer, the Guarantor and the Trustee, without the consent of the holders of Notes, to execute supplemental indentures for certain enumerated purposes and, with the consent of the holders of not less than a majority in aggregate principal amount of the Notes then outstanding under the Indenture, to change or modify in any manner the rights of the holders of the Notes, provided that no such modification or amendment may, without the consent of each holder of Notes affected thereby, among other things:

(i) change the Stated Maturity of the Notes;

(ii) reduce the principal amount of or payments of interest on any Notes;

(iii) change any obligation of the Issuer or the Guarantor to pay Additional Amounts with respect to Notes;

(iv) change the currency or place of payment of the principal of or interest on the Notes;

(v) impair the right to institute suit for the enforcement of any payment due on or with respect to the Notes;

(vi) reduce the above stated percentage of outstanding Notes necessary to modify or amend the Indenture;

(vii) reduce the percentage of the aggregate principal amount of outstanding Notes necessary for waiver of compliance with certain provisions of the Indenture or for waiver of certain defaults;

(viii) change, in any manner adverse to the interest of holders of the Notes, the terms and provisions of the Guarantee in respect of the due and punctual payment of principal of and interest on the Notes; or

(ix) modify such provisions with respect to modification and waiver.

The holders of not less than a majority in principal amount of the Notes then outstanding may, on behalf of holders of all the Notes, waive compliance by the Issuer or the Guarantor with certain restrictive provisions of the Indenture with respect to the Notes. The holders of not less than a majority in principal amount of the Notes may on behalf of all holders of Notes waive any existing or past default or event of default and its consequences under the Indenture with respect to the Notes, except a continuing default or event of default in the payment of principal of, or interest on (or Additional Amount payable in respect of), the Notes then outstanding or in respect of a covenant or provision which under the Indenture cannot be modified or amended without the consent of the holder of each Note then outstanding affected thereby. Any such waivers will be conclusive and binding on all holders of the Notes, whether or not they have given consent to such waivers, and on all future holders of the Notes, whether or not notation of such waivers is made upon the Notes. Any instrument given by or on behalf of any holder of a Note in connection with any consent to any such waiver will be irrevocable once given and will be conclusive and binding on all subsequent holders of such Note.

Substitution

The Indenture contains provisions permitting the Trustee to agree, subject to such amendment of the Indenture and such other conditions as the Trustee may require, but without consent of the holders of the Notes (if the Trustee is satisfied that to do so would not be materially prejudicial to the interests of the holders of the Notes, as evidenced by the delivery of an opinion of counsel to the Trustee to that effect), to the substitution of certain other entities in place of the Issuer, or of any previous substituted company, as principal debtor under the Indenture and the Notes. Any substitution will be subject to the condition that such substituting entity deliver to the Trustee an opinion of U.S. tax counsel of recognized standing to the effect that the beneficial owners of the Notes will not recognize income, gain or loss for U.S. federal income tax purposes as a result of the substitution and will be subject to U.S. federal income tax on the same amounts and in the same manner and at the same times as would be the case as if the substitution had not occurred.

Limitation on Liens

The Guarantor will not, and will not permit any of its Principal Subsidiaries (other than Listed Principal Subsidiaries) to create, incur, assume or permit to exist any Lien upon any of its property or assets, now owned or hereafter acquired, to secure any Indebtedness of the Guarantor or such Principal Subsidiary (or any guarantee or indemnity in respect thereof) without, in any such case, making effective provision whereby the Guarantee will be secured either at least equally and ratably with such Indebtedness or by such other Lien as shall have been approved by the holders of not less than a majority in aggregate principal amount of the Notes at the time outstanding as provided in the Indenture, for so long as such Indebtedness will be so secured, unless, after giving effect thereto, the aggregate outstanding principal amount of all such secured Indebtedness (excluding that of Listed Principal Subsidiaries and their respective Subsidiaries) entered into after the date of the Indenture would not exceed 50% of the Guarantor's Adjusted Consolidated Net Worth.

The foregoing restriction will not apply to:

(i) Liens existing on or prior to the date of the Indenture;

(ii) Liens for taxes or assessments or other applicable governmental charges or levies;

(iii) Liens created or arising by operation of law or created in the ordinary course of business, including, but not limited to, landlords' liens and statutory liens of carriers, warehousemen, mechanics, materialmen, vendors and other liens securing amounts which are not more than 60 days overdue or which are being contested in good faith;

(iv) Liens incurred or deposits made in the ordinary course of business in connection with workers' compensation, unemployment insurance and other types of social security or to secure the performance of tenders, statutory obligations, surety and appeal bonds, bids, leases, government contracts or undertakings, performance and return of money bonds, interconnection, access or resale agreements with other telecommunications companies or organizations, and similar obligations;

(v) easements, rights-of-way, zoning and similar restrictions and other similar charges or encumbrances not interfering with the ordinary conduct of the business of the Guarantor and such Principal Subsidiaries;

(vi) Liens created on any property or assets acquired, leased or developed (including improved, constructed, altered or repaired) after the date of the Indenture; *provided, however*, that (i) any such Lien shall be confined to the property or assets acquired, leased or developed (including improved, constructed, altered or repaired); (ii) the principal amount of the debt encumbered by such Lien shall not exceed the cost of the acquisition or development of such property or assets or any improvements thereto (including any construction, repair or alteration) or thereon and (iii) any such Lien shall be created concurrently with or within three years following the acquisition, lease or development (including construction, improvement, repair or alteration) of such property or assets;

(vii) rights of set off of a financial institution with respect to deposits or other accounts of the Guarantor or such Principal Subsidiary held by such financial institution in an amount not to exceed the aggregate amount owed to such financial institution by the Guarantor or such Principal Subsidiary, as the case may be;

(viii) Liens on documents and the goods they represent in connection with letters of credit, trade finance and similar transactions entered into in the ordinary course of business;

(ix) Liens arising in connection with industrial revenue, development or similar bonds or other indebtedness or means of project financing (not to exceed the value of the project financed and limited to the project financed);

(x) Liens in favor of the Guarantor or any Principal Subsidiary;

(xi) leases, subleases, licenses and sublicenses granted to third parties in the ordinary course of business;

(xii) attachment, judgment and other similar Liens arising in connection with court proceedings which are effectively stayed while the underlying claims are being contested in good faith by appropriate proceedings;

(xiii) any Lien against any property or assets of a Person existing at the time such Person becomes a Principal Subsidiary or arising after such acquisition pursuant to contractual commitments entered into prior to and not in contemplation of such acquisition;

(xiv) any Lien existing on any property or assets prior to the acquisition thereof, which Lien was not created in connection with the acquisition thereof, except for Liens permitted pursuant to clause (vi) above;

(xv) Liens on any property or assets of the Guarantor or any such Principal Subsidiary in favor of any government or any subdivision thereof, securing the obligations of the Guarantor or such Principal Subsidiary under any contract or payment owed to such governmental entity pursuant to applicable laws, rules, regulations or statutes;

(xvi) Liens created in connection with any sale and leaseback transaction;

(xvii) any renewal or extension of any of the Liens described in the foregoing clauses which is limited to the original property or assets covered thereby; or

(xviii) Liens in respect of Indebtedness with respect to which the Guarantor or any Principal Subsidiary has paid money or deposited money or securities with a fiscal agent, trustee or depository to pay or discharge in full the obligations of the Guarantor and its Subsidiaries in respect thereof (other than the obligations that such money or securities so paid or deposited, and the proceeds therefrom, be sufficient to pay or discharge such obligations in full).

Consolidation, Merger and Sale of Assets

The Indenture provides that neither the Guarantor nor the Issuer may consolidate with or merge into any other Person in a transaction in which the Guarantor or the Issuer, as the case may be, is not the surviving entity, or convey, transfer or lease its properties and assets substantially as an entirety to, any Person unless:

(i) any Person formed by such consolidation or into which the Guarantor or the Issuer, as the case may be, is merged or to whom the Guarantor or the Issuer, as the case may be, has conveyed, transferred or leased its properties and assets substantially as an entirety is a corporation, partnership, trust or other entity validly existing under the laws of the jurisdiction of its organization and such Person expressly assumes by an indenture supplemental to the Indenture all the obligations of the Issuer or the Guarantor under the Indenture, the Notes or the Guarantee, as the case may be;

(ii) immediately after giving effect to the transaction, no Event of Default, and no event which, after notice or lapse of time or both, would become an Event of Default, shall have occurred and be continuing; and

(iii) if, as a result of the transaction, property of the Guarantor or any of its Subsidiaries would become subject to a Lien that would not be permitted under "— Limitation on Liens" above, the Guarantor, the Issuer or such successor Person takes such steps as shall be necessary to secure the Notes and the Guarantee at least equally and ratably with the Indebtedness secured by such Lien or by such other Lien as shall have been approved by holders of the Notes pursuant to the Indenture.

An assumption of the Issuer's obligations under the Notes by any Person might be deemed for U.S. federal income tax purposes to be an exchange of the Notes for new Notes by the beneficial owners thereof, resulting in the recognition of gain or loss for such purposes and possibly certain other adverse tax consequences. Investors should consult their own tax advisors regarding the tax consequences of such an assumption.

Limitations on Issuer's Activities

For so long as the Notes are outstanding, the Issuer will conduct no business or any other activities other than the offering, sale or issuance of indebtedness and the lending of the proceeds thereof to the Guarantor and any other activities in connection therewith. Upon any merger of the Issuer into the Guarantor or of the Guarantor into the Issuer, this covenant will no longer apply.

Events of Default

Each of the following shall constitute an Event of Default under the Indenture with respect to the Notes:

(i) failure to pay principal of any Note within five Business Days after the due date for such payment;

(ii) failure to pay interest on any Note within 30 days after the due date for such payment;

(iii) failure to perform any other covenant or agreement of the Guarantor or the Issuer in the Indenture, and such failure continues for 60 days after there has been given, by registered or certified mail, to the Guarantor or the Issuer, as the case may be, by the Trustee or by the holders of at least 25% in aggregate principal amount of the Notes then outstanding (with a copy to the Trustee) a written notice specifying such failure and requiring it to be remedied and stating that such notice is a "Notice of Default" under the Indenture;

(iv) the Guarantee shall cease to be in full force or effect or the Guarantor shall deny or disaffirm its obligations under the Guarantee;

(v) (a) failure to pay upon final maturity (after giving effect to the expiration of any applicable grace period therefor) the principal of any Indebtedness of the Issuer, the Guarantor or any Principal Subsidiary, (b) acceleration of the maturity of any Indebtedness of the Issuer, the Guarantor or any Principal Subsidiary following a default by the Issuer, the Guarantor or such Principal Subsidiary, if such Indebtedness is not discharged, or such acceleration is not annulled, within 10 days after receipt of the written notice as provided in the Indenture, or (c) failure to pay any amount payable by the Issuer, the Guarantor or any Principal Subsidiary under any guarantee or indemnity in respect of any Indebtedness of any other Person if such obligation is not discharged or otherwise satisfied within 10 days after receipt of written notice as provided in the Indenture; *provided, however*, that no such event set forth in clause (a), (b) or (c) shall constitute an Event of Default unless the aggregate outstanding Indebtedness to which all such events relate exceeds US$30,000,000 (or its equivalent in any other currency); and

(vi) certain events in bankruptcy, insolvency or reorganization in respect of the Issuer, the Guarantor or any Principal Subsidiary as provided in the Indenture.

If an Event of Default (other than an Event of Default described in clause (vi) above) with respect to the Notes shall occur and be continuing, either the Trustee or the holders of at least 25% in aggregate principal amount of the Notes then outstanding by written notice as provided in the Indenture may declare the unpaid principal amount of the Notes and any accrued and unpaid interest thereon (and any Additional Amount payable in respect thereof) to be due and payable immediately upon receipt of such notice. If an Event of Default in clause (vi) above shall occur, the unpaid principal amount of all the Notes then outstanding and any accrued and unpaid interest thereon will automatically, and without any declaration or other action by the Trustee or any holder of Notes, become immediately due and payable. After a declaration of acceleration but before a judgment or decree for payment of the money due has been obtained by the Trustee, the holders of at least a majority in aggregate principal amount of the Notes then outstanding may, under certain circumstances, rescind and annul such acceleration if all Events of Default, other than the nonpayment of accelerated principal, have been cured or waived as provided in the Indenture. For information as to waiver of defaults, see "— Modification and Waiver."

Subject to the provisions of the Indenture relating to the duties of the Trustee in case an Event of Default shall occur and be continuing, the Trustee will be under no obligation to exercise any of the trusts or powers vested in it by the Indenture at the request, order or direction of any of the holders of Notes, unless such holders shall have offered to the Trustee security or indemnity reasonably satisfactory to it against the costs, expenses and liabilities which may be incurred therein or thereby. Subject to certain provisions, including those requiring security or indemnification of the Trustee, the holders of a majority in aggregate principal amount of the Notes then outstanding will have the right to direct the time, method and place of conducting any proceeding for any remedy available to the Trustee or exercising any trust or power conferred on the Trustee with respect to the Notes. No holder of any Notes will have any right to institute any proceeding, judicial or otherwise, with respect to the Indenture or the Notes, or for the appointment of a receiver or a trustee, or for any other remedy thereunder, unless (i) such holder has previously given to the Trustee written notice of a continuing Event of Default with respect to the Notes, (ii) the holders of at least 25% in aggregate principal amount of the Notes then outstanding have made written request to the Trustee to institute such proceeding, (iii) such holder or holders have offered reasonable indemnity to the Trustee and (iv) the Trustee has failed to institute such proceeding, and has not received from the holders of a majority in aggregate principal amount of the Notes then outstanding a direction inconsistent with such request, within 60 days after such notice, request and offer. However, such limitations do not apply to a suit instituted by a holder of a Note for the enforcement of the right to receive payment of the principal of or interest on such Note on or after the applicable due date specified in such Note.

Certain Definitions

Set forth below are definitions of certain of the terms used herein. Additional terms are defined elsewhere above or in the Indenture.

"*Adjusted Consolidated Net Worth*" means the sum of (a) all amounts paid up (or credited as paid up) on all classes of the Guarantor's issued share capital, revenue or capital reserves, capital contribution, or any other accounts that are included as shareholders' funds under Hong Kong GAAP and (b) the aggregate outstanding principal amount of Subordinated Indebtedness.

"*Business Day*" means a day in The City of New York and Hong Kong other than a Saturday, Sunday or a day on which banking institutions in The City of New York or Hong Kong are authorized or obligated by law or executive order to remain closed.

"*Capital Stock*" means any and all shares, interests (including joint venture interests), participations or other equivalents (however designated) of capital stock of a corporation or any and all equivalent ownership interests in a Person (other than a corporation).

"*Indebtedness*" of any Person means, any indebtedness for or in respect of money borrowed that has a final maturity of one year or more from its date of incurrence or issuance and that is evidenced by any agreement or other instrument, excluding trade payables; *provided, however*, that for the purposes of determining the amount of Indebtedness of the Guarantor outstanding at any relevant time, the amount included as Indebtedness of the Guarantor in respect of finance leases shall be the net amount from time to time properly characterized as "obligations under finance leases" in accordance with Hong Kong GAAP.

"*Lien*" means any mortgage, charge, pledge, lien, encumbrance, hypothecation, title retention, security interest or security arrangement of any kind.

"*Listed Principal Subsidiary*" means any Principal Subsidiary, the shares of which are at the relevant time listed on The Stock Exchange of Hong Kong Limited or any other recognized stock exchange.

"*Person*" means any individual, corporation, limited liability company, partnership, joint venture, association, joint stock company, trust, unincorporated organization, government or any agency or political subdivision thereof or any other entity.

"*Principal Subsidiary*" at any time shall mean a Subsidiary of the Guarantor:

(i) as to which one or more of the following conditions is satisfied:

(a) its net profit or (in the case of a Subsidiary of the Guarantor which has Subsidiaries) consolidated net profit attributable to the Guarantor (in each case before taxation and exceptional items) is at least 5% of the consolidated net profit of the Guarantor and its Subsidiaries (before taxation and exceptional items), but in each case after deducting minority interests in Subsidiaries; or

(b) its net assets or (in the case of a Subsidiary of the Guarantor which has Subsidiaries) consolidated net assets attributable to the Guarantor (in each case after deducting minority interests in Subsidiaries) are at least 5% of the consolidated net assets (after deducting minority interests in Subsidiaries) of the Guarantor and its Subsidiaries;

all as calculated by reference to the then latest audited financial statements (consolidated or, as the case may be, unconsolidated) of the Subsidiary of the Guarantor and the then latest audited financial statements of the Guarantor provided that: (1) in the case of a Subsidiary of the Guarantor acquired after the end of the financial period to which the then latest relevant audited accounts relate, the reference to the then latest audited accounts for the purposes of the calculation above shall, until audited accounts for the financial period in which the acquisition is made are published, be deemed to be a reference to the accounts adjusted to consolidate the latest audited accounts of the Subsidiary in the accounts; (2) if, in the case of a Subsidiary of the Guarantor which itself has one or more Subsidiaries, no consolidated accounts are prepared and audited, its consolidated net assets and consolidated net profits shall be determined on the basis of pro forma consolidated accounts of the relevant Subsidiary and its Subsidiaries prepared for this purpose by its auditors; (3) if the accounts of a Subsidiary of the Guarantor (not being a Subsidiary referred to in (1) above) are not consolidated with those of the Guarantor then the determination of whether or not the Subsidiary of the Guarantor is a Principal Subsidiary shall, if the Guarantor requires, be based on a pro forma consolidation of its accounts (consolidated, if appropriate) with the consolidated accounts of the Guarantor and its Subsidiaries; or

(ii) to which is transferred all or substantially all of the assets of a Subsidiary of the Guarantor which immediately prior to the transfer was a Principal Subsidiary, provided that, with effect from such transfer, the Subsidiary which so transfers its assets and undertakings shall cease to be a Principal Subsidiary (but without prejudice to paragraph (i) above) and the Subsidiary of the Guarantor to which the assets are so transferred shall become a Principal Subsidiary.

A certificate of the auditors of the Guarantor as to whether or not a Subsidiary is a Principal Subsidiary shall be conclusive and binding on all parties in the absence of manifest error.

"*Redeemable Stock*" means any class or series of Capital Stock of any Person that by its terms or otherwise is (i) required to be redeemed prior to the Stated Maturity of the Notes, (ii) redeemable at the option of the holder thereof at any time prior to the Stated Maturity of the Notes or (iii) convertible into or exchangeable for Capital Stock referred to in clause (i) or (ii) or Indebtedness having a scheduled maturity prior to the Stated Maturity of the Notes.

"*Stated Maturity*" means July 20, 2015.

"*Subordinated Indebtedness*" means the principal amount of Indebtedness of the Guarantor (including perpetual debt, which the Guarantor is not required to repay) which (i) has a final maturity and a weighted average life to maturity longer than the Stated Maturity of the Notes and (ii) is issued or assumed pursuant to, or evidenced by, an indenture or other instrument containing provisions for the subordination of such Indebtedness to the Notes including (x) a provision that in the event of any bankruptcy, insolvency or other similar proceeding in respect of the Guarantor, the holders of the Notes shall be entitled to receive payment in full in cash of all principal, Additional Amounts and interest on the Notes (including all interest arising after the commencement of such proceeding whether or not an allowed claim in such proceeding) before the holder or holders of any such Subordinated Indebtedness shall be entitled to receive any payment of principal, interest or premium thereon, (y) a provision that if an Event of Default has occurred and is continuing under the Indenture, the holder or holders of any such Subordinated Indebtedness shall not be entitled to payment of any principal, interest or premium in respect thereof unless or until such Event of Default shall have been cured or waived or shall have ceased to exist, and (z) a provision that the holder or holders of such Subordinated Indebtedness may not accelerate the maturity thereof as a result of any default relating thereto so long as any Note is outstanding.

"*Subsidiary*" means, as applied to any Person, any corporation or other entity of which a majority of the outstanding Voting Shares is, at the time, directly or indirectly, owned by such Person.

"*Successor Jurisdiction*" means the jurisdiction in which any successor Person to the Issuer (including any entity substituted in place of the Issuer, or of any previous substituted company) or the Guarantor is organized or any authority therein or thereof having the power to tax.

"*U.S. Government Obligations*" means securities that are (i) direct obligations of the United States of America for the payment of which its full faith and credit is pledged or (ii) obligations of an agency or instrumentality of the United States of America the payment of which is unconditionally guaranteed as a full faith and credit obligation by the United States of America, and shall also include a depositary receipt issued by a bank or trust company as custodian with respect to any such U.S. Government Obligation or a specific payment of interest on or principal of any such U.S. Government Obligation held by such custodian for the account of the holder of a depositary receipt; provided that (except as required by law) such custodian is not authorized to make any deduction from the amount payable to the holder of such depositary receipt from any amount received by the custodian in respect of the U.S. Government Obligation or the specific payment of interest on or principal of the U.S. Government Obligation evidenced by such depositary receipt.

"*Voting Shares*" means, with respect to any Person, the Capital Stock having the general voting power under ordinary circumstances to vote on the election of the members of the board of directors or other governing body of such Person (irrespective of whether or not at the time stock of any other class or classes shall have or might have voting power by reason of the happening of any contingency).

Defeasance and Discharge

Each of the Issuer and the Guarantor may discharge its obligations under the Notes and the Indenture by irrevocably depositing in trust with the Trustee money in U.S. dollars or U.S. Government Obligations, or both, sufficient to pay principal of and interest on the Notes (and any Additional Amounts in respect thereof) to maturity or redemption within one year, subject to meeting certain other conditions.

Each of the Issuer and the Guarantor may also elect to

(1) discharge most of its obligations in respect of the Notes and the Indenture, not including obligations related to the defeasance trust or to the replacement of Notes or the obligations of the Issuer or the Guarantor to the Trustee (legal defeasance) or

(2) discharge its obligations under most of the covenants and under clause (iii) of "— Consolidation, Merger and Sale of Assets" (and, upon such discharge, the events listed in clauses (iii), (iv) and (v) under "— Events of Default" will no longer constitute Events of Default) (covenant defeasance)

by irrevocably depositing in trust with the Trustee money in U.S. dollars or U.S. Government Obligations, or both, sufficient to pay principal of and interest on the Notes (and any Additional Amounts in respect thereof) to maturity or redemption and by meeting certain other conditions, including delivery to the Trustee of (i) either a ruling received by the Issuer or the Guarantor, as the case may be, from the U.S. Internal Revenue Service or an opinion of independent legal counsel of recognized standing with respect to U.S. federal income tax matters to the effect that the beneficial owners of the Notes will not recognize income, gain or loss for U.S. federal income tax purposes as a result of the defeasance and will be subject to U.S. federal income tax on the same amount and in the same manner and at the same times as would otherwise have been the case, which opinion of counsel must, solely in the case of legal defeasance, be based on a ruling received by the Issuer or the Guarantor, as the case may be, from the U.S. Internal Revenue Service, a published ruling of the U.S. Internal Revenue Service or other changes in applicable U.S. federal income tax law, and (ii) an opinion of legal counsel to the effect that the holders of the Notes (other than British Virgin Islands persons and Hong Kong persons, respectively) will not recognize withholding or deduction of Taxes under the laws of the British Virgin Islands or Hong Kong or any political subdivision or any authority thereof or therein or any territory or possession thereof or area subject to its jurisdiction, as the case may be, or any Successor Jurisdiction thereto as a result of the defeasance.

Concerning the Trustee

Pursuant to the Indenture, the Trustee will be designated by the Issuer as the initial Paying and Transfer Agent and Registrar for the Notes. The corporate trust office of the Trustee is currently located at 452 Fifth Avenue, New York, New York 10018.

The Indenture provides that the Trustee, except during the continuance of an Event of Default, undertakes to perform such duties and only such duties as are specifically set forth in such Indenture. If an Event of Default has occurred and is continuing, the Trustee will use the same degree of care and skill in its exercise of the rights and powers vested in it by the Indenture as a prudent person would exercise under the circumstances in the conduct of such person's own affairs.

Indemnification for Judgment Currency Fluctuations

To the fullest extent permitted by law, the obligations of the Guarantor or the Issuer to any holder of Notes under the Indenture or the Notes, as the case may be, shall, notwithstanding any judgment in a currency (the Judgment Currency) other than U.S. dollars (the Agreement Currency), be discharged only to the extent that on the Business Day following receipt by such holder or the Trustee, as the case may be, of any amount in the Judgment Currency, such holder or the Trustee, as the case may be, may in accordance with normal banking procedures purchase the Agreement Currency with the Judgment Currency. If the amount of the Agreement Currency so purchased is less than the amount originally to be paid to such holder or the Trustee, as the case may be, in the Agreement Currency, the Guarantor and the Issuer agree, as a separate obligation and notwithstanding such judgment, to pay the difference and if the amount of the Agreement Currency so purchased exceeds the amount originally to be paid to such holder, such holder or the Trustee, as the case may be, agrees to pay to or for the account of the Guarantor or the Issuer, as the case may be, such excess, provided that such holder shall not have any obligation to pay any such excess as long as a default by the Guarantor or the Issuer in its obligations under the Indenture or the Notes has occurred and is continuing, in which case such excess may be applied by such holder to such obligations.

Notices

Notices to holders of Notes will be mailed to them (or the first named of joint holders) by first class mail (or, if first class mail is unavailable, by airmail) at their respective addresses in the register and will be deemed to have been given on the fourth Business Day after the date of mailing.

Governing Law and Consent to Jurisdiction

The Notes, the Guarantee and the Indenture are governed by and will be construed in accordance with the laws of the State of New York. The Guarantor and the Issuer have each agreed that any action arising out of or based upon the Indenture, the Guarantee or the Notes may be instituted in any U.S. federal or New York State court located in the Borough of Manhattan, The City of New York, and has irrevocably submitted to the non-exclusive jurisdiction of any such court in any such action. The Guarantor and the Issuer have each irrevocably appointed Corporation Service Company as their respective agent upon which process may be served in any such action.

Each of the Issuer and the Guarantor has agreed that, to the extent that it is or becomes entitled to any sovereign or other immunity, it will waive such immunity in respect of its obligations under the Indenture.

Certain Information Requirements

So long as the Notes and the Guarantee remain outstanding and are "restricted securities" within the meaning of Rule 144(a)(3) of the Securities Act, the Guarantor will furnish, upon the request of any holder of a beneficial interest in a Note, such information as is specified in paragraph (d)(4) of Rule 144A, to such holder or beneficial owner or to a prospective purchaser of the Note or interest therein who is a Qualified Institutional Buyer within the meaning of Rule 144A, in order to permit compliance by such holder or beneficial owner with Rule 144A in connection with the resale of the

Note or beneficial interest therein in reliance on Rule 144A unless, at the time of such request, the Guarantor is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, or is included in the list of foreign private issuers that claim exemption from the registration requirements of Section 12(g) of the Exchange Act (and therefore is required to furnish the Commission certain information pursuant to Rule 12g3-2(b) under the Exchange Act).

In addition, for the convenience of the holders of the Notes, for so long as such information is not otherwise publicly available, the Guarantor will furnish to the Trustee and make available to holders of the Notes, in English, the annual audited consolidated financial statements of the Guarantor for its most recent calendar year (or, at its option, most recent fiscal year), commencing with the year ended December 31, 2005, not later than four months after the date upon which the financial period ended, and its interim unaudited consolidated financial statements for the first six months of such calendar or fiscal year, commencing with the six month period ended June 30, 2005, not later than three months after the end of that six month period. Such annual audited consolidated financial statements or interim unaudited consolidated financial statements, as the case may be, shall include a period-to-period comparison to the relevant period of the prior year.

Notes; Delivery and Form

The statements set forth herein include summaries of certain rules and operating procedures of DTC, Euroclear and Clearstream which will affect transfers of interests in the global notes.

The Notes sold in offshore transactions to non-U.S. persons in reliance on Regulation S will be initially in the form of one or more Regulation S global notes, fully registered without interest coupons, which will be deposited with HSBC Bank USA, National Association (in such capacity, the Custodian) for DTC and registered in the name of Cede & Co., as nominee of DTC, for the accounts of Euroclear and Clearstream.

The Notes sold to qualified institutional buyers in reliance on Rule 144A will be issued initially in the form of one or more Rule 144A global notes, fully registered without interest coupons, which will be deposited with the Custodian for DTC and registered in the name of Cede & Co., as nominee of DTC.

The Regulation S global notes and Rule 144A global notes may be exchanged for individual certificated notes in fully registered form in the circumstances described under "— Individual Notes" below.

Notes issued under Regulation S or Rule 144A will be issued in minimum denominations of US$100,000 and in integral multiples of US$1,000 above that amount.

The Notes (including beneficial interests in the global notes) will be subject to certain restrictions on transfer set forth therein and in the Indenture and will bear a legend regarding such restrictions as set forth under "Transfer Restrictions." Under certain circumstances, transfers may be made only upon receipt by the Trustee of a written certification (in the form(s) provided in the Indenture).

Until 40 days after the later of the commencement of the offering of the Notes and the Closing Date (as defined in the purchase agreement with respect to the Notes), beneficial interests in a Regulation S global note may be held only through Euroclear or Clearstream, unless delivery is made through the related Rule 144A global note in accordance with the certification requirements described in this paragraph. Prior to the 40th day after the later of the commencement of the offering and the Closing Date, a beneficial interest in a Regulation S global note may be transferred within the United States to a person who takes delivery in the form of an interest in the related Rule 144A global note only if the transferor, and any person acting on its behalf, reasonably believes that the transferee is a qualified institutional buyer, and upon receipt by the Trustee of a written certification (in the form(s) provided in the Indenture) from the transferee to the effect that (i) such transferee is a qualified institutional buyer purchasing for its own account (or for the account of one or more QIBs over which account it exercises sole investment discretion) and (ii) the transfer was made in a transaction meeting the requirements of Rule 144A. After the 40th day after the later of commencement of the offering of the Notes and the Closing Date (but not earlier), investors may also hold interests in a Regulation S global note through organizations other than Euroclear or Clearstream that are either Participants (as hereinafter defined) or Euroclear Participants (as hereinafter defined) or Clearstream Participants (as hereinafter defined).

Beneficial interests in a Rule 144A global note may be transferred to a person who takes delivery in the form of an interest in a Rule 144A global note without any written certification from the transferor or the transferee. Beneficial interests in a Rule 144A global note may be transferred to a person who takes delivery in the form of an interest in a Regulation S global note only upon receipt by the Trustee of written certifications (in the form(s) provided in the Indenture) from the transferor to the effect that such transfer is being made in accordance with Rule 903 or 904 of Regulation S or Rule 144 under the Securities Act (if available). If such transfer occurs on or prior to the 40th day after the later of the commencement of the offering of the Notes and the Closing Date, the interest transferred will be held immediately thereafter through Euroclear or Clearstream.

Any individual notes issued in exchange for an interest in a Rule 144A global note under the circumstances described under "Individual Notes" below may be transferred (a) to a person who takes delivery in the form of an interest in a Rule 144A global note only upon receipt by the Trustee of written certifications that the transfer is being made in accordance with the requirements of Rule 144A or (b) to a person who takes delivery in the form of an interest in a Regulation S global note only upon receipt by the Trustee of written certifications (in the form(s) provided in the Indenture) from the transferor that the transfer has been made in compliance with Rule 903 or Rule 904 of Regulation S under the Securities Act. If such transfer occurs on or prior to the 40th day after the later of the commencement of the offering of the Notes and the Closing Date, the interest transferred will be held immediately thereafter through Euroclear or Clearstream.

Any beneficial interest in one of the global notes that is transferred to an entity who takes delivery in the form of an interest in the other global note will, upon transfer, cease to be an interest in such global note and become an interest in the other global note and, accordingly, will thereafter be subject to all transfer restrictions, if any, and other procedures applicable to beneficial interests in such other global note for as long as it remains such an interest.

Investors may hold their interests in the global notes directly through DTC, Clearstream or Euroclear, as the case may be, if they are participants in such systems, or indirectly through organizations which are participants in such systems Clearstream and Euroclear will hold interests in the Regulation S global notes on behalf of their participants through customers' securities accounts in their respective names on the books of their respective depositaries, which are participants in DTC.

Transfers between participants in DTC (the Participants) will be effected in the ordinary way in accordance with DTC rules. Transfers between participants in Clearstream and Euroclear (Clearstream Participants and Euroclear Participants, respectively) will be effected in the ordinary way in accordance with their respective rules and operating procedures.

Subject to compliance with the transfer restrictions applicable to the Notes, cross-market transfers between DTC, on the one hand, and Clearstream or Euroclear Participants, on the other hand, will be effected in DTC in accordance with DTC rules on behalf of Euroclear or Clearstream, as the case may be. Such crossmarket transactions, however, will require delivery of instructions to Euroclear or Clearstream, as the case may be, by the counterparty in such system in accordance with its rules and procedures and within its established deadlines. Euroclear or Clearstream, as the case may be, will, if the transaction meets its settlement requirements, deliver instructions to DTC to take action to effect final settlement on its behalf by delivering or receiving payment in accordance with DTC's system.

Persons who are not Participants may beneficially own interests in the global notes held by DTC only through Participants or Indirect Participants (as defined below) (including Euroclear and Clearstream). So long as Cede & Co., as the nominee of DTC, is the registered owner of the global notes, Cede & Co. for all purposes will be considered the sole holder of such Notes.

Payment of interest and principal on the global notes will be made to Cede & Co., the nominee for DTC, as the registered owner of the global notes by wire transfer of immediately available funds. Neither the Issuer, the Guarantor nor the Trustee will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in the global notes or for maintaining, supervising or reviewing any records relating to such beneficial ownership interest.

The Issuer has been informed by DTC that, upon receipt of any payment of interest on or the redemption price of the global notes, DTC will credit Participants' accounts with payments in amounts proportionate to their respective beneficial interests in the global notes as shown on the records of DTC. Payments of interest on and principal of the Notes held through Clearstream or Euroclear will be credited to the cash accounts of Clearstream Participants or Euroclear Participants, as the case may be, in accordance with the relevant system's rules and procedures. Payments by Participants to owners of beneficial interests in the global notes held through such Participants will be the responsibility of such Participants, as is the case with securities held by broker-dealers, either directly or through nominees, for the accounts of customers and registered in "street name."

Because DTC can only act on behalf of Participants, who in turn act on behalf of Indirect Participants and certain banks, the ability of a person having a beneficial interest in the global notes to pledge such interest to persons or entities that do not participate in the DTC system, or to otherwise take actions in respect of such interest, may be affected by the lack of a physical certificate.

So long as the Notes are represented by global notes and such global notes are held on behalf of DTC or any other clearing system, such clearing system or its nominee will be considered the sole holder of the Notes represented by the applicable global notes for all purposes under the Indenture, including, without limitation, obtaining consents and waivers thereunder, and neither the Trustee, the Issuer nor the Guarantor shall be affected by any notice to the contrary. Neither the Trustee, the Issuer nor the Guarantor shall have any responsibility or obligation with respect to the accuracy of any records maintained by any clearing system or any Participant of such clearing system. The clearing systems will take actions on behalf of their Participants (and any such Participants will take actions on behalf of any Indirect Participants) in accordance with their standard procedures. To the extent that any clearing system acts upon the direction of the holders of the beneficial interests in the applicable global note and such beneficial holders give conflicting instructions, the applicable clearing system may take conflicting actions in accordance with such instructions.

DTC has advised the Issuer that it will take any action permitted to be taken by a holder of Notes (including, without limitation, the presentation of Notes for exchange) only at the direction of one or more Participants and only in respect of the principal amount of the Notes represented by the global note as to which such Participant or Participants has or have given such direction.

Clearstream or Euroclear, as the case may be, will take any action permitted to be taken by a holder of Notes (including, without limitation, the presentation of Notes for exchange) on behalf of a Clearstream Participant or a Euroclear Participant only in accordance with its relevant rules and procedures and subject to its ability to effect such actions through DTC.

DTC has advised the Issuer as follows:

DTC is a limited purpose trust company organized under the laws of the State of New York, a "banking organization" within the meaning of New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the Uniform Commercial Code and a "Clearing Agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC was created to hold securities for its Participants and facilitate the clearance and settlement of securities transactions between Participants through electronic book-entry changes in accounts of its Participants, thereby eliminating the need for the physical movement of certificates. Participants include securities brokers and dealers, banks, trust companies and clearing corporations and may include certain other organizations. Indirect access to the DTC system is available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a Participant, either directly or indirectly (Indirect Participants).

Although DTC, Clearstream and Euroclear have agreed to the foregoing procedures in order to facilitate transfers of interests in the global notes among participants of DTC, Clearstream and Euroclear, they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. Neither the Issuer, the Guarantor nor the Trustee will have any responsibility for the performance by DTC, Clearstream and Euroclear, or their respective Participants or Indirect Participants, of their respective obligations under the rules and procedures governing their operations.

Individual Notes

If DTC is at any time unwilling or unable to continue as depository and a successor depository is not appointed by the Issuer within 90 days or if there shall have occurred and be continuing an Event of Default (as described above) with respect to the Notes, the Issuer will issue individual Notes in certificated, fully registered form in exchange for the global notes.

The Issuer has undertaken to the SGX-ST that for long as the Notes are listed on the SGX-ST and the rules of the SGX-ST so require, the Issuer will appoint and maintain a paying agent in Singapore, where the Notes may be presented or surrendered for payment or redemption, in the event that a global Note is exchanged for individual Notes in certificated form. In addition, in the event that a global Note is exchanged for individual Notes in certificated form, announcement of such exchange shall be made by the Issuer or on its behalf through SGX-ST and such announcement will include all material information with respect to the delivery of the individual Notes in certificated form, including details of the paying agent in Singapore.

Subject to the transfer restrictions set forth on the individual Notes in certificated form, the holder of such individual Notes in certificated form may transfer or exchange such Notes (whether received directly from the Issuer or in exchange for beneficial interests in the global notes) by surrendering them at the corporate trust office of the Trustee or at the office of the paying agent in Singapore. Prior to any proposed transfer of individual Notes in certificated form (other than pursuant to an effective registration statement), the holder may be required to provide certifications and other documentation relating to the manner of such transfer and submit such certifications and other documentation to the Trustee as described under "— Notes; Delivery and Form" above. Upon the transfer, exchange or replacement of individual Notes in certificated form not bearing the legend referred to under "Transfer Restrictions," the Trustee will deliver individual Notes in certificated form that do not bear the legend. Upon the transfer, exchange or replacement of individual Notes in certificated form bearing the legend, or upon specific request for removal of the legend on an individual Note in certificated form, the Trustee will deliver only individual Notes in certificated form that bear such legend or shall refuse to remove such legend, as the case may be, unless there is delivered to the Issuer or the Guarantor such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the Issuer or the Guarantor that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act.

Same-Day Settlement in Respect of Global Notes

So long as any Notes are represented by global notes registered in the name of DTC or its nominee, such Notes will trade in DTC's same-day funds settlement system, and secondary market trading activity in such Notes will therefore be required by DTC to settle in immediately available funds. No assurance can be given as to the effect, if any, of settlement in immediately available funds on trading activity in the Notes.

DESCRIPTION OF OTHER INDEBTEDNESS

Set forth below is a description of certain of the Guarantor's other indebtedness. The Guarantor has guaranteed obligations of other PCCW Group companies (excluding subsidiaries of the Guarantor) in the aggregate principal amount of HK$9,313 million as at December 31, 2004. See "Related Party Transactions" and Note 31 of the Audited Financial Statements.

Long-Term Loan Facilities with Commercial Banks and Other Financial Institutions

On August 8, 2003, the Guarantor entered into a seven-year HK$2,800 million revolving loan and term loan facility (the Seven Year Revolver). The facility was split equally between the revolving loan and term loan facilities. On October 29, 2003, the Guarantor entered into an amendment agreement to increase the amount under the revolving loan facility to HK$2,800 million and reduce the amount available under the term loan facility to zero. The interest is calculated at HIBOR plus a variable margin as determined by a pricing grid pursuant to which the margin for an interest period will vary according to the senior unsecured debt ratings assigned to the Guarantor at the beginning of such interest period.

On December 12, 2003, the Guarantor entered into a five-year HK$6,000 million revolving loan facility (the Five Year Revolver). The interest is calculated at HIBOR plus a variable margin as determined by a pricing grid pursuant to which the margin for an interest period will vary according to the senior unsecured debt ratings assigned to the Guarantor at the beginning of such interest period.

On December 22, 2003, the Guarantor entered into a six-year HK$2,000 million revolving loan facility (the Six Year Revolver). The interest is calculated at HIBOR plus a margin of 0.325% per annum.

The Seven Year Revolver, the Six Year Revolver and the Five Year Revolver are together referred to as the Revolvers. As at July 12, 2005, the Guarantor had drawndown HK$500 million under the Five Year Revolver and had not drawn down any amounts under the Six Year Revolver or the Seven Year Revolver.

Summary of Certain Provisions of the Revolvers

Financial Covenants. The Guarantor must comply with the following covenants in respect of the relevant periods (described below) as long as any of the Seven Year Revolver, Six Year Revolver or Five Year Revolver remain outstanding. The EBITDA to interest ratio for the Guarantor and its subsidiaries (the HKTC Group) must not be less than 2 to 1 for any relevant period. A "relevant period" refers to each twelve-month period ending on March 31, and each twelve-month period ending on September 30.

The HKTC Group's total debt to EBITDA ratio must not exceed 5 to 1 for any relevant period. The next testing of these financial covenants will be carried out on August 1, 2005, and thereafter on February 1 and August 1 in each subsequent calendar year.

General Covenants. The Guarantor (and where applicable, the HKTC Group) must also comply with certain other covenants, which include those set out below. The Guarantor and its principal subsidiaries (other than listed principal subsidiaries and their subsidiaries) must not create or permit any encumbrance over their respective assets other than those specifically permitted by the Revolvers.

The obligations of the Guarantor under the Revolvers must at all times rank at least *pari passu* with all its other present and future unsecured and unsubordinated indebtedness.

The HKTC Group may not enter into any transactions with other PCCW companies outside the HKTC Group unless they are made on an arm's length basis.

The Guarantor must protect and maintain all licences (including the FC licence), authorizations, consents and approvals under all applicable telecommunications regulations (including the Telecommunications Ordinance) which are material and necessary for the conduct by the HKTC Group of its core business and must comply with all material conditions attaching to these licenses, authorizations, consents and approvals.

Events of Default. The Revolvers describe the events or circumstances that would constitute an event of default. They include non-payment of any amount payable under the Revolvers and related agreements, failure to comply with the financial covenants enumerated above, revocation or suspension of the Guarantor's FC license or such license becoming subject to such conditions as would have a material adverse effect on the HKTC Group, breach of certain other covenants and other events of default standard for facilities of this type.

Notes

On November 15, 2001, PCCW-HKT Capital Limited, a wholly owned subsidiary of the Guarantor, issued US$750 million 7.75% Guaranteed Notes due 2011 (Notes due 2011). On November 26, 2001, PCCW-HKT Capital Limited issued a further US$250 million 7.75% Guaranteed Notes due 2011 which are fungible and consolidated to form a single series with the Guaranteed Notes issued on November 15, 2001. The Notes due 2011 are unconditionally and irrevocably guaranteed by the Guarantor.

The interest rate payable on the Notes due 2011 will be subject to adjustment from time to time if either Moody's or S&P downgrades the rating ascribed to the senior unsecured debt of the Guarantor below Baal in the case of Moody's, or below BBB in the case of S&P. In this event, the interest rate payable on the Notes due 2011 will be increased by 0.25% per annum for each rating notch downgrade below the applicable level by each rating agency. In addition, if Moody's or S&P subsequently increases the rating ascribed to the senior unsecured debt of the Guarantor, then the interest rate then payable on the Notes due 2011 will be decreased by 0.25% per annum for each rating notch upgrade by each rating agency, but in no event will the interest rate be reduced to below the initial interest rate on the Notes due 2011. There is no limit to the number of times the interest rate payable on the Notes due 2011 can be adjusted prior to their maturity.

The interest rate payable on the Notes due 2011 has been adjusted to 8.00% based on the current ratings of the Guarantor.

On July 17, 2003, PCCW-HKT Capital No.2 Limited, a wholly owned subsidiary of the Guarantor, issued US$500 million 6.00% Guaranteed Notes due 2013 (Notes due 2013). The Notes due 2013 are unconditionally and irrevocably guaranteed by the Guarantor.

The Notes due 2011 are rated "Baa2" by Moody's and "BBB" by S&P. The Notes due 2013 are rated "Baa2" by Moody's, "BBB" by S&P and "BBB+" by Fitch.

CERTAIN TAX CONSIDERATIONS

Hong Kong Taxation

Under existing Hong Kong law, neither the Issuer nor the Guarantor nor any paying agent will be required to deduct or withhold for or on account of any Hong Kong taxes in respect of payments on the Notes or under the Guarantee. The Guarantor is also not required to deduct or withhold for or on account of any Hong Kong taxes in respect of payments on the Intercompany Loan. The Notes are not subject to Hong Kong stamp duty upon issue or on any subsequent transfer and will not be subject to Hong Kong estate duty on the death of a Note holder.

Hong Kong profits tax is charged on every person carrying on a trade, profession or business in Hong Kong in respect of assessable profits arising in or derived from Hong Kong from such trade, profession or business. Under the Inland Revenue Ordinance (Chapter 112 of the Laws of Hong Kong) as it is currently applied, Hong Kong profits tax may be charged on revenue profits arising on the sale, disposal, or redemption of Notes where such sale, disposal, or redemption is or forms part of a trade, profession or business carried on in Hong Kong and the profits are derived from Hong Kong.

Interest on the Notes will be subject to Hong Kong profits tax where such interest is received by or accrues to:

(a) a financial institution (as defined in the Inland Revenue Ordinance) by way of interest which arises through or from the carrying-on by the financial institution of its business in Hong Kong, notwithstanding that the moneys in respect of which the interest is received or accrues are made available outside Hong Kong; or

(b) a corporation carrying on a trade, profession or business in Hong Kong by way of interest derived from Hong Kong; or

(c) a person, other than a corporation, carrying on a trade, profession or business in Hong Kong by way of interest derived from Hong Kong and such interest is in respect of the funds of the trade, profession or business.

Hong Kong is not party to any income tax treaty with the United States, other than with respect to certain shipping businesses.

The foregoing summary is of a general nature only and is based on Hong Kong law as at the date of this Offering Circular and is subject to any changes in law occurring after such date, which changes could be made on a retroactive basis. The foregoing summary does not purport to be a comprehensive description of all of the Hong Kong tax considerations that may be relevant to a decision to purchase, own or dispose of the Notes and does not purport to deal with the Hong Kong tax consequences applicable to all categories of investors, some of which may be subject to special rules. Prospective purchasers of the Notes should consult with their own professional tax advisors as to the particular consequences of holding the Notes which may affect them.

British Virgin Islands Taxation

At the date of this Offering Circular payments on the Notes (including interest payments) by the Issuer to persons who are not resident in the British Virgin Islands will not be subject to taxation in the British Virgin Islands. No withholding tax will be required to be deducted by the Issuer on any such payments to such persons provided that such persons are not individuals resident in an EU Member State. Gains realised upon a sale, exchange, retirement, redemption or other disposal of the Notes by persons who are not resident in the British Virgin Islands also will be exempt from British Virgin Islands tax. No estate, inheritance, succession or gift tax, rate, duty, levy or other charge is payable by persons who are not resident in the British Virgin Islands with respect to the Notes. The Notes will not be subject to stamp duty in the British Virgin Islands.

EU Savings Directive

The Council of the European Union adopted the Council Directive 2003/48/EC on the taxation of savings income on June 3, 2003. Under this Directive, EU Member States are required to provide to the tax authorities of another EU Member State details of payments of interest (or other similar income) paid by a person within its jurisdiction to or for the benefit of an individual resident in that other EU Member State, except that for an indefinite transitional period Belgium, Luxembourg and Austria will instead be required to operate a withholding tax system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain agreements relating to information exchange with certain other countries and territories). Holders of the Notes who are individuals should note that no additional amounts would be payable by the Issuer in respect of any withholding tax imposed as a result thereof.

The British Virgin Islands is not a member of the European Union and not within the European Union fiscal territory, but has voluntarily applied the provisions of the Directive. Implementation involves a withholding tax system in respect of payments of interest, or other similar income, made to an individual beneficial owner resident in an EU Member State by a paying agent situated in the British Virgin Islands (the terms "beneficial owner" and "paying agent" for this purpose are as defined in the EU Directive itself). The withholding tax system would apply for a transitional period prior to the implementation of a system of automatic communication to EU Member States of information regarding such payments. During this transitional period, such an individual beneficial owner resident in an EU Member State will be entitled to request a paying agent in the British Virgin Islands not to withhold tax from such payments but instead to apply a system by which the details of such payments are communicated to the tax authorities of the EU Member State in which the beneficial owner is resident.

In summary, withholding tax in the British Virgin Islands would only apply to individual beneficial owners of Notes who are resident in an EU Member State and who receive interest or other similar income from a paying agent situated in the British Virgin Islands. Such a holder could request such British Virgin Islands paying agent not to withhold tax but to exchange information instead. Holders of Notes who are individuals should note that no additional amounts would be payable by the Issuer in respect of any withholding imposed in the British Virgin Islands as a result of the Directive.

United States Federal Income Taxation

This disclosure is limited to the U.S. federal income tax issues addressed herein. Additional issues may exist that are not addressed in this disclosure and that could affect the U.S. federal income tax treatment of the Notes. This tax disclosure was written in connection with the promotion or marketing of the Notes by the Issuer, the Guarantor and the Manager, and it cannot be used by any holder for the purpose of avoiding penalties that may be asserted against the holder under the Internal Revenue Code. Holders should seek their own advice based on their particular circumstances from an independent tax advisor.

The following summary describes certain U.S. federal income tax consequences of the acquisition, ownership and disposition of Notes by a U.S. Holder (as defined below). The summary set forth below applies only to U.S. Holders that will hold Notes as capital assets and that purchase such Notes in this offering at their "issue price" (which will be the first price to the public, not including bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers, at which a substantial amount of the Notes is sold for money). In addition, this summary does not address all of the U.S. federal income tax consequences that may be relevant to a holder in light of the holder's particular circumstances or to holders subject to special situations, such as dealers or traders in securities or currencies, financial institutions, banks, tax-exempt entities, life insurance companies, persons liable for alternative minimum tax, partnerships or other entities treated as partnerships for U.S. federal income tax purposes, persons holding Notes as part of a hedging, integrated, conversion or constructive sale transaction or a straddle, certain U.S. expatriates or persons whose functional currency is not the U.S. dollar. The discussion below is based upon the Internal Revenue Code of 1986, as amended, Treasury regulations, rulings, administrative pronouncements and judicial decisions, all as in effect as at the date hereof, and all of which may be repealed, revoked or modified, possibly with retroactive effect. Further, this discussion does not address any U.S. state, local or other tax consequences to U.S. Holders of the Notes. **Prospective purchasers of Notes should consult their own tax advisors concerning the particular U.S. federal income tax consequences to them of the purchase, ownership and disposition of Notes in light of their situations, as well as any tax consequences arising under the laws of any state, local, foreign or other relevant taxing jurisdiction.**

As used herein, a "U.S. Holder" means a beneficial owner of a Note that is, for U.S. federal income tax purposes, (i) a citizen or individual resident of the United States, (ii) a corporation, or other entity taxable as a corporation, created or organized in or under the laws of the United States or any political subdivision thereof, or (iii) an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source.

Payments of Interest

Interest on a Note will be taxable to a U.S. Holder as ordinary income at the time it is received or accrued in accordance with the U.S. Holder's method of accounting for U.S. federal income tax purposes. For foreign tax credit limitation purposes, such interest generally will be considered foreign source income. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income.

Sale, Exchange and Retirement of Notes

Upon the sale, exchange, retirement or other taxable disposition of a Note, a U.S. Holder will recognize capital gain or loss equal to the difference between the amount realized upon the sale, exchange, retirement or other disposition (less any accrued and unpaid interest, which will be taxable as described under "Payments of Interest" above) and the U.S. Holder's tax basis in the Note. A U.S. Holder's tax basis in a Note generally will be the U.S. Holder's cost therefor. Gain or loss recognized by a U.S. Holder on the sale, exchange, retirement or other disposition of a Note will generally be treated as U.S. source capital gain or loss and will be long-term capital gain or loss if at the time of sale, exchange, retirement or other disposition, the Note has been held for more than one year. Gains of non-corporate U.S. Holders derived with respect to capital assets held for more than one year generally are eligible for reduced rates of taxation. The deductibility of capital losses is subject to limitations.

Information Reporting and Backup Withholding

Payments of interest and proceeds from the sale of a Note that are made within the United States or through certain U.S.-related financial intermediaries may be subject to information reporting and to backup withholding unless the U.S. Holder is a corporation or other exempt recipient or, in the case of backup withholding, the U.S. Holder provides a correct taxpayer identification number and certifies that no loss of exemption from backup withholding has occurred.

Any amounts withheld under the backup withholding rules will be allowed as a refund or a credit against the U.S. Holder's U.S. federal income tax liability provided the required information is furnished to the U.S. Internal Revenue Service.

TRANSFER RESTRICTIONS

Offers and Sales by the Manager

The Notes and the Guarantee have not been and will not be registered under the Securities Act or any state securities laws. The Notes may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons, except (i) in compliance with the registration requirements of the Securities Act and all other applicable securities laws, or (ii) pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act, all applicable state securities laws or the applicable securities laws of any other jurisdiction. Accordingly, the Notes are being offered and sold only (i) to "qualified institutional buyers" (as defined in Rule 144A under the Securities Act) in compliance with Rule 144A (QIBs) and (ii) to purchasers outside the United States who are non-U.S. persons (foreign purchasers), which term shall include dealers or other professional fiduciaries in the United States acting on a discretionary basis for foreign beneficial owners (other than an estate or trust), in reliance upon Regulation S under the Securities Act (Regulation S).

Investor Representation and Restrictions on Resales

Each purchaser of Notes will be deemed to (1) represent that it is purchasing the Notes for its own account or an account with respect to which it exercises sole investment discretion and that it or such account is (i) a QIB, and is aware that the sale to it is being made in reliance on Rule 144A, or (ii) a foreign purchaser that is outside the United States (or a foreign purchaser that is a dealer or other fiduciary as referred to above), (2) acknowledge that the Notes have not been and will not be registered under the Securities Act, and may not be offered or sold within the United States except as set forth below and (3) agree not to resell, pledge or otherwise transfer the Notes within the United States except (a) if such purchaser is an initial purchaser, (i) to the Guarantor or any subsidiary thereof, (ii) to a Qualified Institutional Buyer in compliance with Rule 144A under the Securities Act, (iii) outside the United States to a foreign purchaser in reliance upon Regulation S or (iv) pursuant to an exemption from registration provided by Rule 144 under the Securities Act (if available) or (b) if such purchaser is a subsequent purchaser of an interest in the 144A global note, as set forth in (a) above and, in addition, pursuant to any available exemption from the registration requirements under the Securities Act (provided that as a condition to the registration of transfer of any Notes otherwise than as described in (a) above or (c) below, the Issuer, the Guarantor or the Trustee may, in circumstances that any of them deems appropriate, require evidence, in addition to that required pursuant to (4) below, as to compliance with any such exemption) or (c) pursuant to an effective registration statement under the Securities Act, and (4) agree that upon transfer of the Notes or an interest therein, the transferee will be required to provide the certification described under "Description of the Notes and Guarantee — Notes; Delivery and Form," (5) agree that the certificates representing the Notes will bear the legend described below and (6) agree that it shall notify any purchaser of Notes from it of the provisions of clauses (3), (4), (5) and (6) hereof; *provided* that beginning 41 days after the later of the commencement of the offering of the Notes and the Closing Date, these restrictions shall not apply with respect to sales, pledges or other transfers of interests in the Regulation S global note.

Each certificate representing a Note will bear the following legend (unless such Note has been sold pursuant to a registration statement that has been declared effective under the Securities Act and *provided* that 41 days after the later of the commencement of the offering of the Notes and the Closing Date, such legend included on the Regulation S global note shall have no effect and may be removed by the Trustee upon direction of the Issuer, the Guarantor or a holder of any interest in the Regulation S global note):

> THIS NOTE AND THE GUARANTEE RELATED TO THIS NOTE HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), AND, ACCORDINGLY, THIS NOTE MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES EXCEPT AS SET FORTH IN THE FOLLOWING

SENTENCE. BY ITS ACQUISITION HEREOF, THE HOLDER (1) AGREES THAT IT WILL NOT RESELL, PLEDGE OR OTHERWISE TRANSFER THE NOTES EXCEPT (A) IF SUCH PURCHASER IS AN INITIAL PURCHASER, (I) TO THE GUARANTOR OR THE ISSUER OR ANY SUBSIDIARY THEREOF, (II) TO A QUALIFIED INSTITUTIONAL BUYER IN COMPLIANCE WITH RULE 144A UNDER THE SECURITIES ACT, (III) OUTSIDE THE UNITED STATES IN A TRANSACTION IN COMPLIANCE WITH REGULATION S UNDER THE SECURITIES ACT, (IV) PURSUANT TO AN EXEMPTION FROM REGISTRATION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT (IF AVAILABLE) OR (B) IF SUCH PURCHASER IS A SUBSEQUENT PURCHASER OF AN INTEREST IN THE 144A GLOBAL NOTE, AS SET FORTH IN (A) ABOVE AND, IN ADDITION, PURSUANT TO ANY AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS UNDER THE SECURITIES ACT (PROVIDED THAT AS A CONDITION TO THE REGISTRATION OF TRANSFER OF ANY NOTES OTHERWISE THAN AS DESCRIBED IN (A) ABOVE OR (C) BELOW, THE ISSUER, THE GUARANTOR OR THE TRUSTEE MAY, IN CIRCUMSTANCES THAT ANY OF THEM DEEMS APPROPRIATE, REQUIRE EVIDENCE, IN ADDITION TO THAT OTHERWISE REQUIRED, AS TO COMPLIANCE WITH ANY SUCH EXEMPTION) OR (C) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT. THE HOLDER HEREOF, BY PURCHASING THIS NOTE, AGREES THAT IT WILL NOTIFY EACH PURCHASER OF THIS NOTE FROM IT OF THE ABOVE RESTRICTIONS AND OF THIS LEGEND.

Each purchaser (i) acknowledges that the Issuer, the Guarantor, the Manager and others will rely upon the truth and accuracy of the foregoing acknowledgments, representations and agreements, and agrees that if any of the acknowledgments, representations or agreements deemed to have been made by it by its purchase of Notes are no longer accurate, it shall promptly notify the Issuer, the Guarantor and the Manager and (ii) represents, if it is acquiring any Notes as a fiduciary or agent for one or more investor accounts, that it has sole investment discretion with respect to each such account and it has full power to make the foregoing acknowledgments, representations and agreements on behalf of each such account.

PLAN OF DISTRIBUTION

Under the terms and subject to the conditions set forth in the Purchase Agreement dated July 13, 2005 (the Purchase Agreement), The Hongkong and Shanghai Banking Corporation Limited (the Manager) has agreed to purchase, and the Issuer has agreed to sell to the Manager, US$500,000,000 principal amount of Notes.

The Purchase Agreement provides that the obligations of the Manager to pay for and accept delivery of the Notes are subject to approval of certain legal matters by their counsel and to certain other conditions. The Manager is obligated to take and pay for all of the Notes if any are taken.

In the Purchase Agreement, subject to the conditions thereof, the Manager has agreed to purchase the Notes from the Issuer at 98.742% of their principal amount. The Manager has advised the Issuer and the Guarantor that it proposes initially to offer the Notes to investors at the offering price set forth on the cover page hereof. After the initial offering of the Notes, the offering price and other selling terms may from time to time be varied by the Manager.

The Purchase Agreement provides that the Issuer and the Guarantor will jointly and severally indemnify the Manager against certain liabilities, including under the Securities Act.

The Notes are a new issue of securities with no established trading market. Approval in-principle has been obtained for the listing of the Notes on the SGX-ST, but the Issuer does not intend to apply for listing of the Notes on a U.S. national securities exchange. The Issuer and the Guarantor have been advised by the Manager that it presently intends to make a market in the Notes, as permitted by applicable laws and regulations. The Manager is not obligated, however, to make a market in the Notes and any such market making may be discontinued at the sole discretion of the Manager. Accordingly, no assurance can be given as to the liquidity of, or trading markets for, the Notes.

In connection with the offering of the Notes, the Manager may engage in transactions that stabilize, maintain or otherwise affect the price of the Notes. Specifically, the Manager may over-allot in connection with the offering, creating short positions in the Notes for its own account. In addition, to cover syndicate over-allotments or to stabilize the price of the Notes, the Manager may bid for, and purchase, any of the Notes in the open market. Finally, the underwriting syndicate may reclaim selling concessions allowed to a Manager or a dealer for distributing the Notes in the offering, if the syndicate repurchases previously distributed Notes in transactions to cover syndicate short positions, in stabilization transactions or otherwise. Any of these activities may stabilize or maintain the market price of any of the Notes above independent market levels. However, there is no assurance that the Manager (or the persons acting on behalf of the Manager) will undertake stabilization action. Any stabilization action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if begun, may be ended at any time, but it must end no later than 30 days after the issue date of the Notes.

United States

The Notes and the Guarantee (the Securities) have not been and will not be registered under the Securities Act or any state securities laws and, unless so registered, may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable state securities laws. Accordingly, the Notes are being offered and sold by the Manager only (i) to Qualified Institutional Buyers pursuant to Rule 144A and (ii) outside the United States to non-U.S. persons in reliance on Regulation S under the Securities Act (Regulation S). See “Transfer Restrictions.”

The Manager has represented and agreed that it has offered the Securities and will offer and sell the Securities (i) as part of its distribution at any time and (ii) otherwise until 40 days after the later of the commencement of the offering and the Closing Date only in accordance with Regulation S or Rule 144A or any other available exemption from registration under the Securities Act. In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of the Notes within the United States by a dealer (whether or not participating in the offering of the Notes) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in compliance with Rule 144A or pursuant to another exemption from the registration requirements of the Securities Act.

As used herein the terms "United States" and "U.S. person" have the meanings given to them in Regulation S.

European Economic Area

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a Relevant Member State), the Manager has represented and agreed that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the Relevant Implementation Date), it has not made and will not make an offer of Securities to the public in that Relevant Member State prior to the publication of a prospectus in relation to the Securities which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive, except that it may, with effect from and including the Relevant Implementation Date, make an offer of Securities to the public in that Relevant Member State at any time:

(a) to legal entities which are authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities;

(b) to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts; or

(c) in any other circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this paragraph, the expression an "offer of Securities to the public" in relation to any Securities in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Securities to be offered so as to enable an investor to decide to purchase or subscribe the Securities, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression Prospectus Directive means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

United Kingdom

The Manager has represented and agreed that:

(a) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of Section 21 of the Financial Services and Markets Act 2000 (the FSMA)) received by it in connection with the issue or sale of the Securities in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer or the Guarantor; and

(b) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Securities in, from or otherwise involving the United Kingdom.

Singapore

This Offering Circular has not been registered as a prospectus with the Monetary Authority of Singapore and the Securities will be offered in Singapore pursuant to exemptions invoked under Section 274 and Section 275 of the Securities and Futures Act 2001 (the SFA), Chapter 289, of Singapore. Accordingly, the Manager has represented and agreed that the Securities may not be offered or sold or be made subject of an invitation for subscription or purchase, nor may this Offering Circular or any other offering document or material relating to the Securities be circulated or distributed, directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor or other person specified in Section 274 of the SFA, (ii) to a sophisticated investor, and in accordance with the conditions, specified in Section 275 of the SFA or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provisions of the SFA.

Hong Kong

The Manager has represented and agreed that (i) it has not offered or sold and will not offer or sell in Hong Kong by means of any document, any Securities other than (x) to persons whose ordinary business it is to buy or sell shares or debentures (whether as principal or agent), (y) to "professional investors" as defined in the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) (the SFO) and any rules made thereunder or (z) in other circumstances which do not result in the document being a "prospectus" as defined in the Companies Ordinance (Cap. 32 of the Laws of Hong Kong) or which do not constitute an offer to the public within the meaning of the Companies Ordinance; and (ii) it has not issued or had in its possession for the purpose of issue and will not issue or have in its possession for the purpose of issue any other document, invitation or advertisement relating to the Securities whether in Hong Kong or elsewhere which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to Securities which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" as defined in the SFO and any rules made thereunder.

Japan

The Manager has represented and agreed that (i) the Manager understands that the Securities have not been and will not be registered under the Securities and Exchange Law of Japan; and (ii) it has not offered or sold, and agrees not to offer or sell, directly or indirectly, any Securities in Japan or to, or for the account or benefit of, any resident of Japan or to, or for the account or benefit of, any person for reoffering or resale, directly or indirectly, in Japan or to, or for the account or benefit of, any resident of Japan except pursuant to any exemption from the registration requirements of the Securities and Exchange Law of Japan and otherwise in compliance with applicable provisions of Japanese law. As used in this paragraph, "resident of Japan" means any person residing in Japan, including any corporation or other entity organized under the laws of Japan.

Germany

The Manager has represented and agreed that it has not and will not offer, sell or publicly promote or advertise the Securities, and the Securities may not be offered or sold, in the Federal Republic of Germany other than in compliance with the provisions of the German Securities Prospectus Act (*Wertpapierprospektgesetz, WpPG*) of June 22, 2005, as amended, or any other laws applicable in the Federal Republic of Germany governing the issue, offering and sale of securities.

France

The Manager has represented and agreed that it has not offered or sold and will not offer or sell, directly or indirectly, the Securities to the public in the Republic of France (*appel public à l' épargne*), and has not distributed or caused to be distributed and will not distribute or cause to be distributed to the public in the Republic of France, any offering circular or any other offering material relating to the Securities, and that such offers, sales and distributions have been and shall only be made in France to qualified investors (*investisseurs qualifiés*) acting for their own account, as defined in, and in accordance with, Article L.411-1 and L.411-2 of the *Code Monétaire et Financier* and their implementing *décret*.

British Virgin Islands

The Manager has represented and agreed that it has not made and will not make any invitation on behalf of the Issuer or Guarantor to the public in the British Virgin Islands to purchase the Securities, and the Securities offered through this Offering Circular may not be offered or sold, directly or indirectly, in the British Virgin Islands or to any resident of the British Virgin Islands, except as permitted by British Virgin Islands law.

The Manager and its affiliates have provided, and may in the future provide, investment banking, commercial banking and advisory services to, and have made, and may in the future make, investments in members of the Pacific Century Group.

LEGAL MATTERS

Certain legal matters in connection with the issue and sale of the Notes and the Guarantee offered hereby will be passed upon for the Issuer and the Guarantor by Davis Polk & Wardwell, with respect to certain matters of New York law and United States federal securities law, Simmons & Simmons, with respect to certain matters of Hong Kong law, and Harney Westwood & Riegels, with respect to certain matters of British Virgin Islands law. Certain legal matters under New York law and United States federal securities laws with respect to the offering of the Notes and the Guarantee will be passed upon for the Manager by Allen & Overy.

RATINGS

The Notes have been rated "Baa2" by Moody's, "BBB" by S&P and "BBB+" by Fitch. The credit ratings accorded the Notes are not a recommendation to purchase, hold or sell the Notes inasmuch as such ratings do not comment as to market price or suitability for a particular investor. There can be no assurance that the ratings will remain in effect for a given period or that the ratings will not be revised by the rating agencies in the future if, in their judgment, circumstances so warrant.

INDEPENDENT AUDITORS

The Audited Financial Statements as at December 31, 2002, 2003 and 2004 and for the years ended December 31, 2002, 2003 and 2004 included in this Offering Circular have been audited by KPMG, certified public accountants, as stated in their report appearing herein.

GENERAL INFORMATION

1. The Regulation S global notes and the Rule 144A global notes have been accepted for clearance through Clearstream and Euroclear. For the Regulation S global notes, the CUSIP Number is G69552AA8, the International Securities Identification Number (ISIN) is USG69552AA80 and the Common Code is 022517724. For the Rule 144A global notes, the CUSIP Number is 69319PAA3, the ISIN is US69319PAA30 and the Common Code is 022517643.

2. The Issuer and the Guarantor have obtained all necessary consents, approvals and authorizations as may be required in connection with the issue and performance of the Notes and the giving of the Guarantee, except as disclosed in this Offering Circular. The issue of the Notes was approved by resolutions of the Issuer passed on July 8, 2005 and the giving of the Guarantee by the Guarantor was authorized by resolutions of the Guarantor passed on July 6, 2005.

3. Except as disclosed in this Offering Circular, there has been no material adverse change in the financial position or prospects of the Guarantor since December 31, 2004 and there has been no material adverse change in the financial position or prospects of the Issuer since its date of incorporation.

4. Other than as referred to elsewhere in this Offering Circular, neither the Issuer nor the Guarantor nor any of the Guarantor's subsidiaries is involved in any litigation or arbitration proceedings that if determined adversely to the Guarantor, the Issuer or any of its subsidiaries would, in the aggregate, have a material adverse effect on the consolidated financial position of the Guarantor and the Guarantor's subsidiaries (including the Issuer) taken as a whole, nor is the Issuer, the Guarantor or any of the Guarantor's subsidiaries aware that any such proceedings are pending or threatened.

SUMMARY OF CERTAIN DIFFERENCES BETWEEN HONG KONG GAAP AND U.S. GAAP

The following is a general summary of significant differences between Hong Kong GAAP and U.S. GAAP as applicable to the Guarantor:

The financial position and the results of operations of the Guarantor have been prepared in accordance with Hong Kong GAAP, which differs in certain significant respects from U.S. GAAP. Certain differences between Hong Kong GAAP and U.S. GAAP relevant to the Guarantor's financial position and results are summarized below. The Guarantor has not quantified the effects of the differences between Hong Kong GAAP and U.S. GAAP, and therefore there can be no assurance that the financial position and results of operations reported in accordance with Hong Kong GAAP would not be adversely impacted if determined in accordance with U.S. GAAP. Such summary should not be construed to be exhaustive. Additionally, no attempt has been made to identify disclosure, presentation or classification differences that would affect the manner in which transactions and events are presented in the Guarantor's financial position and results or notes thereto. Further, no attempt has been made to identify future differences between Hong Kong GAAP and U.S. GAAP as a result of prescribed changes in accounting standards. Regulatory bodies that promulgate Hong Kong GAAP and U.S. GAAP have significant projects ongoing that could affect future comparisons such as this one. Finally, no attempt has been made to identify all future differences between Hong Kong GAAP and U.S. GAAP that may affect the Guarantor's financial position and results of operations as a result of transactions or events that may occur in the future.

a) **Revenue recognition**

Under Hong Kong GAAP, non-refundable installation fee related to activation of telephone and broadband Internet services is recognized as revenue when services are provided.

Under U.S. GAAP, installation fee related to activation of ongoing telephone and broadband Internet services is deferred and recognized as revenue over the expected term of the customer relationships.

b) **Investment Properties**

Under Hong Kong GAAP, investment properties with an unexpired lease term of more than 20 years are stated at the balance sheet date at their open market value. They are valued at intervals of not more than three years by external qualified valuers and in each intervening year valuations are undertaken by professionally qualified executives of the Guarantor's ultimate holding company. Surpluses arising on revaluation on a portfolio basis are credited to the income statement to the extent of any deficit arising on revaluation previously charged to the income statement and are thereafter taken to the investment properties revaluation reserve; deficits arising on revaluation are firstly set off against any previous revaluation surpluses taken to investment properties revaluation reserve and thereafter charged to the income statement. No depreciation is provided on investment properties with an unexpired lease term of more than 20 years.

Under U.S. GAAP, investment properties are carried at historical cost less accumulated depreciation.

c) **Impairment of long-lived assets**

Under Hong Kong GAAP, internal and external sources of information are reviewed at each balance sheet date to identify indications that the asset may be impaired or an impairment loss previously recognized no longer exists or may have decreased. If an indication of impairment exists, the asset's recoverable amount is estimated. An impairment loss is recognized in the income statement whenever the carrying value of an asset exceeds its recoverable amount. The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

Under Hong Kong GAAP, in respect of assets other than goodwill, an impairment loss is reversed if there has been a favorable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is reversed only if the loss was caused by a specific external event of an exceptional nature that is not expected to recur, and the increase in recoverable amount relates clearly to the reversal of the effect of that specific event. A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognized in prior years. Reversals of impairment losses are credited to the income statement in the year in which the reversals are recognized.

Under U.S. GAAP, if the carrying value of a long-lived asset is less than its undiscounted sum of estimated future cash flows, the long-lived asset should be adjusted downward to the lower of carrying value and fair value establishing a new cost basis. The new cost basis is not changed for subsequent recoveries in fair value.

d) **Accounting for goodwill**

Under Hong Kong GAAP, positive goodwill arising on consolidation represents the excess of the cost of the acquisition over the Guarantor's share of the fair value of the identifiable assets and liabilities of the subsidiaries acquired. Positive goodwill is amortized to the consolidated income statement on a straight-line basis over its estimated useful life of 10 years. Positive goodwill is in the consolidated balance sheet at cost less any accumulated amortization and impairment losses.

Under U.S. GAAP SFAS No. 142, goodwill is not amortized but is tested for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired, using the prescribed two-step process. The first step screens for potential impairment of goodwill if the fair value of the reporting unit is less than its carrying value, while the second step measures the amount of goodwill impairment, if any, by comparing the implied fair value of goodwill to its carrying value.

e) **Basis of presentation**

Under Hong Kong GAAP, assets and liabilities of a business that are transferred between entities under common control in connection with a business reorganization are accounted for at fair value from the effective date of transfer.

Under U.S. GAAP, assets and liabilities of a business that are transferred between entities under common control in connection with a business reorganization or acquisition are accounted for at historical cost in a manner similar to a pooling of interests ("as-if-pooling-of-interests accounting"). In "as-if-pooling-of-interests accounting", the financial statements of the acquiror for periods prior to the transfers are restated to reflect the assets and liabilities and results of operations of the transferred business on a combined basis from the date of common control. Any difference between the amounts paid and the historical cost is reflected as either a deemed dividend or contributed capital.

f) **Restructuring costs**

Under Hong Kong GAAP, restructuring costs are provided for when a legal or constructive obligation to pay such cost is established.

Under U.S. GAAP, certain restructuring costs relating to employees who continue to provide the services to the group are deferred and recognized when the services are performed.

g) **Employee stock option schemes**

Under Hong Kong GAAP, when the Guarantor grants employees options to acquire shares of its ultimate holding company at nil consideration, no employee benefit cost or obligation is recognized at the date of grant or upon exercise of the options.

Under U.S. GAAP, compensation expense is recorded in an entity's financial statements when share options on the stock of the entity's parent company are granted to its employees. Under Accounting Principles Board Opinion No. 25 "Accounting for stock issued to employees" and related interpretation, the amount of compensation expense is determined based on the intrinsic value, i.e. the excess, if any, of the quoted market price of the stock over the exercise price of the options at the measurement date and is amortized over the vesting period of the options concerned. Certain modifications to outstanding options result in a new measurement date and in certain instances result in variable accounting.

Alternatively, under U.S. GAAP, a company could adopt the fair value model included in Statement 123. Under this model, stock options are valued at fair value at the date of grant and the compensation cost is recognized over the vesting period.

h) **Derivative instruments**

Under Hong Kong GAAP, gains and losses on the revaluation and maturity of forward foreign exchange contracts used for hedging purposes are recorded in the income statement and are offset against gains and losses arising from the foreign exchange transactions and revaluation of foreign currency denominated assets and liabilities which these contracts are hedging. Interest rate swaps are used to manage exposure to interest rate fluctuations. The notional amounts are recorded off balance sheet. Interest flows are accounted for on an accrual basis. Interest income or expense arising from the interest rate swap contracts are netted off against the related interest income or expense applicable to the on-balance sheet items which these financial instruments are hedging.

Under U.S. GAAP, SFAS No. 133 "Accounting for Derivative Instruments and Hedge Activities", as amended by SFAS No. 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities" requires all financial instruments and derivatives to be recognized on the balance sheet at fair value. The accounting for changes in fair value depends on whether the derivative instrument is designated and qualifies as a hedging relationship. The gain or loss on a derivative instrument designated and qualifying as a fair value hedging instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk shall be recognized currently in the income statement. The gain or loss on a derivative instrument designated and qualifying as a cash flow hedging instrument shall be reported as a component of other comprehensive income and reclassified into the income statement in the same period affected by the hedged forecasted transaction. The gain or loss on a derivative instrument not qualifying for hedge accounting should be recognized in the income statement.

i) **Deferred taxation**

Under Hong Kong GAAP, apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilized, are recognized. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilized. The limited exceptions to recognition of deferred tax assets and liabilities include those temporary differences arising from goodwill not deductible for tax purposes and from the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided that they are not part of a business combination).

Under Hong Kong GAAP, the amount of deferred tax recognized is measured based on the expected manner of realization or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted. The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilized. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Under U.S. GAAP, deferred tax assets and liabilities are recognized for the expected future tax consequences of all taxable temporary differences and loss or tax credit carryforwards using enacted tax rates expected to be in effect when these differences are realized. Valuation allowances are recorded for deferred tax assets for which it is more likely than not that such assets will not be realized.

ANNEX A

GLOBAL CLEARANCE AND SETTLEMENT

Investors in the Notes may hold the Notes through any of DTC, Euroclear or Clearstream. The Notes will be transferable as home market instruments in both the European and United States domestic markets. Initial settlement and all secondary trades will settle in same-day funds. Although DTC, Euroclear and Clearstream have agreed to the procedures provided below in order to facilitate transfers of Notes among participants of DTC, Euroclear and Clearstream, they are under no obligation to perform or continue to perform such procedures, and such procedures may be modified or discontinued at any time. Neither the Issuer or the Guarantor will have any responsibility for the performance by DTC, Euroclear or Clearstream or their respective participants or indirect participants of their respective obligations under the rules and procedures governing their operations.

The Clearing System

DTC

DTC is a limited purpose trust company organized under the laws of the State of New York, a "banking organization" within the meaning of New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC was created to hold securities for its Participants and facilitate the clearance and settlement of securities transactions between Participants through electronic book-entry changes in accounts of its participants, thereby eliminating the need for physical movement of certificates. Participants include securities brokers and dealers, banks, trust companies and clearing corporations and certain other organizations. Indirect access to the DTC system is available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a Participant, either directly or indirectly (indirect participants).

Euroclear and Clearstream

Euroclear and Clearstream hold securities for participating organizations and facilitate the clearance and settlement of securities transactions between their respective participants through electronic book-entry changes in accounts of such participants. Euroclear and Clearstream provide to their participants, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream interface with domestic securities markets. Euroclear and Clearstream participants are financial institutions such as underwriters, securities brokers and dealers, banks, trust companies and certain other organizations. Indirect access to Euroclear or Clearstream is also available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a Euroclear or Clearstream participant, either directly or indirectly.

Initial Settlement

The Notes will be issued initially in the form of one or more 144A global notes and Regulation S global notes in book-entry form and will be deposited with HSBC Bank USA, National Association as custodian for DTC. Investors' interests in Notes held in book-entry form by DTC will be represented through financial institutions acting on their behalf as direct and indirect participants in DTC. As a result, Euroclear and Clearstream will initially hold positions on behalf of their participants through their depositories, which in turn, will hold such positions in accounts as participants of DTC.

Investors electing to hold their Notes through DTC will follow the DTC settlement practices applicable to U.S. corporate debt obligations *provided* that the Notes will trade in DTC's same-day funds settlement system.

Investor securities custodian accounts will therefore be credited with their holdings against payment in same-day funds on the settlement date.

Investors electing to hold their Notes through Euroclear or Clearstream accounts will follow the settlement procedures applicable to conventional eurobonds. The Notes will be credited to the accounts of depositories and will be processed by Euroclear or Clearstream in accordance with usual new issue procedures.

Secondary Marketing Trading

Because the purchaser determines the place of delivery, it is important to establish at the time of trading of any Notes where both the purchaser's and seller's accounts are located to ensure that settlement can be made on the desired value date.

Trading between DTC participants

Secondary market trading between DTC participants (other than the depositaries for Euroclear and Clearstream) will be settled using the procedures applicable to United States corporate debt obligations in same-day funds.

Trading between Euroclear and/or Clearstream participants

Secondary market trading between Euroclear participants and/or Clearstream participants will be settled using the procedures applicable to conventional eurobonds in same-day funds.

Trading between DTC seller and Euroclear or Clearstream purchaser

When Notes are to be transferred from the account of a DTC participant (other than the depositaries for Euroclear and Clearstream) to the account of a Euroclear participant or a Clearstream participant, the purchaser must send instructions to Euroclear or Clearstream through a participant at least one Business Day prior to settlement. Euroclear or Clearstream, as the case may be, will instruct their respective depositaries to receive the Notes against payment. Payment will include interest accrued on the Notes from and including the last interest payment date to and excluding the settlement date, on the basis of a calendar year consisting of twelve 30-day calendar months. For transactions settling on the 31st day of the month, payment will include interest accrued to and excluding the first day of the following month. Payment will then be made by a Euroclear or Clearstream depository, to the DTC participant's account against delivery of the Notes. After settlement has been completed, the Notes will be credited to the respective clearing system and by the clearing system, in accordance with its usual procedures, to the Euroclear participants' or Clearstream participants' account. Credit for the Notes will appear on the next day (European time) and cash debt will be back-valued to, and interest on the Notes will accrue from, the value date (which would be the preceding day when settlement occurs in New York). If settlement is not completed on the intended value date (i.e., the trade fails), the Euroclear or Clearstream cash debt will be valued instead as at the accrual settlement date.

Euroclear participants and Clearstream participants will need to make available to the respective clearing system the funds necessary to process same-day funds settlement. The most direct means of doing so is to preposition funds for settlement, either from cash on hand or existing lines of credit, as they would for any settlement occurring within Euroclear or Clearstream. Under this approach, they may take on credit exposure to Euroclear or Clearstream until the Notes are credited to their accounts one day later.

As an alternative, if Euroclear or Clearstream has extended a line of credit to them, participants can elect not to pre-position funds and allow their credit line to be drawn upon to finance settlement. Under this procedure, Euroclear participants or Clearstream participants purchasing the Notes would incur overdraft charges for one day assuming they cleared the overdraft when the Notes were credited to their accounts. However, interest on the Notes would accrue from the value date. Therefore, in many cases, the investment income on the Notes earned during that one-day period may substantially reduce or offset the amount of such overdraft charges, although this result will depend on each participant's particular cost of funds.

Because the settlement is taking place during New York business hours, DTC participants can employ their usual procedures for sending the Notes to a Euroclear or Clearstream depository, for the benefit of Euroclear participants or Clearstream participants. The sale proceeds will be available to the DTC seller on the settlement date. Thus, to the DTC participant, a cross-market transaction will settle no differently than a trade between two DTC participants.

Trading between Euroclear or Clearstream seller and DTC purchaser

Due to time zone differences in their favor, Euroclear participants and Clearstream participants may employ their customary procedures for transactions in which the Notes are to be transferred by the respective clearing system through a Euroclear or Clearstream depository, to another DTC participant. The seller must send instructions to Euroclear or Clearstream through a participant at least one business day prior to settlement. In these cases, Euroclear or Clearstream will instruct a Euroclear or Clearstream depository, as appropriate, to credit the Notes to the DTC participant's account against payment. Payment will include interest accrued on the Notes from and including the payment date to and excluding the settlement date on the basis of a calendar year consisting of twelve 30-day calendar months. For transactions settling on the 31st day of the month, payment will include interest accrued to and excluding the first day of the following month. The payment will then be reflected in the amount of the Euroclear participant or Clearstream participant the following day, and receipt of the cash proceeds in the Euroclear or Clearstream participant's account will be back-valued to the value date. (which would be the preceding day, when settlement occurs in New York). If the Euroclear participant or Clearstream participant has a line of credit with its respective clearing system and elects to draw on such line of credit in anticipation of receipt of the sale proceeds in its account, the back-valuation may substantially reduce or offset any overdraft charges incurred over that one-day period. If settlement is not completed on the intended value date (i.e., the trade fails), receipt of the cash proceeds in the Euroclear or Clearstream participant's account would instead be valued as at the accrual settlement date.

Finally, day traders that use Euroclear or Clearstream and that purchase the Notes from DTC participants for credit to Euroclear participants or Clearstream participants should note that these trades would automatically fail on the sale side unless affirmative action were taken. At least three techniques should be readily available to eliminate this potential problem:

(1) borrowing through Euroclear or Clearstream for one day (until the purchase side of the day trade is reflected in the Euroclear account or Clearstream account) in accordance with the clearing system's customary procedures;

(2) borrowing the Notes in the United States from a DTC participant no later than one day prior to settlement, which would give the Notes sufficient time to be reflected in the borrower's Euroclear account or Clearstream account in order to settle the sale side of the trade; or

(3) staggering the value dates for the buy and sell sides of the trade so that the value date for the purchase from the DTC participant is at least one day prior to the value date for the sale to the Euroclear participant or Clearstream participant.

INDEX TO AUDITED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2002, 2003 AND 2004

Auditors' Report

To the Directors of PCCW-HKT Telephone Limited
(incorporated in Hong Kong with limited liability)

We have audited the non-statutory financial statements on pages F-3 to F-43 which have been prepared in accordance with accounting principles generally accepted in Hong Kong. As explained in note 1, these financial statements have been prepared by the directors for the years ended December 31, 2002, 2003 and 2004, which are not the company's statutory financial years.

Respective responsibilities of directors and auditors

The directors of the company have undertaken to prepare these financial statements to give a true and fair view of the state of affairs of the company and the group as at December 31, 2002, 2003 and 2004 and of the group's profit and cash flows for the years then ended. In preparing such financial statements it is fundamental that appropriate accounting policies are selected and applied consistently, that judgments and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Basis of opinion

We conducted our audits in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's and the group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audits so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Opinion

In our opinion, the non-statutory financial statements give a true and fair view of the state of affairs of the company and of the group as at December 31, 2002, 2003 and 2004 and of the group's profit and cash flows for the years then ended.

KPMG

Certified Public Accountants

Hong Kong, March 30, 2005

PCCW-HKT Telephone Limited

Consolidated income statements

	Notes	Year ended December 31 2002 HK$M	2003 HK$M	2004 HK$M
Turnover	3	15,126	14,118	12,923
Other income	4	—	114	326
Other revenue	5	137	23	55
Operating costs	6	(9,035)	(8,212)	(8,123)
Restructuring costs	7	(411)	—	(13)
Impairment loss on fixed assets	8	—	(966)	—
Fixed assets written off		(40)	—	—
Profit from operations		5,777	5,077	5,168
Finance costs	9	(1,308)	(981)	(791)
Profit before taxation		4,469	4,096	4,377
Taxation	10(a)	(924)	(1,054)	(910)
Profit attributable to shareholders	11 & 26	3,545	3,042	3,467

The notes on pages F-9 to F-43 form part of these financial statements.

PCCW-HKT Telephone Limited

Consolidated balance sheets

	Notes	As at December 31 2002 HK$M	2003 HK$M	2004 HK$M
Non-current assets				
Fixed assets	13	13,775	12,313	11,809
Goodwill	14	480	428	376
Loan to ultimate holding company	15	—	—	4,476
Loan to intermediate holding company	16	33,986	16,705	—
Deferred tax assets	10(c)	—	44	—
		48,241	29,490	16,661
Current assets				
Inventories		41	55	33
Trade and other receivables	18	4,155	5,092	4,486
Cash and cash equivalents	19	1,056	985	277
		5,252	6,132	4,796
Current liabilities				
Trade and other payables	20	3,803	3,168	3,695
Taxation	10(b)	901	824	589
		4,704	3,992	4,284
Net current assets		548	2,140	512
Total assets less current liabilities		48,789	31,630	17,173
Non-current liabilities				
Interest-bearing borrowings	21	29,220	11,605	11,582
Deferred tax liabilities	10(c)	1,457	1,410	1,375
Defined benefit liability	23(a)	419	347	128
		31,096	13,362	13,085
Net assets		17,693	18,268	4,088
Capital and reserves				
Share capital	25	2,164	2,164	2,164
Reserves	26	15,529	16,104	1,924
Shareholders' funds		17,693	18,268	4,088

The financial statements on pages F-3 to F-8 were approved and authorised for issue by the Board of Directors on March 30, 2005 and were signed on their behalf by:

/s/ Alexander A Arena	/s/ Francis T F Yuen
Director	Director

The notes on pages F-9 to F-43 form part of these financial statements.

PCCW-HKT Telephone Limited

Balance sheets

	Notes	As at December 31 2002 HK$M	2003 HK$M	2004 HK$M
Non-current assets				
Fixed assets	13	13,563	12,124	11,636
Loan to ultimate holding company	15	—	—	4,476
Loan to intermediate holding company	16	33,986	16,705	—
Investments in subsidiaries	17	595	595	595
		48,144	29,424	16,707
Current assets				
Inventories		38	47	32
Trade and other receivables	18	4,404	5,007	5,891
Cash and cash equivalents	19	1,044	980	276
		5,486	6,034	6,199
Current liabilities				
Trade and other payables	20	3,627	2,357	2,023
Taxation	10(b)	901	812	589
		4,528	3,169	2,612
Net current assets		958	2,865	3,587
Total assets less current liabilities		49,102	32,289	20,294
Non-current liabilities				
Interest-bearing borrowings	21	29,220	11,605	11,582
Deferred tax liabilities	10(c)	1,457	1,410	1,375
Defined benefit liability	23(a)	420	133	130
		31,097	13,148	13,087
Net assets		18,005	19,141	7,207
Capital and reserves				
Share capital	25	2,164	2,164	2,164
Reserves	26	15,841	16,977	5,043
Shareholders' funds		18,005	19,141	7,207

The financial statements on pages F-3 to F-8 were approved and authorised for issue by the Board of Directors on March 30, 2005 and were signed on their behalf by:

/s/ Alexander A Arena	/s/ Francis T F Yuen
Director	Director

The notes on pages F-9 to F-43 form part of these financial statements.

PCCW-HKT Telephone Limited

Consolidated statements of changes in equity

	Notes	Year ended December 31 2002 HK$M	2003 HK$M	2004 HK$M
Shareholders' equity at January 1		20,392	17,693	18,268
(Deficit)/surplus on revaluation of investment properties, not recognised in the consolidated income statement	13 & 26	(11)	—	16
Net profit for the year	26	3,545	3,042	3,467
Dividends approved during the year	12 & 26	(6,233)	(2,467)	(17,663)
Shareholders' equity at December 31		17,693	18,268	4,088

The notes on pages F-9 to F-43 form part of these financial statements.

PCCW-HKT Telephone Limited

Consolidated cash flow statements

	Notes	Year ended December 31 2002	2003	2004
		HK$M	HK$M	HK$M
Operating activities				
Profit before taxation		4,469	4,096	4,377
Adjustments for:				
- Depreciation		2,476	2,129	1,967
- Amortisation of goodwill		39	52	52
- Finance costs		1,308	981	791
- Interest income		(137)	(23)	(55)
- Other income		—	(114)	(326)
- Foreign exchange (gain)/loss		(3)	2	(35)
- Impairment loss on fixed assets		—	966	—
- Loss on disposal of fixed assets		1	—	—
- Fixed assets written off		40	—	—
Operating profit before changes in working capital		8,193	8,089	6,771
Decrease/(increase) in inventories		15	(14)	22
(Increase)/decrease in trade and other receivables		(306)	(851)	217
Decrease in trade and other payables		(225)	(993)	(458)
Increase/(decrease) in defined benefit liability		67	(72)	(3)
Cash generated from operations		7,744	6,159	6,549
Tax paid				
- Hong Kong Profits Tax paid		(1,050)	(1,222)	(1,152)
Net cash from operating activities		6,694	4,937	5,397
Investing activities				
Loan granted to ultimate holding company		—	—	(2,800)
Payment for purchase of fixed assets		(1,301)	(1,335)	(1,630)
Proceeds from disposal of a subsidiary, net of cash disposed	27	—	—	214
Proceeds from disposal of fixed assets		2	5	160
Interest received		137	23	23
Loans repaid by intermediate holding company		2,662	17,281	—
Cash acquired from purchase of a subsidiary	28	17	—	—
Net cash generated from/(used in) investing activities		1,517	15,974	(4,033)

PCCW-HKT Telephone Limited

Consolidated cash flow statements — (Continued)

	Note	2002	2003	2004
		Year ended December 31		
		HK$M	**HK$M**	**HK$M**
Financing activities				
Proceeds from new bank loans		10,000	—	10,200
Proceeds from new notes issued		—	3,900	—
Proceeds from new loan from ultimate holding company		3,510	—	—
Repayment of bank loans		(16,450)	(16,093)	(10,200)
Repayment of loan from ultimate holding company		—	(5,537)	—
Dividends paid		(6,233)	(2,467)	(1,263)
Borrowing costs paid		(1,156)	(761)	(777)
Loan facility fees paid		(102)	(138)	(32)
Proceeds from termination of swap contracts		—	114	—
Net cash used in financing activities		(10,431)	(20,982)	(2,072)
Net decrease in cash and cash equivalents		(2,220)	(71)	(708)
Cash and cash equivalents at January 1		3,276	1,056	985
Cash and cash equivalents at December 31	19	1,056	985	277

The notes on pages F-9 to F-43 form part of these financial statements.

PCCW-HKT Telephone Limited

Notes on the financial statements

1 BASIS OF PREPARATION

The company is a private limited company incorporated in Hong Kong. The directors consider as at December 31, 2004 the ultimate holding company to be PCCW Limited ("PCCW"), a company incorporated in Hong Kong.

The financial statements have been prepared in accordance with the accounting policies set out in note 2. The accounting policies set out in note 2 are in accordance with all applicable Hong Kong Financial Reporting Standards (which includes all applicable Statements of Standard Accounting Practices and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants and accounting principles generally accepted in Hong Kong. The financial statements have been prepared on a consistent basis with the audited statutory financial statements of the company for the years ended March 31, 2002, 2003 and 2004.

The measurement basis used in the preparation of the financial statements is historical cost modified by the revaluation of investment properties as explained in the accounting policies set out below.

The financial information has been prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance in so far as they relate to the preparation of the financial statements. The financial statements should not be taken as being the statutory financial statements of the group or the company prepared for the purposes of complying with sections 122 and 124 of the Hong Kong Companies Ordinance.

Recently issued accounting standards

The Hong Kong Institute of Certified Public Accountants has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards ("new HKFRSs") which are effective for accounting periods beginning on or after 1 January 2005.

The group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004. The group has already commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a significant impact on its results of operations and financial position.

2 PRINCIPAL ACCOUNTING POLICIES

A summary of the principal accounting policies adopted by the group is set out as follows:

(a) **Subsidiaries**

A subsidiary, in accordance with the Hong Kong Companies Ordinance, is a company in which the group, directly or indirectly, holds more than half of the issued share capital, or controls more than half of the voting power, or controls the composition of the board of directors. Subsidiaries are considered to be controlled if the company has the power, directly or indirectly, to govern the financial and operating policies, so as to obtain benefits from their activities.

An investment in a controlled subsidiary is consolidated into the consolidated financial statements.

Intra-group balances and transactions, and any unrealised profits arising from intra-group transactions, are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

In the company's balance sheet, an investment in a subsidiary is stated at cost less any impairment losses (see note 2(f)).

(b) **Goodwill**

Positive goodwill arising on consolidation represents the excess of the cost of the acquisition over the company's share of the fair value of the identifiable assets and liabilities of the subsidiaries acquired. Positive goodwill is amortised to the consolidated income statement on a straight-line basis over its estimated useful life of 10 years. Positive goodwill is stated in the consolidated balance sheet at cost less any accumulated amortisation and impairment losses (see note 2(f)).

On disposal of a subsidiary, any attributable amount of positive goodwill not previously amortised through the consolidated income statement is included in the calculation of the profit or loss on disposal.

(c) **Revenue recognition**

Revenue is recognised when it is probable that the economic benefits will flow to the group and when the revenue and cost, if applicable, can be measured reliably, as follows:

(i) Telecommunications revenue charged on the basis of the usage of the group's network and facilities is recognised when the related services are rendered. Telecommunications revenue for services provided for fixed periods is recognised on a straight line basis over the respective contract periods. Non-refundable installation fee related to activation of telephone and broadband Internet services is recognized as revenue when services are rendered. Other telecommunications revenue is recognised when products are delivered or services are rendered to customers.

(ii) Revenue from the provision of interactive multimedia services and support services is recognised when the services are rendered.

(iii) Interest income from bank deposits and loans receivable is accrued on a time-apportioned basis on the principal outstanding and at the rate applicable.

(d) **Fixed assets**

(i) Investment properties with an unexpired lease term of more than 20 years are stated at the balance sheet date at their open market value. They are valued at intervals of not more than three years by external qualified valuers and in each intervening year valuations are undertaken by professionally qualified executives of the company's ultimate holding company. Surpluses arising on revaluation on a portfolio basis are credited to the income statement to the extent of any deficit arising on revaluation previously charged to the income statement and are thereafter taken to the investment properties revaluation reserve; deficits arising on revaluation are firstly set off against any previous revaluation surpluses taken to investment properties revaluation reserve and thereafter charged to the income statement.

(ii) Projects under construction are stated at specifically identified cost and are included in the costs of fixed assets. The expenditure capitalised includes attributable staff costs, subcontracting costs, cost of materials, borrowing costs and attributable overheads.

(iii) Fixed assets other than investment properties and projects under construction are stated in the balance sheet at cost less accumulated depreciation (see note 2(e)) and impairment losses (see note 2(f)).

(iv) Subsequent expenditure relating to a fixed asset that has already been recognised is added to the carrying amount of the asset when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the enterprise. All other subsequent expenditure is recognised as an expense in the period in which it is incurred.

(v) Gains or losses arising from the retirement or disposal of a fixed asset are determined as the difference between the estimated net disposal proceeds and the carrying amount of the asset and are recognised in the income statement on the date of retirement or disposal. On disposal of an investment property, the related portion of surpluses or deficits previously taken to the investment properties revaluation reserve is also transferred to the income statement for the year.

(e) **Depreciation**

No depreciation is provided on projects under construction or investment properties with an unexpired lease term of more than 20 years. Depreciation is calculated to write off the cost of other fixed assets on a straight-line basis over their estimated useful lives as follows:

Leasehold land	the remaining term of the lease
Buildings	the shorter of 50 years or the remaining term of the lease
Exchange equipment	3 to 15 years
Transmission plant	5 to 25 years
Other plant and equipment	1 to 16 years

(f) **Impairment of assets**

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or an impairment loss previously recognised no longer exists or may have decreased:

— fixed assets (other than properties carried at revalued amounts);

— investments in subsidiaries; and

— positive goodwill.

If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised in the income statement whenever the carrying amount of such an asset exceeds its recoverable amount.

(i) *Calculation of recoverable amount*

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

(ii) *Reversals of impairment losses*

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is reversed only if the loss was caused by a specific external event of an exceptional nature that is not expected to recur, and the increase in recoverable amount relates clearly to the reversal of the effect of that specific event.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the income statement in the year in which the reversals are recognised.

(g) **Employee benefits**

Salaries, annual bonuses, paid annual leave, leave passage and the cost to the group of non-monetary benefits are accrued in the year in which the associated services are rendered by employees of the group.

Contributions to defined contribution schemes, including Mandatory Provident Funds as required under the Hong Kong Mandatory Provident Fund Schemes Ordinance, are recognised as an expense in the income statement as incurred.

The group's ultimate holding company, PCCW, operates a defined benefit retirement scheme for the qualifying employees of PCCW group companies. The group's net obligation in respect of the defined benefit retirement scheme is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine the present value, and the fair value of any scheme assets is deducted. The discount rate is the yield at balance sheet date on high quality corporate bonds that have maturity dates approximating the terms of the group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

To the extent that any cumulative unrecognised actuarial gain or loss in respect of the scheme exceeds ten percent of the greater of the present value of the defined benefit obligation and the fair value of scheme assets, that portion is recognised in the consolidated income statement of PCCW over the expected average remaining working lives of the employees participating in the scheme. Otherwise, the actuarial gain or loss is not recognised. The amount of actuarial gain or loss recognised in the consolidated income statement of PCCW is allocated to the group based on the proportion of the present value of the group's defined benefit obligation in respect of the scheme to total present value of the defined benefit obligation of the scheme.

Where the calculation of the group's net obligation results in a negative amount, the asset recognised is limited to the net total of any cumulative unrecognised net actuarial losses and past service costs and the present value of any future refunds from the scheme or reductions in future contributions to the scheme.

When the group grants employees options to acquire shares of its ultimate holding company at nil consideration, no employee benefit cost or obligation is recognised at the date of grant or upon exercise of the options.

Termination benefits are recognised when, and only when, the group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

(h) **Inventories**

Inventories are stated at the lower of cost and net realisable value.

Cost is calculated using the weighted average cost formula and comprises all costs of purchase and other costs incurred in bringing the inventories to their present location and condition.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

(i) **Income tax**

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the income statement.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities include those temporary differences arising from goodwill not deductible for tax purposes and from the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided that they are not part of a business combination).

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if, and only if, the company or the group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

— in the case of current tax assets and liabilities, the company or the group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or

— in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:

  — the same taxable entity; or

  — different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

(j) **Translation of foreign currencies**

Foreign currency transactions during the year are translated into Hong Kong dollars at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the exchange rates ruling at the balance sheet date. Foreign currency assets, being equity investments or other long-term non-monetary assets, the holding or the use or the subsequent disposal of which will generate receipts in a foreign currency, hedged by foreign currency borrowings, are translated into Hong Kong dollars at the exchange rates ruling at the balance sheet date.

Exchange gains and losses are dealt with in the income statement, except those arising from the translation at closing rates of foreign currency assets hedged by foreign currency borrowings, and the gains and losses on those foreign currency borrowings (to the extent of exchange differences arising on the foreign currency assets), which are taken directly to reserves.

(k) **Operating leases**

Rental income and expenses under operating leases are accounted for in the income statement on a straight-line basis over the periods of the respective leases.

(l) **Borrowing costs**

Borrowing costs are expensed in the income statement in the period in which they are incurred, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

(m) **Prepaid loan facility fees**

Prepaid loan facility fees are carried forward and charged to the consolidated income statement on a straight-line basis over the period of the facility.

(n) **Related parties**

For the purposes of these financial statements, parties are considered to be related to the group if the group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the group and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

Assets and liabilities of a business that are transferred between entities under common control in connection with a business reorganization are accounted for at fair value from the effective date of transfer.

The group has taken advantage of the exemption from the disclosure requirements of Statement of Standard Accounting Practice 2.120 "Related party disclosure" ("SSAP 20") as the company is a wholly owned subsidiary and the consolidated financial statements in which the company is included contain related party disclosures required by SSAP 20.

(o) **Cash equivalents**

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition. Bank overdrafts that are repayable on demand and form an integral part of the group's cash management are also included as a component of cash and cash equivalents for the purpose of the consolidated cash flow statement.

(p) **Provisions and contingent liabilities**

Provisions are recognised for liabilities of uncertain timing or amount when the company or group has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Restructuring costs are provided for when a legal or constructive obligation to pay such cost is established.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(q) **Off-balance sheet financial instruments**

Gains and losses on the revaluation and maturity of forward foreign exchange contracts used for hedging purposes are recorded in the income statement and are offset against gains and losses arising from the foreign exchange transactions and revaluation of foreign currency denominated assets and liabilities which these contracts are hedging.

Interest rate swaps are used to manage exposure to interest rate fluctuations. The notional amounts are recorded off balance sheet. Interest flows are accounted for on an accrual basis. Interest income or expense arising from the interest rate swap contracts are netted off against the related interest income or expense applicable to the on-balance sheet items which these financial instruments are hedging.

3 TURNOVER

The principal activity of the group is the provision of telecommunications services. Turnover comprises the following:

(i) Local telephony services - amounts accruing to the group from domestic telephone lines and associated value-added services, payphones and charges for wholesale interconnect services.

(ii) Local data and broadband services - amounts accruing to the group from local leased circuits, managed data services, wholesale and retail broadband access lines.

(iii) International telecommunications services - amounts accruing to the group from international voice and data telecommunications services which include gross retail collections from the group's international telephone services and delivery fees for delivery of international traffic.

(iv) Other services - amounts accruing to the group from technical, management and maintenance services.

Turnover is categorised as follows:

	Year ended December 31		
	2002	**2003**	**2004**
	HK$M	**HK$M**	**HK$M**
Local telephony services	6,864	6,024	5,301
Local data and broadband services	4,582	4,636	4,463
International telecommunications services	2,777	2,161	1,608
Other services	903	1,297	1,551
	15,126	14,118	12,923

4 OTHER INCOME

	Year ended December 31		
	2002	**2003**	**2004**
	HK$M	**HK$M**	**HK$M**
Gain on disposal of a subsidiary (note 27)	—	—	172
Gain on disposal of fixed assets	—	—	154
Gain on termination of swap contracts	—	114	—
	—	114	326

In 2003, the group received $114 million from terminating swap contracts that were entered into for hedging against the group's borrowings.

5 OTHER REVENUE

	Year ended December 31		
	2002	2003	2004
	HK$M	HK$M	HK$M
Interest income from loan to ultimate holding company	—	—	32
Interest income from loan to intermediate holding company	82	—	—
Interest on bank deposits	55	23	23
	137	23	55

6 OPERATING COSTS

Operating costs during the year are categorised as follows:

	Year ended December 31		
	2002	2003	2004
	HK$M	HK$M	HK$M
Depreciation	2,476	2,129	1,967
Cost of services provided	1,939	1,560	1,914
Subcontracting costs	56	374	1,242
Salaries and related costs (note 6(a))	1,829	1,488	994
Rent, rates and utilities	574	551	581
Management fee paid to fellow subsidiary	—	—	480
Management fee paid to intermediate holding company	877	637	—
Amortization of goodwill (note 14)	39	52	52
Loss on disposal of fixed assets	1	—	—
Other operating costs	1,244	1,421	893
	9,035	8,212	8,123

(a) Staff costs:

	Year ended December 31		
	2002	2003	2004
	HK$M	HK$M	HK$M
Contributions to defined contribution retirement schemes	22	58	57
Expenses/(income) recognised in respect of defined benefit retirement scheme (note 23(a)(iv))	133	68	(3)
Retirement costs	155	126	54
Salaries, wages and other benefits	1,674	1,362	940
	1,829	1,488	994

The group capitalised salaries and related costs of $51 million during the year (2003: $224 million; 2002: $334 million) in relation to the construction of fixed assets.

(b) Included in operating costs are the following charges:

	Year ended December 31		
	2002	2003	2004
	HK$M	HK$M	HK$M
Operating lease charges in respect of land and buildings	141	108	131
Auditors' remuneration	2	2	2
Directors' remuneration:			
- Fees	—	—	—
- Other emoluments	—	—	—

7 RESTRUCTURING COSTS

In 2002, the group outsourced a significant portion of its network maintenance function to newly established companies owned by, and to employ, staff previously employed by the group. Approximately 1,600 of the company's employees transferred employment to the above companies.

In November 2002, approximately 3,000 of the company's employees agreed to transfer their employment to a new wholly owned subsidiary, Cascade Limited, with effect from January 1, 2003. In addition, approximately 430 employees were made redundant in the month.

Restructuring cost in 2002 related to ex-gratia payments, curtailment loss on retirement schemes, payment in lieu of notice and payment for untaken leave.

Restructuring cost in 2004 primarily represent ex-gratia payments, payment in lieu of notice and payment for untaken leave to certain staff made redundant during the year.

8 IMPAIRMENT LOSS ON FIXED ASSETS

In 2003, certain fixed assets of the group became obsolete or otherwise impaired due to technology and market changes in the sectors in which the group operated. Accordingly, the group recognised an impairment loss of $966 million in 2003.

9 FINANCE COSTS

	Year ended December 31		
	2002	2003	2004
	HK$M	HK$M	HK$M
Interest on bank loans and other borrowings repayable beyond 5 years	1,145	541	747
Interest on bank advances and other borrowings wholly repayable within 5 years	2	292	5
Loan facility fees and other finance costs	194	165	59
Less: Interest capitalised into projects under construction	(33)	(17)	(20)
	1,308	981	791

Interest expense has been capitalised at rates equivalent to the cost of funds to the group which varied from 3.9% to 5.5% (2003: 2.7% to 4.9%; 2002: 3% to 3.5%).

10 TAXATION

(a) Taxation in the consolidated income statement represents:

	Year ended December 31		
	2002	2003	2004
	HK$M	HK$M	HK$M
Current tax — provision for Hong Kong Profits Tax			
- tax for the year	1,058	1,154	935
- under-provision/(over-provision) in respect of prior years	10	(9)	5
	1,068	1,145	940
Deferred tax			
- reversal of temporary differences	(144)	(223)	(30)
- effect of increase in tax rate on deferred tax balances at January 1	—	132	—
	(144)	(91)	(30)
Total tax expense in the consolidated income statement	924	1,054	910

The provision for Hong Kong Profits Tax is calculated at 16% of the group's estimated assessable profits for the year 2002.

In March 2003, the Hong Kong Government announced an increase in the Profits Tax rate applicable to the group's operations in Hong Kong from 16% to 17.5%. This increase was taken into account in the preparation of the group's financial statements for the year ended December 31, 2003. Accordingly, the provision for Hong Kong Profits Tax in respect of the company for 2003 was calculated at the following Profits Tax rates of its estimated assessable profits:

— 16% applicable for the period from January 1, 2003 to March 31, 2003; and

— 17.5% applicable for the period from April 1, 2003 to December 31, 2003.

The provision for Hong Kong Profits Tax in respect of the company's subsidiaries for 2003 is calculated at 17.5% of their estimated assessable profits for the year.

The provision for Hong Kong Profits Tax is calculated at 17.5% of the group's estimated assessable profits for the year 2004.

Reconciliation between tax expense and accounting profit at applicable tax rates:

	Year ended December 31		
	2002	2003	2004
	HK$M	HK$M	HK$M
Profit before taxation	4,469	4,096	4,377
Notional tax on profit before taxation, calculated at the applicable Profits Tax rates	715	696	766
Tax effect of unused tax losses not recognised	43	113	104
Tax effect of non-deductible expenses	165	126	101
Tax effect of non-taxable income	(9)	(4)	(67)
Under-provision/(over-provision) in respect of prior years	10	(9)	5
Tax effect of temporary differences not recognised	—	—	1
Effect on opening deferred tax balances resulting from an increase in tax rate during the year	—	132	—
Tax expense	924	1,054	910

(b) Current taxation in the balance sheets represents:

	As at December 31			As at December 31		
	The group			The company		
	2002	2003	2004	2002	2003	2004
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
Provision for Hong Kong Profits Tax for the year	1,058	1,154	925	1,058	1,142	925
Provisional Profits Tax paid	(157)	(330)	(341)	(157)	(330)	(341)
	901	824	584	901	812	584
Balance of Profits Tax provision relating to prior years	—	—	5	—	—	5
	901	824	589	901	812	589

The company has been in dispute with Hong Kong's Inland Revenue Department (the "IRD") regarding the deductibility of certain interest payments totalling $1,708 million in the current and previous years' tax computations. Subsequent to the balance sheet date, the company received official notification from the IRD in respect of its intention to disallow the deduction of interest payments in dispute and to issue additional assessments. The directors consider that their grounds for claiming the deduction are reasonable and will lodge a formal objection to the IRD against the additional assessments and accordingly no provision for taxation has been made in the financial statements.

(c) Deferred tax assets and liabilities recognised:

The components of deferred tax (assets)/liabilities recognised in the balance sheets and the movements during the years are as follows:

The group

	Depreciation allowances in excess of related depreciation	Employee defined benefit liability	Others	Total
	HK$M	HK$M	HK$M	HK$M
At January 1, 2002	1,649	(58)	10	1,601
Credited to consolidated income statement	(124)	(2)	(18)	(144)
At December 31, 2002	1,525	(60)	(8)	1,457
At January 1, 2003	1,525	(60)	(8)	1,457
Credited to consolidated income statement	(79)	(12)	—	(91)
At December 31, 2003	1,446	(72)	(8)	1,366
At January 1, 2004	1,446	(72)	(8)	1,366
(Credited)/charged to consolidated income statement	(40)	7	3	(30)
Transferred from fellow subsidiaries	—	(5)	—	(5)
Reduction through disposal of a subsidiary (note 27)	—	44	—	44
At December 31, 2004	1,406	(26)	(5)	1,375

The company

	Depreciation allowances in excess of related depreciation	Employee defined benefit liability	Others	Total
	HK$M	HK$M	HK$M	HK$M
At January 1, 2002	1,649	(58)	10	1,601
Credited to income statement	(124)	(2)	(18)	(144)
At December 31, 2002	1,525	(60)	(8)	1,457
At January 1, 2003	1,525	(60)	(8)	1,457
Credited to income statement	(80)	(11)	—	(91)
Transferred to a subsidiary	—	44	—	44
At December 31, 2003	1,445	(27)	(8)	1,410
At January 1, 2004	1,445	(27)	(8)	1,410
(Credited)/charged to income statement	(39)	1	3	(35)
At December 31, 2004	1,406	(26)	(5)	1,375

	The group			The company		
	2002	2003	2004	2002	2003	2004
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
Net deferred tax asset recognised on the balance sheet	—	(44)	—	—	—	—
Net deferred tax liability recognised on the balance sheet	1,457	1,410	1,375	1,457	1,410	1,375
	1,457	1,366	1,375	1,457	1,410	1,375

No provision for deferred taxation has been made in respect of the revaluation surpluses arising on investment properties as the disposal of these assets at their carrying value would result in capital gains which the directors consider are not subject to any tax liability.

Deferred tax assets of the group have not been recognised in respect of the following items:

	As at December 31		
	2002	2003	2004
	HK$M	HK$M	HK$M
Tax losses carried forward	(647)	(797)	(901)
Taxable temporary differences	31	30	29
Other items	(3)	(2)	(2)
Unprovided deferred tax assets	(619)	(769)	(874)

Deferred tax assets have not been recognised in respect of these items because it is not probable that future taxable profits will be available against which the benefits therefrom can be utilised. The tax losses do not expire under current tax legislation.

11 PROFIT ATTRIBUTABLE TO SHAREHOLDERS

The consolidated profit attributable to shareholders includes a profit of $5,713 million (2003: $3,603 million; 2002: $3,857 million) which has been dealt with in the financial statements of the company.

12 DIVIDENDS

	Year ended December 31		
	2002	2003	2004
	HK$M	HK$M	HK$M
Interim dividend approved and paid of $7.0316 per share for the year ended March 31, 2004 (2003: $nil; 2002: $nil)	—	—	15,215
Final dividend approved and paid of $0.0721 per share for the year ended March 31, 2004 (2003: $0.455 per share for the year ended March 31, 2003; 2002: $1.628 per share for the year ended March 31, 2002)	3,523	985	156
Interim dividends declared and paid of $1.0595 per share for the year ending March 31, 2005 (2003: $0.685 per share for the year ended March 31, 2004; 2002: $1.252 per share for the year ended March 31, 2003)	2,710	1,482	2,292
	6,233	2,467	17,663

13 FIXED ASSETS

The group

	Leasehold land and buildings	Investment properties	Exchange equipment	Trans-mission plant	Other plant and equipment	Projects under construction	Total
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
Cost or valuation:							
At January 1, 2002	1,596	124	13,114	10,992	6,691	1,522	34,039
Additions							
- through acquisition of subsidiary	—	—	—	—	451	59	510
- others	—	—	405	78	158	585	1,226
Disposals	—	—	(15)	—	(73)	—	(88)
Reclassification	5	(7)	796	381	139	(1,314)	—
Deficit on revaluation (note 26)	—	(11)	—	—	—	—	(11)
At December 31, 2002	1,601	106	14,300	11,451	7,366	852	35,676
Representing:							
Cost	1,601	—	14,300	11,451	7,366	852	35,570
Valuation	—	106	—	—	—	—	106
	1,601	106	14,300	11,451	7,366	852	35,676
At January 1, 2003	1,601	106	14,300	11,451	7,366	852	35,676
Additions	—	—	129	236	322	951	1,638
Disposals	—	—	(82)	(18)	(12)	—	(112)
Reclassification	—	—	337	339	128	(804)	—
At December 31, 2003	1,601	106	14,684	12,008	7,804	999	37,202
Representing:							
Cost	1,601	—	14,684	12,008	7,804	999	37,096
Valuation	—	106	—	—	—	—	106
	1,601	106	14,684	12,008	7,804	999	37,202
At January 1, 2004	1,601	106	14,684	12,008	7,804	999	37,202
Additions	—	—	399	333	430	298	1,460
Disposals	(11)	—	(193)	(27)	(73)	—	(304)
Reclassification	9	(10)	642	119	233	(993)	—
Surplus on revaluation (note 26)	—	16	—	—	—	—	16
At December 31, 2004	1,599	112	15,532	12,433	8,394	304	38,374
Representing:							
Cost	1,599	—	15,532	12,433	8,394	304	38,262
Valuation	—	112	—	—	—	—	112
	1,599	112	15,532	12,433	8,394	304	38,374

The group (continued)

	Leasehold land and buildings	Investment properties	Exchange equipment	Trans-mission plant	Other plant and equipment	Projects under construction	Total
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
Depreciation:							
At January 1, 2002........	421	—	7,964	6,101	4,699	—	19,185
Through acquisition of subsidiary	—	—	—	—	285	—	285
Charge for the year	33	—	1,357	515	571	—	2,476
Written back on disposals..................	—	—	(13)	—	(32)	—	(45)
At December 31, 2002 ..	454	—	9,308	6,616	5,523	—	21,901
At January 1, 2003........	454	—	9,308	6,616	5,523	—	21,901
Charge for the year	34	—	968	526	601	—	2,129
Impairment loss	—	—	377	375	214	—	966
Written back on disposals..................	—	—	(82)	(15)	(10)	—	(107)
At December 31, 2003 ..	488	—	10,571	7,502	6,328	—	24,889
At January 1, 2004........	488	—	10,571	7,502	6,328	—	24,889
Charge for the year	33	—	880	461	593	—	1,967
Written back on disposals..................	(6)	—	(193)	(27)	(65)	—	(291)
At December 31, 2004 ..	515	—	11,258	7,936	6,856	—	26,565
Net book value:							
At December 31, 2004 ..	1,084	112	4,274	4,497	1,538	304	11,809
At December 31, 2003 ..	1,113	106	4,113	4,506	1,476	999	12,313
At December 31, 2002 ..	1,147	106	4,992	4,835	1,843	852	13,775
At December 31, 2001 ..	1,175	124	5,150	4,891	1,992	1,522	14,854

The company

	Leasehold land and buildings	Investment properties	Exchange equipment	Trans-mission plant	Other plant and equipment	Projects under construction	Total
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
Cost or valuation:							
At January 1, 2002	1,596	124	13,114	10,992	6,691	1,522	34,039
Additions	—	—	405	78	114	581	1,178
Disposals	—	—	(15)	—	(73)	—	(88)
Reclassification	5	(7)	796	381	91	(1,266)	—
Deficit on revaluation (note 26)	—	(11)	—	—	—	—	(11)
At December 31, 2002	1,601	106	14,300	11,451	6,823	837	35,118
Representing:							
Cost	1,601	—	14,300	11,451	6,823	837	35,012
Valuation	—	106	—	—	—	—	106
	1,601	106	14,300	11,451	6,823	837	35,118
At January 1, 2003	1,601	106	14,300	11,451	6,823	837	35,118
Additions	—	—	129	236	296	902	1,563
Disposals	—	—	(82)	(18)	(12)	—	(112)
Reclassification	—	—	337	339	114	(790)	—
At December 31, 2003	1,601	106	14,684	12,008	7,221	949	36,569
Representing:							
Cost	1,601	—	14,684	12,008	7,221	949	36,463
Valuation	—	106	—	—	—	—	106
	1,601	106	14,684	12,008	7,221	949	36,569
At January 1, 2004	1,601	106	14,684	12,008	7,221	949	36,569
Additions	—	—	399	333	389	283	1,404
Disposals	(11)	—	(193)	(27)	(66)	—	(297)
Reclassification	9	(10)	642	119	188	(948)	—
Surplus on revaluation (note 26)	—	16	—	—	—	—	16
At December 31, 2004	1,599	112	15,532	12,433	7,732	284	37,692
Representing:							
Cost	1,599	—	15,532	12,433	7,732	284	37,580
Valuation	—	112	—	—	—	—	112
	1,599	112	15,532	12,433	7,732	284	37,692

The company (continued)

	Leasehold land and buildings	Investment properties	Exchange equipment	Trans-mission plant	Other plant and equipment	Projects under construction	Total
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
Depreciation:							
At January 1, 2002	421	—	7,964	6,101	4,699	—	19,185
Charge for the year	33	—	1,357	515	510	—	2,415
Written back on disposals	—	—	(13)	—	(32)	—	(45)
At December 31, 2002	454	—	9,308	6,616	5,177	—	21,555
At January 1, 2003	454	—	9,308	6,616	5,177	—	21,555
Charge for the year	34	—	968	526	523	—	2,051
Impairment loss	—	—	377	375	194	—	946
Written back on disposals	—	—	(82)	(15)	(10)	—	(107)
At December 31, 2003	488	—	10,571	7,502	5,884	—	24,445
At January 1, 2004	488	—	10,571	7,502	5,884	—	24,445
Charge for the year	33	—	880	461	528	—	1,902
Written back on disposals	(6)	—	(193)	(27)	(65)	—	(291)
At December 31, 2004	515	—	11,258	7,936	6,347	—	26,056
Net book value:							
At December 31, 2004	1,084	112	4,274	4,497	1,385	284	11,636
At December 31, 2003	1,113	106	4,113	4,506	1,337	949	12,124
At December 31, 2002	1,147	106	4,992	4,835	1,646	837	13,563
At December 31, 2001	1,175	124	5,150	4,891	1,992	1,522	14,854

Investment properties were revalued at December 31, 2004 by an independent firm of surveyors, CB Richard Ellis Limited, on an open market value basis, making reference to comparable sales evidence as available in the markets. The revaluation surplus of $16 million has been transferred to the investment properties revaluation reserve (note 26) (2003: $Nil; 2002: revaluation deficit of $11 million).

The group leases out investment properties under operating leases. The leases typically run for an initial period of two to four years. None of the leases includes contingent rentals.

Gross rental income received from the group's and company's investment properties and leasehold land and buildings amounted to $43 million (2003: $70 million; 2002: $65 million).

The group's total future minimum lease payments under non-cancellable operating leases are receivable as follows:

	2002	2003	2004
	HK$M	HK$M	HK$M
Within 1 year	10	9	7
After 1 year but within 5 years	16	7	3
	26	16	10

The analysis of net book value of the group's and company's properties, all of which are situated in Hong Kong, comprises:

	As at December 31					
	2002		2003		2004	
	Leasehold land and buildings	Investment properties	Leasehold land and buildings	Investment properties	Leasehold land and buildings	Investment properties
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
Long-term leasehold						
- not less than 50 years	47	106	68	106	71	112
Medium-term leasehold						
- less than 50 years but not less than 10 years	1,100	—	1,045	—	1,013	—
	1,147	106	1,113	106	1,084	112

14 GOODWILL

	HK$M
Cost:	
At January 1, 2002	—
Additions	519
At December 31, 2002	519
	—
At January 1, 2003 and at December 31, 2003	519
At January 1, 2004 and at December 31, 2004	519
Accumulated amortisation:	
At January 1, 2002	—
Amortisation for the year (note 6)	39
At December 31, 2002	39
At January 1, 2003	39
Amortisation for the year (note 6)	52
At December 31, 2003	91
At January 1, 2004	91
Amortisation for the year (note 6)	52
At December 31, 2004	143
Carrying amount:	
At December 31, 2004	376
At December 31, 2003	428
At December 31, 2002	480
At December 31, 2001	—

15 LOAN TO ULTIMATE HOLDING COMPANY

Loan to ultimate holding company is unsecured and non-interest bearing, except for $2,800 million which bears interest at HIBOR plus 0.79% per annum and is repayable on demand. The amount is not expected to be settled within one year from the balance sheet date.

16 LOAN TO INTERMEDIATE HOLDING COMPANY

Loan to intermediate holding company was unsecured, non-interest bearing and had no fixed terms of repayment. The loan was repaid in full during the year ended December 31, 2004.

17 INVESTMENTS IN SUBSIDIARIES

	2002	2003	2004
	HK$M	HK$M	HK$M
Unlisted shares, at cost	595	595	595

Set out below are the particulars of the subsidiaries which principally affected the results, assets or liabilities of the group.

All of these are controlled subsidiaries as defined under note 2(a) and have been consolidated into the group financial statements unless otherwise stated.

			Percentage of ownership interest		
Name of company	**Place of incorporation**	**Particulars of issued and paid up capital**	**group's effective holding**	**held by the company**	**Principal activity**
PCCW IMS Limited (Note)	Hong Kong	2 shares of HK$1 each	100	100	Provision of retail broadband and narrowband internet access services under the "Netvigator" brandname, interactive multimedia services, international telecommunication services and provision of support services to a fellow subsidiary
Cascade Limited (Note)	Hong Kong	10,000 shares of HK$1 each	100	100	Design, build and operation of network infrastructures including the provision of technical consultancy and operation outsourcing services
PCCW-HKT Capital Limited	British Virgin Islands	1 share of US$1	100	100	Issuer of bonds
PCCW-HKT Capital No.2 Limited	British Virgin Islands	1 share of US$1	100	100	Issuer of bonds
PCCW-HKT Capital No.3 Limited	British Virgin Islands	1 share of US$1	100	100	Non-trading
PCCW-HKT Capital No.4 Limited	British Virgin Islands	1 share of US$1	100	100	Non-trading

Note: The group acquired a 100% interest in PCCW IMS Limited ("IMS") for $595 million with effect from April 1, 2002. As a result, the group's profit for 2002 and the net assets as at December 31, 2002 had both decreased by $312 million, due to the losses incurred by IMS since that date and the amortisation of goodwill.

On November 5, 2002, the group acquired 100% interest in Cascade Limited ("Cascade") as part of the restructuring referred to in note 7. Cascade provided support and maintenance services to both the company and third parties. It became operational on January 1, 2003.

On March 19, 2004, the group disposed of its entire interest in Cascade for a consideration of $215 million. Further details are set out in note 27 on the financial statements.

18 TRADE AND OTHER RECEIVABLES

	As at December 31					
	The group			The company		
	2002	2003	2004	2002	2003	2004
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
Amounts due from holding companies and fellow subsidiaries	3,006	3,905	3,259	3,006	2,796	2,874
Trade debtors	984	926	715	916	873	657
Other debtors and prepayments	165	175	441	159	170	405
Prepaid loan facility fees	—	86	71	—	86	71
Amounts due from subsidiaries	—	—	—	323	1,082	1,884
	4,155	5,092	4,486	4,404	5,007	5,891

Amounts due from holding companies and fellow subsidiaries are unsecured, interest free and repayable on demand.

Amounts due from subsidiaries are unsecured, repayable on demand and non-interest bearing, except for $780 million (2003: $780 million; 2002: $323 million) which bears interest at HIBOR plus 1% per annum.

19 CASH AND CASH EQUIVALENTS

	As at December 31					
	The group			The company		
	2002	2003	2004	2002	2003	2004
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
Deposits with banks and other financial institutions	985	918	223	985	918	223
Cash at bank and in hand	71	67	54	59	62	53
Cash and cash equivalents in the balance sheets and consolidated cash flow statements	1,056	985	277	1,044	980	276

20 TRADE AND OTHER PAYABLES

	As at December 31					
	The group			The company		
	2002	2003	2004	2002	2003	2004
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
Amounts due to holding companies, fellow subsidiaries and related companies	460	430	1,505	460	168	103
Deferred revenue	623	605	598	569	500	467
Trade and other creditors	1,097	818	493	1,090	655	426
Interest payable	139	211	328	60	25	139
Accrued liabilities:						
- purchase of fixed assets	186	360	201	174	336	189
- operating expenses	1,216	556	443	1,121	311	395
Fixed asset creditors	17	129	98	9	117	87
Customer deposits	65	59	29	65	59	28
Amounts due to subsidiaries	—	—	—	79	186	189
	3,803	3,168	3,695	3,627	2,357	2,023

Amounts due to holding companies, fellow subsidiaries, subsidiaries and related companies are unsecured, interest free and repayable on demand.

21 NON-CURRENT INTEREST-BEARING BORROWINGS

	As at December 31					
	The group			The company		
	2002	2003	2004	2002	2003	2004
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
7.75% Guaranteed Notes due 2011	7,730	7,740	7,713	—	—	—
6% Guaranteed Notes due 2013	—	3,865	3,869	—	—	—
Bank loans (note 22)	15,953	—	—	15,953	—	—
Loan from subsidiaries (unsecured)	—	—	—	7,730	11,605	11,582
Subordinated loan from ultimate holding company (unsecured)	5,537	—	—	5,537	—	—
	29,220	11,605	11,582	29,220	11,605	11,582

The 7.75% Guaranteed Notes due 2011 ("7.75% Notes") were issued by PCCW-HKT Capital Limited, a wholly owned subsidiary of the company, and the proceeds received were lent to the company on the same terms as the 7.75% Notes. The 7.75% Notes are unconditionally and irrevocably guaranteed by the company.

The 6% Guaranteed Notes due 2013 ("6% Notes") were issued by PCCW-HKT Capital No.2 Limited, a wholly owned subsidiary of the company, and the proceeds received were lent to the company on the same terms as the 6% Notes. The 6% Notes are unconditionally and irrevocably guaranteed by the company.

On October 26, 2001 and January 29, 2002, the group drew down subordinated loans of US$260 million (approximately $2,027 million) and US$450 million (approximately $3,510 million) respectively from PCCW. The subordinated loans bore interest at LIBOR plus 2% and at 1% respectively, and were repayable on demand subject to the terms of the subordinated loan agreements. The balances were treated as non-current liabilities, however, because as at December 31, 2002, the directors did not expect the loans to be repaid within one year.

22 BANK LOANS

Bank loans of the group and the company are repayable as follows:

	As at December 31		
	2002	2003	2004
	HK$M	HK$M	HK$M
After 2 years but within 5 years	—	—	—
After 5 years	16,093	—	—
	16,093	—	—
Less: Prepaid loan facility fees	(140)	—	—
	15,953	—	—

At December 31, 2002, the group's and the company's bank loans are repayable as follows:

	As at December 31		
	2002	2003	2004
	HK$M	HK$M	HK$M
Repayable on February 6, 2008	6,093	—	—
Repayable on March 15, 2008	5,000	—	—
Repayable on April 22, 2009	5,000	—	—
	16,093	—	—

The loan repayable on February 6, 2008 were drawn down on February 6, 2001. Part of the loan was denominated in Hong Kong dollars and bore interest at HIBOR plus 1.55%. Part of the loan was denominated in United Stated States dollars and bore interest at LIBOR plus 1.45%. The interest rate margin would increase depending on future changes to certain financial ratios of the company.

On March 15, 2002 and April 22, 2002, the company drew down two new bank loans of $5,000 million each pursuant to term loan facility agreements. The term loans were denominated in Hong Kong dollars and bore interest at HIBOR plus 0.55% and plus 0.65% respectively and were repayable on March 15, 2008 and April 22, 2009 respectively. Proceeds of the loans were used to repay part of the company's existing bank loans originally drawn down on February 6, 2001.

All the bank loans of the group and the company were unsecured and repaid in 2003.

23 EMPLOYEE RETIREMENT BENEFITS

The company's ultimate holding company, PCCW, operates both defined contribution (including Mandatory Provident Fund Scheme) and defined benefit retirement schemes for its qualifying employees. The schemes are administered by independent trustees, with their assets held separately from those of the group.

(a) Defined benefit retirement scheme ("the scheme")

The scheme is funded by contributions from the group and other PCCW group companies in accordance with an independent actuary's recommendation based on annual actuarial valuations. The latest independent actuarial valuations of the scheme was at December 31, 2004 and was prepared by Mr. Aaron Wong of Watson Wyatt Hong Kong Limited, Fellow of the Canadian Institute of Actuaries (Canada) and Fellow of the Society of Actuaries (USA), using the projected unit credit method. The actuarial valuation indicates that the group's obligations under the scheme is 96% (2003: 93%; 2002: 77%) covered by the scheme assets held by the trustees.

On July 1, 2003, the scheme was restructured such that the scheme service in determining the level of benefit was frozen as of June 30, 2003 whereas the scheme salary and multiple will continue to grow. Benefits for employee services from July 1, 2003 are accrued at members' choice under either the Defined Contribution Retirement Scheme or Mandatory Provident Fund Scheme operated by PCCW (see note 23(b)).

(i) The amounts recognised in the balance sheets are as follows:

	As at December 31			As at December 31		
	The group			The company		
	2002	2003	2004	2002	2003	2004
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
Present value of wholly or partly funded obligations	2,748	3,089	1,043	2,710	1,125	1,017
Fair value of scheme assets	(2,108)	(2,878)	(997)	(2,074)	(1,048)	(970)
Net unrecognised actuarial (losses)/gains	(221)	136	82	(216)	56	83
	419	347	128	420	133	130

A portion of the above liability is expected to be settled after more than one year. It is not practicable, however, to segregate this amount from the amounts payable in the next twelve months. Accordingly, the defined benefit liability has been recorded as a non-current liability.

(ii) Movements in the net liability recognised in the balance sheets are as follows:

	As at December 31			As at December 31		
	The group			The company		
	2002	2003	2004	2002	2003	2004
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
At January 1	352	419	347	352	420	133
Expense/(income) recognised in the income statements (note 23(a)(iii))	230	68	(3)	227	30	(3)
Reductions through disposal of a subsidiary	—	—	(216)	—	—	—
Contributions paid to the scheme	(166)	(171)	—	(159)	(69)	—
Additions/(deductions) through transfer of employees from/(to) group companies	—	31	—	—	(248)	—
Additions through acquisition of a subsidiary	3	—	—	—	—	—
At December 31	419	347	128	420	133	130

(iii) Expense/(income) recognised in the consolidated income statement is as follows:

	2002	2003	2004
	HK$M	HK$M	HK$M
Interest cost	274	156	59
Expected return on scheme assets	(293)	(152)	(59)
Losses/(gains) on curtailment/settlement	87	—	(3)
Current service cost	162	62	—
Net actuarial losses recognised	—	2	—
	230	68	(3)
Actual (loss)/return on scheme assets	(230)	482	76

(iv) The expense/(income) is recognised in the following line items in the consolidated income statement:

	2002	2003	2004
	HK$M	HK$M	HK$M
Salaries and related cost (note 6(a))	133	68	(3)
Restructuring cost (note 7)	97	—	—
	230	68	(3)

(v) The principal actuarial assumptions used as at December 31, 2004 (expressed as weighted averages) are as follows:

	The group and the company		
	2002	2003	2004
Discount rate	5.5%	5.25%	4.00%
Expected rate of return on scheme assets	6.5%	5.75%	5.75%
Future salary increases			
- 2003	3.5%	N/A	N/A
- 2004	3.5%	0%	N/A
- 2005	3.5%	2%	0%
- 2006	3.5%	2%	2%
- 2007 and thereafter	3.5%	3.5%	3.5%

(b) **Defined contribution retirement schemes**

PCCW group also operates a Defined Contribution Retirement Scheme ("Defined Contribution Scheme") and a Mandatory Provident Fund Scheme ("the MPF scheme") under the Occupational Retirement Schemes Ordinance and Hong Kong Mandatory Provident Fund Schemes Ordinance, respectively, for employees employed under the Hong Kong Employment Ordinance and not previously covered by the defined benefits retirement scheme. The MPF scheme is also a defined contribution retirement scheme administered by independent trustees. Under the above schemes, the employer and its employees are each required to make contributions to the scheme at 5% of the employees' relevant income, subject to a cap of monthly relevant income of $20,000. Contributions to the Defined Contribution Scheme vest after one year from the date of employment and vest immediately for the MPF schemes.

24 EQUITY COMPENSATION BENEFITS

The company's ultimate holding company, PCCW, has a share option scheme which was adopted in September 1994 and amended in May 2002. The board of directors of PCCW may at their discretion invite employees of the group, including directors and other eligible persons, to take up options to subscribe for shares of PCCW. For options granted before May 23, 2002, the exercise price in relation to each option was determined by the board of directors of PCCW in its absolute discretion, but in any event would not be less than the higher of the nominal value of the PCCW shares and 80 percent of the average of the closing prices of the PCCW shares on The Stock Exchange of Hong Kong Limited ("SEHK") for the five trading days immediately preceding the relevant date of offer.

For options granted on or after May 23, 2002, the exercise price in relation to each option shall be determined by the board of directors of PCCW in its absolute discretion, but in any event shall not be less than the highest of:

(i) the nominal value of a share of PCCW;

(ii) the closing price of the shares of PCCW as stated in the daily quotation sheet of the SEHK on the date of grant; and

(iii) the average closing price of the shares of PCCW as stated in the daily quotation sheets of the SEHK for the five trading days immediately preceding the date of grant.

The vesting period and exercisable period of the options are determined by the directors but in any case no options can be exercised later than ten years from the date of grant. Each option gives the holder the right to subscribe for one share.

(a) **Movements in share options**

	Number
At January 1, 2002	56,409,284
Issued (note 24(c))	35,600,000
Addition through acquisition of a subsidiary (note 24(d))	2,791,200
Forfeited/lapsed	(15,573,200)
At December 31, 2002 (note 24(b))	79,227,284
At January 1, 2003	
- Balance before 5 to 1 consolidation (note 24(h))	79,227,284
- Balance adjusted for 5 to 1 consolidation (note 24(h))	15,845,456
Issued (note 24(c))	17,335,000
Net addition through transfer of employees (note 24(e))	576,360
Forfeited/lapsed	(957,180)
At December 31, 2003 (note 24(b))	32,799,636
At January 1, 2004	32,799,636
Net addition through transfer of employees (note 24 (e))	946,316
Reduction through disposal of a subsidiary (note 24(f))	(16,705,780)
Exercised (note 24(g))	(841,328)
Forfeited/lapsed	(1,759,860)
At December 31, 2004 (note 24(b))	14,438,984
Options vested at December 31, 2004	7,476,695
Options vested at December 31, 2003	10,899,275
Options vested at December 31, 2002 (adjusted for 5 to 1 consolidation)	5,009,065

(b) **Terms of unexpired and unexercised share options at balance sheet dates**

Date granted	Exercisable period	Exercise price	2002 Number	2003 Number	2004 Number
		$			
August 17, 1999 to September 15, 1999	August 17, 2000 to August 17, 2009	11.78	43,866	43,866	115,732
October 25, 1999 to November 23, 1999	August 17, 2000 to October 25, 2009	22.76	—	—	112,800
August 26, 2000 to September 24, 2000	May 26, 2001 to August 26, 2010	60.12	9,400	9,400	—
February 8, 2000 to March 8, 2000	February 8, 2001 to February 8, 2010	75.24	—	—	86,700
October 27, 2000 to November 25, 2000	March 15, 2001 to October 27, 2010	24.36	7,772,710	7,588,290	2,869,080
January 22, 2001 to February 20, 2001	January 22, 2001 to January 22, 2011	16.84	685,880	807,720	1,642,600
February 20, 2001	February 8, 2002 to February 8, 2011	18.76	—	—	86,700
April 17, 2001 to May 16, 2001	May 26, 2001 to April 17, 2011	10.30	81,640	76,080	28,840
July 16, 2001 to September 15, 2001	July 16, 2002 to July 16, 2011	9.16	131,960	134,280	127,160
May 10, 2002	April 11, 2003 to April 11, 2012	7.915	—	—	86,700
November 13, 2002	November 13, 2002 to November 12, 2012	6.15	7,120,000	7,040,000	—
July 25, 2003	July 25, 2004 to July 23, 2013	4.35	—	17,100,000	9,282,672
			15,845,456	32,799,636	14,438,984

Comparatives have been restated to take account of share consolidation (note 24(h)).

(c) No share options were granted in 2004. Details of share options granted in 2002 and 2003, all of which were granted at nil consideration, are set out below. The number of shares disclosed below have been adjusted for the 5 to 1 consolidation.

Date granted	Exercisable period	Exercise price	2002 Number	2003 Number	2004 Number
		$			
July 25, 2003	July 25, 2004 to July 23, 2013	4.35	—	17,335,000	—
November 13, 2002	November 13, 2003 to November 12, 2012	6.15	7,120,000	—	—
			7,120,000	17,335,000	—

(d) Details of outstanding share options for employees of a newly acquired subsidiary on the date of acquisition are set out below. The number of shares disclosed below have been adjusted for 5 to 1 consolidation.

Date granted	Exercisable period	Exercise price	2002 Number	2003 Number	2004 Number
		$			
October 27, 2000	March 15, 2001 to October 27, 2010	24.36	354,360	—	—
January 22, 2001	January 22, 2001 to January 22, 2011	16.84	185,600	—	—
April 17, 2001	May 26, 2001 to April 17, 2011	10.30	4,560	—	—
July 16, 2001	July 16, 2001 to July 16, 2011	9.16	13,720	—	—
			558,240	—	—

(e) During 2003 and 2004, certain employees were transferred to the group from fellow subsidiaries or vice versa.

Details of outstanding share options granted to these employees at the time of transfer are as follows:

Date granted	Exercisable period	Exercise price	2002 Number	2003 Number	2004 Number
		$			
August 17, 1999 to September 15, 1999	August 17, 2000 to August 17, 2009	11.78	—	—	90,666
October 25, 1999 to November 23, 1999	August 17, 2000 to October 25, 2009	22.76	—	—	112,800
February 8, 2000 to March 8, 2000	February 8, 2001 to February 8, 2010	75.24	—	—	86,700
October 27, 2000 to November 25, 2000	March 15, 2001 to October 27, 2010	24.36	—	398,840	(267,330)
January 22, 2001 to February 20, 2001	January 22, 2001 to January 22, 2011	16.84	—	162,600	1,324,880
February 20, 2001	February 8, 2002 to February 8, 2011	18.76	—	—	86,700
April 17, 2001 to May 16, 2001	May 26, 2001 to April 17, 2011	10.30	—	5,040	(7,040)
July 16, 2001 to September 15, 2001	July 16, 2002 to July 16, 2011	9.16	—	9,880	57,240
May 10, 2002	April 11, 2003 to April 11, 2012	7.915	—	—	86,700
July 25, 2003	July 25, 2004 to July 23, 2013	4.35	—	—	(625,000)
			—	576,360	946,316

(f) Details of outstanding share options granted to employees of a disposed subsidiary at the date of disposal are set out below.

Date granted	Exercisable period	Exercise price	2002 Number	2003 Number	2004 Number
		$			
October 27, 2000 to November 25, 2000	March 15, 2001 to October 27, 2010	24.36	—	—	3,882,180
January 22, 2001 to February 20, 2001	January 22, 2001 to January 22, 2011	16.84	—	—	436,800
April 17, 2001 to May 16, 2001	May 26, 2001 to April 17, 2011	10.30	—	—	29,600
July 16, 2001 to September 15, 2001	July 16, 2002 to July 16, 2011	9.16	—	—	52,200
November 13, 2002	November 13, 2003 to November 12, 2012	6.15	—	—	6,940,000
July 25, 2003	July 25, 2004 to July 23, 2013	4.35	—	—	5,365,000
			—	—	16,705,780

(g) Details of share options exercised during the year are set out below.

Exercise date	Exercise price	Market value per share at exercise date	Proceeds received	2002 Number	2003 Number	2004 Number
	$	$	$			
July 26, 2004	4.35	5.45	577,093	—	—	132,665
July 27, 2004	4.35	5.50	361,050	—	—	83,000
July 28, 2004	4.35	5.45	87,000	—	—	20,000
July 30, 2004	4.35	5.35	142,097	—	—	32,666
August 6, 2004	4.35	5.30	21,750	—	—	5,000
August 9, 2004	4.35	5.30	28,997	—	—	6,666
August 12, 2004	4.35	5.15	21,750	—	—	5,000
August 18, 2004	4.35	5.00	69,600	—	—	16,000
August 19, 2004	4.35	5.10	4,350	—	—	1,000
August 23, 2004	4.35	5.35	56,550	—	—	13,000
August 24, 2004	4.35	5.30	108,750	—	—	25,000
August 25, 2004	4.35	5.50	134,850	—	—	31,000
August 26, 2004	4.35	5.50	352,350	—	—	81,000
August 31, 2004	4.35	5.20	165,300	—	—	38,000
September 3, 2004	4.35	5.15	21,750	—	—	5,000
September 7, 2004	4.35	5.15	152,250	—	—	35,000
September 8, 2004	4.35	5.20	43,500	—	—	10,000
September 9, 2004	4.35	5.10	126,150	—	—	29,000
September 10, 2004	4.35	5.20	143,550	—	—	33,000
September 13, 2004	4.35	5.20	43,500	—	—	10,000
September 14, 2004	4.35	5.15	91,350	—	—	21,000
September 15, 2004	4.35	5.15	21,750	—	—	5,000
September 20, 2004	4.35	5.30	43,500	—	—	10,000
September 22, 2004	4.35	5.30	13,050	—	—	3,000
September 24, 2004	4.35	5.15	69,600	—	—	16,000
October 4, 2004	4.35	5.15	43,500	—	—	10,000
October 5, 2004	4.35	5.20	21,750	—	—	5,000
October 28, 2004	4.35	4.75	100,050	—	—	23,000

Exercise date	Exercise price	Market value per share at exercise date	Proceeds received	2002 Number	2003 Number	2004 Number
	$	$	$			
November 2, 2004	4.35	4.825	43,500	—	—	10,000
November 4, 2004	4.35	4.775	21,750	—	—	5,000
November 12, 2004	4.35	4.90	21,750	—	—	5,000
November 23, 2004	4.35	4.875	43,500	—	—	10,000
November 26, 2004	4.35	4.85	26,100	—	—	6,000
December 16, 2004...................	4.35	4.85	43,500	—	—	10,000
December 17, 2004...................	4.35	4.80	21,750	—	—	5,000
December 21, 2004...................	4.35	4.825	217,496	—	—	49,999
December 28, 2004...................	4.35	5.05	21,750	—	—	5,000
December 29, 2004...................	4.35	4.975	56,550	—	—	13,000
December 30, 2004...................	4.35	4.925	75,394	—	—	17,332
				—	—	841,328

(h) On January 8, 2003, PCCW consolidated every five issued and unissued ordinary shares of $0.05 each into one share of $0.25. The information as set out in the above notes, have been adjusted for the share consolidation. As at December 31, 2004, PCCW share price was $4.925.

25 SHARE CAPITAL

	As at December 31		
	2002	2003	2004
	HK$M	HK$M	HK$M
Authorised:			
2,500,000,000 ordinary shares of $1 each	2,500	2,500	2,500
Issued and fully paid:			
2,163,783,209 ordinary shares of $1 each	2,164	2,164	2,164

26 RESERVES

(a) **Movements in reserves in the year ended December 31, 2002**

The group

	Share premium	Capital reserve	Investment properties revaluation reserve	Retained profits	Total
	HK$M	HK$M	HK$M	HK$M	HK$M
At January 1, 2002.....................................	397	18	76	17,737	18,228
Net profit for the year	—	—	—	3,545	3,545
Deficit arising on revaluation during the year (note 13)	—	—	(11)	—	(11)
Dividends declared during the year (note 12)	—	—	—	(6,233)	(6,233)
At December 31, 2002................................	397	18	65	15,049	15,529

The company

	Share premium	Capital reserve	Investment properties revaluation reserve	Retained profits	Total
	HK$M	HK$M	HK$M	HK$M	HK$M
At January 1, 2002	397	18	76	17,737	18,228
Net profit for the year (note 11)	—	—	—	3,857	3,857
Deficit arising on revaluation during the year (note 13)	—	—	(11)	—	(11)
Dividends declared during the year (note 12)	—	—	—	(6,233)	(6,233)
At December 31, 2002	397	18	65	15,361	15,841

(b) **Movements in reserves in the year ended December 31, 2003**

The group

	Share premium	Capital reserve	Investment properties revaluation Reserve	Retained profits	Total
	HK$M	HK$M	HK$M	HK$M	HK$M
At January 1, 2003	397	18	65	15,049	15,529
Net profit for the year	—	—	—	3,042	3,042
Dividends declared during the year (note 12)	—	—	—	(2,467)	(2,467)
At December 31, 2003	397	18	65	15,624	16,104

The company

	Share premium	Capital reserve	Investment properties revaluation Reserve	Retained profits	Total
	HK$M	HK$M	HK$M	HK$M	HK$M
At January 1, 2003	397	18	65	15,361	15,841
Net profit for the year (note 11)	—	—	—	3,603	3,603
Dividends declared during the year (note 12)	—	—	—	(2,467)	(2,467)
At December 31, 2003	397	18	65	16,497	16,977

(c) **Movements in reserves in the year ended December 31, 2004**

The group

	Share premium	Capital reserve	Investment properties revaluation reserve	Retained profits	Total
	HK$M	HK$M	HK$M	HK$M	HK$M
At January 1, 2004	397	18	65	15,624	16,104
Net profit for the year	—	—	—	3,467	3,467
Surplus arising on revaluation during the year (note 13)	—	—	16	—	16
Dividends declared during the year (note 12)	—	—	—	(17,663)	(17,663)
At December 31, 2004	397	18	81	1,428	1,924

The company

	Share premium	Capital reserve	Investment properties revaluation reserve	Retained profits	Total
	HK$M	HK$M	HK$M	HK$M	HK$M
At January 1, 2004	397	18	65	16,497	16,977
Net profit for the year (note 11)	—	—	—	5,713	5,713
Surplus arising on revaluation during the year (note 13)	—	—	16	—	16
Dividends declared in during the year (note 12)	—	—	—	(17,663)	(17,663)
At December 31, 2004	397	18	81	4,547	5,043

The application of the share premium account is governed by section 48B of the Hong Kong Companies Ordinance.

The investment properties revaluation reserve has been set up and will be dealt with in accordance with the accounting policy adopted for the revaluation of investment properties (note 2(d)).

27 DISPOSAL OF A SUBSIDIARY

On March 19, 2004 the group disposed of its 100% interest in Cascade to a fellow subsidiary for a consideration of $215 million, which was based on a valuation performed by American Appraisal China Limited as at December 31, 2003.

	HK$M
Net assets disposed:	
Fixed assets	7
Deferred tax assets (note 10(c))	44
Trade and other receivables	482
Cash at bank and on hand	1
Trade and other payables	(252)
Defined benefit liability	(216)
Tax payable	(23)
Net identifiable assets and liabilities	43
Gain on disposal of the subsidiary (note 4)	172
Total consideration received, satisfied in cash	215
Less: Cash of the subsidiary disposed	(1)
Net cash inflow in respect of the disposal of the subsidiary	214

28 ACQUISITION OF A SUBSIDIARY

The group acquired a 100% interest in IMS for HK$595 million effective from April 1, 2002. The consideration was based on a third party valuation report and was settled through intercompany accounts.

	2002
	HK$M
Net assets acquired:	
Fixed assets	225
Inventories	6
Cash at bank and on hand	17
Trade debtors	62
Trade payables	(234)
Net identifiable assets and liabilities	76
Goodwill arising from acquisition	519
Total purchase price settled through intercompany accounts	595

29 MAJOR NON-CASH TRANSACTIONS

(i) During 2002, the group acquired a 100% interest in IMS for $595 million settled through intercompany accounts.

(ii) During 2004, the company declared and settled dividends of $15,000 million by setting off against the loan granted to intermediate holding company.

(iii) During 2004, the company declared and settled dividends of $1,400 million by setting off against the intercompany accounts with intermediate holding company.

(iv) During 2004, the company's intermediate holding company novated $1,705 million of a loan from the company to the ultimate holding company.

30 COMMITMENTS

(a) Capital commitments outstanding at December 31 not provided for in the financial statements were as follows:

	The group			The company		
	2002	2003	2004	2002	2003	2004
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
Capital expenditure authorised but not contracted for	142	331	395	142	319	391
Capital expenditure contracted for	9	58	34	9	58	34
	151	389	429	151	377	425

(b) At December 31, 2004 the total future minimum lease payments under non-cancelable operating leases are payable as follows:

	The group			The company		
	2002	2003	2004	2002	2003	2004
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
Within one year	4	14	4	4	1	4
After one year but within five years	4	—	1	4	—	1
	8	14	5	8	1	5

(c) At December 31, 2004, the group had commitments in respect of the following:

(i) outstanding cross currency interest rate swap contracts totalling approximately $26,889 million (2003: $3,900 million; 2002: $9,048 million). The swap contracts amounting to $23,332 million (2003: $3,900 million; 2002: $9,048 million) are entered into to hedge against the company's and the group's borrowings in foreign currency and interest rate fluctuations. The other swap contracts are entered into on behalf of the ultimate holding company for hedging purposes.

(ii) outstanding forward foreign exchange contracts amounting to $nil (2003: $6,171 million; 2002: $nil). Forward foreign exchange contracts were entered into to hedge against the company's and the group's foreign currency borrowings in 2003.

31 CONTINGENT LIABILITIES

(i) In connection with its customer service contracts, the company had contingent liabilities at December 31, 2004 amounting to $10 million (2003: $8 million; 2002: $18 million) in respect of performance guarantees issued by banks in favour of third parties.

(ii) As at December 31, 2003 and 2004, the company has given an unconditional and irrevocable guarantee to Hongkong International Theme Parks Limited ("HKTPL") on all the obligations and liabilities of PCCW-HKT Business Services Limited ("BSL"), a fellow subsidiary of the company, in connection with an agreement entered into by BSL for the provision and implementation of certain telecom and other systems to HKTPL.

(iii) As at December 31, 2002, 2003 and 2004, the company has also given unconditional and irrevocable guarantees in respect of notes issued by the following fellow subsidiaries of the company, as to payment of principal, premium on redemption and interest in favour of the holders of the notes.

Name of issuer	**Year of expiry**	**Outstanding amount of guaranteed notes**		
		2002	**2003**	**2004**
Profit Century Finance Limited.......	2031	Yen 30,000 million	Yen 30,000 million	Yen 30,000 million
PCCW Capital No. 2 Limited..........	2007	US$450 million	US$450 million	US$450 million
PCCW Capital No. 3 Limited..........	2013	—	—	US$456 million

(iv) As at December 31, 2004, the company has given unconditional and irrevocable guarantees up to $379 million to IBM China/Hong Kong Limited ("IBM") on the due and punctual payments by Unihub Limited and PCCW-HKT Limited, fellow subsidiaries of the company, in connection with the liabilities arising from their purchases for IBM's services and products.

(v) As at December 31, 2004, the company has given an unconditional and irrevocable guarantee to IBM on the due and punctual performance by PCCW Powerbase Data Center Services (HK) Limited ("Powerbase"), a fellow subsidiary of the company, in connection with an agreement entered into by Powerbase for the provision of data center facilities service to IBM.

32 POST BALANCE SHEET EVENTS

Subsequent to December 31, 2004, the company drew down and repaid the following loans pursuant to a $6 billion revolving loan facility agreement. Proceeds from this revolving loan were used by the group as general working capital. The revolving loan was denominated in Hong Kong dollars, unsecured and interest bearing at HIBOR plus 0.275%. Facility fee is payable annually at 0.225% of the revolving loan facility, which will expire on December 12, 2008.

Date of drawdown	**Date of repayment**	**Amount**
January 13, 2005..........	February 14, 2005	$2,000 million
January 18, 2005..........	February 18, 2005	$2,000 million
January 20, 2005..........	February 21, 2005	$2,000 million
February 21, 2005..........	March 21, 2005	$800 million

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PCCW-HKT CAPITAL NO.3 LIMITED

5.25% GUARANTEED NOTES DUE 2015

irrevocably and unconditionally guaranteed by

PCCW-HKT TELEPHONE LIMITED

OFFERING CIRCULAR

HSBC