C. Reasons for the offer and use of proceeds

not applicable

D. Risk Factors

You should carefully consider the risks described below and other information contained in this annual report before making an investment decision. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us, or that we currently deem immaterial, may also impair our business operations. We cannot assure you that any of the events discussed in the risk factors below will not occur. If they do, our business, financial condition or results of operations could be materially adversely affected.

Risks Relating to Our Business and Operations

We cannot assure you that we will be able to prevent total revenues and operating results from continuing to decline.

In fiscal 2006 , our total revenues decreased to HK$1,134.9 million from HK$1,162.1 million in fiscal 2005, and we experienced a net loss of HK$142.1 million versus net loss of HK$163.5 million in fiscal 2005. The loss in fiscal 2006 was due to a decline in contributions from our international telecommunications services and continued losses from our fixed telecommunications network business. We cannot assure you that we will be able to turn around this loss and business decline.

Our international telecommunications revenues declined by 21.5% primarily due to a decrease in the total number of minutes carried by 16.8%. With the drop in average tariff rates and reduced operating scale, we expect that the profit margins in our international telecommunications services will continue to be under pressure and lower revenue will be generated in future.

Our fixed telecommunications network services revenues increased by 13.8% in fiscal 2006 primarily due to an increase in our revenue per user, the effects of which was partially offset by a decrease in our subscription base of 2.2%. The decrease in our subscription base was due to assertive promotions by our competitors, especially the incumbent carrier. We, however, incurred operating losses of approximately HK$106.7 million in fiscal 2006 from such service operations. We expect our fixed telecommunications network service business will continue to incur operating losses as we expend substantial resources on developing and marketing broadband Internet access, local VOIP, IP-TV and corporate data services. We cannot assure you that we will achieve and sustain profitability in our fixed telecommunications network operations.

We have substantially less financial and human resources to apply to the development of our business than some of our main competitors.

The telecommunications and pay-TV markets in Hong Kong are highly competitive. Some of our main competitors for Internet access, local telephony, pay-TV and international telecommunications services have longer operating histories and others are subsidiaries of large business conglomerates. Consequently, our competitors may have resource advantages over us including as follows:

- greater financial, technical, marketing and other resources;
- greater existing infrastructure;
- greater name recognition; and
- larger customer bases.

In addition, certain areas of the fixed telecommunications network services business are very capital intensive. Our competitors may be able to devote more human and financial resources to research and development, network improvement and marketing than we can.

Our growth and profitability could be affected by an increasing number of local and foreign entrants in the international and local telecommunications and Internet access markets.

The Hong Kong government continues to liberalize access into the telecommunications industry in Hong Kong, including issuing new wireless and wire-line fixed telecommunications network services licenses, which we refer to as FTNS Licenses. We expect the Hong Kong government to continue to open the telecommunications market in the next several years. Some of these changes may impact our company. As of December 4, 2006, 247 public non-exclusive telecommunications service licenses, which we refer to as PNETS Licenses, for the provision of external telecommunications services had been issued in Hong Kong. Some of these licenses are held by subsidiaries of major foreign telecommunications providers which have competitive advantage due their global presence and size.

Increasing liberalization of the telecommunications market in Hong Kong may continue to attract new local and foreign entrants to the market, which may broaden the variety of telecommunications services supplied by existing service providers, thereby heightening the overall level of competition in our industry. Increased competition could result in price reductions, reduced gross margins or loss of market share, any of which could adversely affect our future growth and profitability.

The development of our Metro Ethernet network requires significant capital expenditures. These capital expenditures may vary materially from those currently planned and may impose a burden on our financing and operating activities.

Our business is capital intensive, and our capital expenditures may not have the positive effect on our business and revenues that we expect. We have made, and will continue to make, capital investments in the expansion and upgrade of our Metro Ethernet network and the development of our telecommunications services. We incurred total capital expenditures of approximately HK$322.9 million in fiscal 2006. For fiscal 2007, we expect to incur a total capital expenditures of approximately HK$125 million to HK$150 million, the large majority of which will be spent on the continued expansion and upgrade of our Metro Ethernet network.

While we intend to fund such expenditures by using our currently available cash as well as cash flow from operations and the net proceeds from our January 2005 offering of 8.75% senior notes due 2015, which we refer to in this annual report as the 8.75% notes or 10-year senior notes, we may not have adequate capital to fund our projected capital expenditures. Future, additional debt or equity financing may not be available, and debt financing, if available, may involve restrictions on our investing, financing and operating activities.

We may not realize the commercial benefits we expect from our investments, which may adversely impact our business.

We have made significant investments in our network infrastructure to provide the services we offer. The launch of new and commercially viable products and services is important to compete in our business. Commercial acceptance by consumers of the new services we offer may not occur at the rate or level expected, and we may not be able to successfully adapt the new services effectively and economically to meet consumers’ demand, which could limit the return from our investments. Specifically, we cannot assure you that services enabled by upgrading and expanding our Metro Ethernet network will be accepted by the public to the extent required to generate an acceptable rate of return. Furthermore, we cannot assure you that our estimate of the necessary capital expenditure to offer such services will not be exceeded. The failure of any of our services to achieve commercial acceptance could result in additional capital expenditures or a reduction in profitability to the extent that we are required under the applicable accounting standards to recognize a charge for the impairment of assets. Any such charge could materially and adversely affect our financial condition and the results of our operations.

As most of the services we provide through our Metro Ethernet network are still at an early stage of implementation, evaluation of our business and our prospects is difficult.

Due to the short operating history of most of our fixed telecommunications network services, especially our IP-TV services, our historical financial data may not provide a meaningful basis for you to evaluate us and our prospects. These services are still at an early stage of implementation, and the revenue, potential income and cash flows from these new businesses are unproven. Accordingly, evaluation of our businesses and our prospects is difficult, and we cannot give you any assurance that we will continue to succeed in these businesses.

We are in the process of instituting changes to our internal controls and management systems in order to satisfy the requirements of Section 404 of the Sarbanes Oxley Act of 2002. Our failure to timely and successfully institute these changes and to maintain the adequacy of our internal controls could subject us to regulatory actions and may adversely affect our stock price and our ability to raise additional capital.

The United States Securities and Exchange Commission, or the SEC, as required by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules requiring every public company to include a management report on such company's internal controls over financial reporting in its annual report, which contains management's assessment of the effectiveness of the company's internal controls over financial reporting. In addition, an independent registered public accounting firm must attest to and report on management's assessment of the effectiveness of the company's internal controls over financial reporting. As a non-accelerated filer, we are required to file management's first report on internal controls over financial reporting for the fiscal year ending August 31, 2008 and our first auditor's attestation report on management's assessment of internal controls over financial reporting for the fiscal year ending August 31, 2009.

We are in the process of instituting changes to our internal controls and management systems to comply with the requirements. Among others, we are designing procedures to document various controls and relevant testing procedures under requirements stipulated by the Public Company Accounting Oversight Board in the United States. We have assigned an internal audit manager to oversee this compliance process, who reports to both our audit committee and senior management on a periodic basis. In addition, we had hired external consultants to perform a high-level internal control gap analysis.

Notwithstanding our efforts, our management may conclude that our internal controls over our financial reporting are not effective. Moreover, even if our management concludes that our internal controls over financial reporting are effective, our independent registered public accounting firm may still decline to attest to our management's assessment or may issue a report that is qualified if it is not satisfied with our controls or the level at which our controls are documented, designed, operated or reviewed, or if it interprets the relevant requirements differently from us.

If we do not successfully design and implement changes to our internal controls and management systems, or if we fail to maintain the adequacy of these controls as such standards are modified or amended from time to time, we may not be able to comply with Section 404 of the Sarbanes Oxley Act of 2002. This could subject us to regulatory scrutiny and penalties that may result in a loss of public confidence in our management, which could, among other things, adversely affect our customer confidence, stock price, our ability to raise additional capital and operate our business as projected.

Our growth and expansion may impact our ability to manage our operations, increase our costs of operation and adversely affect the quality of our services.

We have pursued and continue to pursue a strategy of aggressive growth in our fixed telecommunications network services business. As part of this strategy, we continue to expand and invest in the Metro Ethernet network infrastructure we use to deliver broadband Internet access, local VOIP, IP-TV and corporate data services. The deployment of these projects has resulted and will result in significant demands on our systems and controls and may impact our administrative, operational and financial resources. Our ability to manage our future growth will depend upon our ability to:

- simultaneously manage implementation of our infrastructure development and marketing plans;
- effectively monitor our operations so as to contain costs and maintain effective quality controls; and
- continue to offer competitive prices to customers for our services.

Our failure to achieve any of the above in an efficient manner and at a pace consistent with the growth of our fixed telecommunications network services business could have an adverse effect on the quality of our services and increase our costs of operation.

We depend on certain key personnel, and our business and growth prospects may be disrupted by the loss of their services.

Our future success is dependent upon the continued service of our key executives and employees. We rely extensively on the services of our executive officers, including Wong Wai Kay, Ricky, our Chairman, and Cheung Chi Kin, Paul, our Chief Financial Officer. While we have employment agreements with members of our senior management staff, we cannot assure you that we will be able to retain these executives and employees. If one or more of our key personnel were unable or unwilling to continue in their present positions, or if they joined a competitor or formed a competing company, we may not be able to replace them easily, our business may be significantly disrupted and our financial condition and results of operations may be materially and adversely affected. Furthermore, as our industry is characterized by high demand and increased competition for talent, we may need to offer higher compensation and other benefits in order to attract and retain key personnel in the future. We cannot assure you that we will be able to attract and retain the key personnel that we will need to achieve our business objectives.

Expansion of our Metro Ethernet network into certain buildings and residences may be limited by physical limitations or our ability to obtain access permits.

Expanding our Metro Ethernet network coverage requires us to install fiber-to-the-building, as well as install Category 5e copper wiring within residential and commercial buildings to reach the subscriber’s premises, which we refer to as in-building-wiring. One of our competitors has already installed in-building-wiring in virtually all buildings, and we along with other fixed telecommunications network service providers may encounter a bottleneck when installing our own in-building-wiring because many buildings have limited physical space for additional in-building wiring. In addition, owners of certain single-owner commercial buildings may grant rights of access to our competitors while barring us from installing our own in-building-wiring. Furthermore, certain developers may have affiliations with our competitors and may attempt to delay our wiring installations. These constraints may hinder the expansion of our Metro Ethernet network from current 1.3 million home pass coverage to our long term target of 1.8 million home passes. Failure to grow our network coverage will limit our growth opportunities and reduce our ability to benefit from economics of scale.

Internet security concerns could limit our ability to develop revenues from Internet access services.

We intend to continue developing our broadband Internet access, local VOIP, IP-TV and corporate data services. Computer viruses, break-ins and other inappropriate or unauthorized uses of our Metro Ethernet network could affect the provision of our full suite of Internet Protocol, or IP, services. Computer viruses, break-ins or other problems could have the following effects on our fixed telecommunications network services business:

- result in interruption, delays or cessation in services to our customers;
- jeopardize the security of confidential information stored in the computer system of our customers; and
- allow for illegal viewing or download of our content.

We may incur significant costs to protect us against the threat of security breaches or to alleviate problems caused by such breaches. In addition, alleviating these problems may cause interruptions, delays or cessation in service to our users, which could cause them to stop using our service or assert claims against us. While we continue to strengthen our network security, there is no assurances that computer viruses and other harmful attacks could not affect our business.

Risks Relating to Our Technological Infrastructure

We will be limited in our ability to continue to expand our internet access business unless we obtain additional network capacity.

Our internet access network has limited capacity. Our ability to continue to increase internet service depends on our ability to expand the network bandwidth on a timely basis, which in turn is subject to:

- the expansion and development of our own international telecommunications facilities;
- the availability of leased capacity from third party carriers at favorable rates; and
- the possible termination or cancellation of our existing contracts.

If we fail to increase the capacity of our international bandwidth, our ability to increase our internet access business market share and revenues will be limited.

We are vulnerable to natural disasters, and other disruptive regional events, which could cause damage to our network and result in lost revenue and perhaps lost customers.

Our network is vulnerable to damage or cessation of operations from fire, earthquakes, severe storms, power loss, telecommunications failures, network software flaws, vandalism, transmission cable cuts and other catastrophic events. We may experience failures or shutdowns relating to individual points of presence or even catastrophic failure of our entire network. Hong Kong’s weather patterns often result in heavy rainfall during certain periods of the year. Any sustained failure of our network, our servers, or any link in the delivery chain, whether from operational disruption, natural disaster or otherwise, resulting in an interruption in our operations, could have a material adverse effect on our business, financial condition and results of operations.

The earthquake in Taiwan on December 26, 2006 interrupted international capacity access to the carriers in Hong Kong. By redirecting our tariff under our contingency plan, we were able to minimize the impact of such interruption to our business by restoring basic international services within two days of the disaster. We, however, cannot assure that our contingency plan will be sufficient to overcome natural disasters and other disruptive regional events in the future.

The loss of key suppliers or their failure to deliver equipment on a timely basis could negatively impact our business prospects.

We rely on our key suppliers Cisco Systems Inc., Nortel Networks Limited and other suppliers to provide equipment, underground cables and other necessary components in building our Metro Ethernet network infrastructure, and for our VOIP equipment. In order for new subscribers to access our IP-TV services, we must install an IP set-top-box in their homes. We must have an adequate supply of such installation equipment on hand to respond to new customer subscriptions in a timely manner. We purchase all of our IP set-top boxes and other equipment from our suppliers on a purchase order basis and have no long-term contracts. If our suppliers are unable to supply us with these products in a timely manner or the costs of these products increase due to unforeseen causes, this could negatively impact our operating results, especially if we are unable to acquire new subscribers or effectively appropriate our costs on to our customers. In addition, if Cisco Systems, Inc. or Nortel is unable or is delayed in providing us with the hardware required for building our fiber-based backbone infrastructure or VOIP equipment, this could negatively impact our operating results.

Our reliance on third parties to provide maintenance and repairs for our Metro Ethernet network could adversely affect our operating results if their services are not timely or do not meet our standards.

We depend on Cisco Systems, Inc. and other third parties for ongoing support and assistance with respect to maintenance and repairs. We are also dependent on certain Hong Kong rail transport providers to maintain and provide us with access to their infrastructure to support the proper functioning of our equipment and fiber-based backbone. If these third parties fail to provide us the equipment we require, or fail to respond or are untimely in their response to our maintenance and repair needs, our customers may experience interruptions or variations in the quality of our fixed telecommunications network services, which may adversely affect our operating results and our ability to retain or add new customers.

If we are unable to stay ahead of technology trends and evolving industry standards, our services may become obsolete.

Telecommunications businesses are characterized by rapidly changing technology and industry standards, evolving subscriber needs and the introduction of new services. The continuously changing nature of these services, and their increasingly shorter life cycles require us to continually improve our performance, services and network in order to compete successfully with the services offered by our competitors. Further, new technology or trends in the telecommunications industry could have an adverse effect on the services we currently offer. For example, the replacement of traditional fixed line home telephones with mobile telephones and/or VOIP services may lead to a decline in our international telecommunications services revenues. Further, technology substitution from global VOIP providers, some of which offer free PC-to-PC based international calls, is also becoming more prevalent. Changing our services in response to market demand may require the adoption of new technologies that could render many of the technologies that we are currently implementing less competitive or obsolete. In addition, our new products and services may contain design flaws or other defects that could have a material adverse effect on our business, operating results or financial condition. To respond successfully to technological advances and emerging industry standards, we may require substantial capital expenditure and access to related or enabling technologies in order to integrate the new technology with our existing technology. We may not be successful in modifying our network infrastructure in a timely and cost-effective manner in response to these changes, which will affect our ability to continue to offer the products and services demanded by our customers.

Risks Relating to the Regulatory, Political and Economic Environment

Regulatory reforms and currently contemplated regulatory initiatives in the telecommunications industry may adversely affect us.

The Hong Kong telecommunications industry is undergoing continuous regulatory reform. Our business and results of operations may be adversely affected by changes in the telecommunications regulations, especially in the following areas:

- In July 2004, a new provision of the Telecommunications Ordinance came into force. This provision specifically regulates merger and acquisition activities in the Hong Kong telecommunications industry by giving the Telecommunications Authority the power to review mergers and acquisitions concerning carrier licensees and to take appropriate actions when it determines that the transaction would, or is likely to, substantially lessen competition in a telecommunications market without any outweighing public benefits. The Telecommunications Authority also has the right to impose conditions upon or oppose or unwind mergers and acquisitions. This regulation may have an adverse effect on our ability to grow our business through mergers and acquisitions.
- We offer local VOIP services through our Metro Ethernet network. Following the conclusion of a public consultation on the regulation of Internet Protocol Telephony Services, the Telecommunications Authority issued a statement on June 20, 2005, setting out its views and decisions on the regulatory and licensing framework for the provision of VOIP services including the creation of a licensing framework, conformance to the existing system of assigning telephone numbers, imposition of interconnection charges and establishing guidelines with respect to the quality of services. The proposed regulatory framework, if adopted, will subject us to further regulations that may affect our operations and increase our compliance costs.
- We offer fixed telecommunications network services. The Telecommunications Authority is currently in the process of developing a new Fixed-Mobile Convergence, or FMC, licensing practice which may supersede the existing distinctions between fixed-line and mobile operator licensing. This regulatory change, together with the development of new technologies, may further accelerate the convergence of fixed and mobile telecommunications services, resulting in more structural competition between fixed-line and mobile telecommunications operators. As we do not have a wireless license, our ability to compete maybe hindered by our inability to offer such services independently.
- We provide our IP-TV services over our Metro Ethernet network under HKBN’s FTNS License. The Hong Kong government has indicated that because our IP-TV services are carried over the Internet, we are exempt under the Broadcasting Ordinance from the requirement to obtain a domestic pay-television program service license. However, the government’s Communications and Technology Branch has informed us that the government is considering a review of the broadcasting regulatory regime and may introduce changes to the existing regulatory framework, including the existing exemption in the Broadcasting Ordinance. However, we cannot predict whether the government may require us to obtain a pay-television program service license in the future.

We require licenses from the Telecommunications Authority to provide our services. If one of these licenses is revoked or not renewed, we would be unable to deliver the services authorized by that license.

We require licenses from the Telecommunications Authority to provide our international telecommunications and fixed telecommunications network services. Our PNETS License is subject to the Telecommunications Authority’s annual renewal and HKBN’s FTNS License awarded in 2000 is initially granted for a term of 15 years, which may be renewed for such further period not exceeding 15 years at the discretion of the Telecommunications Authority. The Telecommunications Authority’s failure to renew or its revocation of any of these licenses for any reason would prohibit us from continuing to offer the services authorized by that license, which would have a significant adverse impact on our revenues and profitability. In addition, future changes in Hong Kong’s telecommunications regulations or policies that would require us to obtain additional licenses could have an adverse impact on our operations.

Our revenues may be adversely affected by increases in tariffs in China.

In China, the Ministry of Information Industry, or the MII, and the State Development Planning Commission jointly set tariffs for all domestic and international long distance services in China using public switched telephone networks, leased lines and data services. Certain tariffs payable by us to our carrier partners are based, among other things, on the tariffs set by these agencies with respect to the calls our subscribers make to persons in China. In fiscal 2006, approximately 75% of our international call traffic volume was to China. We cannot predict the timing, likelihood or magnitude of any tariff adjustments that may be imposed by the

MII and the State Development Planning Commission nor can we predict the extent or potential impact upon our business of any future tariff increases. Such increases may lead to a decrease in traffic, reduce our revenues and adversely affect our business and results of operations. In addition, if we are unable to effectively manage the increased network costs, it would have an adverse effect on our profit margins for international telecommunications services.

We have approximately 50% of our staff located in Guangzhou, China and changes in Chinese labor or business laws may significantly affect our operations and our ability to service our Hong Kong based customers.

Our call center in Guangzhou employs over 1,200 persons and is an important resource for us. We are therefore subject, to a significant degree, to the laws and regulations that govern foreign companies with operations in China. As The Chinese legal system develops, changes in such laws and regulations, their interpretation or their enforcement may lead to restrictions on our ability to hire and retain our employees in China which could impact our ability to provide service to our Hong Kong based customers.

Currency fluctuations of the Hong Kong dollar, our primary operating currency, may increase our operating costs and long term liability.

A major portion of our operating costs is interconnection charges paid to overseas carriers for the delivery of our international calls. Substantially all of these interconnection charges are denominated in U.S. dollars or other currencies other than Hong Kong dollars. In addition, the equipment and hardware we purchase for the expansion of our Metro Ethernet network constitutes a large portion of our capital expenditure and is also denominated in U.S. dollars. Finally, payment of interest, principal and any other amounts due under the 8.75% notes issued in January 2005 are made in U.S. dollars. However, our revenues are predominantly denominated in Hong Kong dollars. Since October 17, 1983, the Hong Kong dollar has been linked to the U.S. dollar at the rate of HK$7.80 per US$1.00. We cannot assure you the link will be maintained.

In addition, the expenses that we incur in relation to our call center located in Guangzhou, China are denominated exclusively in Renminbi, the official currency of the People’s Republic of China. These include the salaries that we pay to our personnel as well as various operating expenses that we incur to maintain our operations. As a result, we are exposed to a certain amount of foreign exchange risk based on fluctuations between the Hong Kong dollar and the Renminbi. The Renminbi is presently pegged to a basket of currencies, and there remains significant international pressure on the PRC government to further liberalize its currency policy. This could result in a further and more significant appreciation in the value of the Renminbi against the Hong Kong dollar, which would increase the cost of operating our call center.

Any depreciation of the Hong Kong dollar against the U.S. dollar, Renminbi or other currencies, would increase our operating costs, including our debt servicing costs, make our capital expenditure plans more expensive, and adversely affect our profitability.

Risks Relating to our Securities

We incurred a net cash outflow before financing activities in each of fiscal years 2005 and 2006.

Our ability to fund operating and capital expenditures and to service debt will depend significantly on our ability to generate cash from operations. In fiscal 2005 and 2006, we incurred net cash outflow before financing activities of HK$480.1 million and HK$308.6 million, respectively. We will need to turn around our operations in order to generate sufficient cash flows to meet our future debt service requirements. However, we cannot assure you that we will be able to do so.

Our ability to generate cash from operations is subject to general economic, financial, industry, legal and other factors and conditions, many of which are outside our control. In particular, our operations are subject to price and demand volatility in the telecommunications industry. If we cannot finance our operations and capital expenditure using cash generated from operations, we may be required to (among other things) incur additional debt, reduce capital expenditures, sell assets, or raise equity. We may not be successful in taking these actions. In particular, Standard & Poor’s and Moody’s Investors Services downgraded our credit rating during 2005, from ‘BB-’ to ‘B’ and from ‘Ba3’to B2’, respectively. These downgrades may limit our ability to obtain future financing or make such financing more costly. Further, our ability to take many of these steps may be subject to approval by future creditors in addition to holders of the 8.75% notes issued in January 2005.