Estimation of cash flows arising from future use of the asset requires careful analysis regarding what we expect to recover from its future use. This includes consideration of our target market share and subscription base, market competition, future changes to our cost structure and technological change. In addition, the residual value of the asset on disposal requires judgment, as the estimated fair value of the asset at the time of disposal could change in response to market conditions and changes in expected use of the asset prior to disposal. Changes in the estimate of cash flows arising from expected future use of the asset or its residual value on disposal — based on changes in market conditions, changes in the use of assets, management plan, and foreseeable technological changes or otherwise — could significantly change the calculation of the fair value or recoverable amount of the asset and the resulting impairment loss. This in turn could significantly affect the results of our operations.

For the three years ended August 31, 2011, no impairment of fixed assets has been recognized.

Accounts receivable

Under IFRSs, provision is made against accounts receivable to the extent they are considered to be doubtful. This provision requires judgment regarding the collectability of certain receivables both as they are incurred and as they age. We assess bad debt provision by type of customers, namely residential, corporate and carrier, based on past experience of recovery of old receivables, the aging of the accounts receivable balance and historical write-off experience. Certain receivables may be initially identified as collectible, yet subsequently become uncollectible and result in a subsequent write-off of the related receivable to the consolidated income statement. Changes in the collectability of accounts receivable for which provisions are not made could affect our future results of operations.

Included in the accounts receivable balance (net of allowance for doubtful debts) were receivables for mobile interconnection charges of HK$68.8 million, HK$39.8 million and less than HK$0.1 million as of August 31, 2009, 2010 and 2011, respectively. The balance represented mobile interconnection charges we billed to the local mobile network operators, and some of these charges had not been collected.

Changes in the allowance for doubtful debts consist of:

	For the year ended August 31,			
	2009	*2010*	*2011*	*2011*
	HK$	HK$	HK$	US$
	(Amounts in thousands)			
Balance at beginning of the year	11,944	3,160	5,823	748
Additions charged to expense	12,103	14,742	13,636	1,751
Write-off	(20,887)	(12,079)	(12,929)	(1,660)
Balance at the end of the year	3,160	5,823	6,530	839

Deferred taxation

We recognized deferred tax assets for all deductible temporary differences and operating loss carry forwards to the extent it is probable that future taxable profits will be available against which the asset can be utilized. The recognition of deferred tax assets requires judgment regarding the results of future operations, including the assumption that there will be sufficient future operations to allow us to utilize the related deferred tax assets. Our management projects future taxable income by considering all available information, including projected future taxable profit by taking into consideration of the effect of our capital expenditures and other plans (such as the existing network capacity, technological changes, future market trends and projected fixed network coverage), tax planning strategies, historical taxable incomes, and the expiration period of the unused tax losses carry forwards of each of our Company and subsidiaries.

As of August 31, 2010 and 2011, we had not recognized deferred tax assets in respect of unused tax losses of HK$8.2 million and HK$8.1 million respectively, because it was not probable that future taxable profits could be generated to utilize the tax losses. All tax losses are subject to agreement with local tax authorities. Any changes in the estimate of future operations could change the recognition of our deferred tax assets, which could significantly affect our results of operations.

USC charges

Our management makes their best estimates for the USC, payable to PCCW-HKT in order to fund the network development costs incurred by PCCW-HKT in remote areas in Hong Kong. Such estimated costs are included as part of our costs of rendering services. The estimate is made based on the provisional rates announced by OFTA and is effective up to the date of the release of our consolidated financial statements. OFTA periodically reviews the actual costs incurred by PCCW-HKT in the development and adjusts the amounts owed to PCCW-HKT, or to be refunded by it, to the respective USC contributing parties, including us. Accordingly, the estimate made by our management for a financial year is subject to changes based on the revisions published by OFTA up to the date prior to the release of our consolidated financial statements. We adjust such differences as an addition to, or reduction of, the corresponding costs of services in that particular reporting period.

Any sum received in advance from PCCW-HKT as an estimated refund of USC on a provisional basis, which is subject to the final confirmation and determination of OFTA, is recorded in other payables and accrued charges in our balance sheet.

Operating Results

The following table sets forth, for the years indicated, a summary of our results of operations.

	For the year ended August 31,			
	2009 HK$	*2010* HK$	*2011* HK$	*2011* US$
		(Amounts in thousands)		
Revenue				
FTNS business	1,230,880	1,356,098	1,484,324	190,601
IDD business	247,359	218,589	197,134	25,314
	1,478,239	1,574,687	1,681,458	215,915
Network costs and costs of sales	(175,129)	(195,292)	(212,315)	(27,263)
Other operating expenses	(1,037,964)	(1,105,604)	(1,097,164)	(140,886)
Other income, net	41,540	7,989	7,249	931
Finance costs	(55,127)	(22,235)	(6,359)	(817)
Profit before taxation	251,559	259,545	372,869	47,880
Income taxes expense	(38,730)	(42,679)	(58,954)	(7,570)
Net income	212,829	216,866	313,915	40,310

Fiscal 2011 Compared to Fiscal 2010

Revenues. Revenues increased by 6.8% to HK$1,681.5 million in fiscal 2011 from HK$1,574.7 million in fiscal 2010, reflecting an increase in revenue from our FTNS business, the effects of which were partially offset by a decrease in revenue from our IDD business. Revenue contribution from our FTNS business increased to 88.3% in fiscal 2011 from 86.1% in fiscal 2010.

- **FTNS business**. Revenues from our FTNS business increased by 9.5% to HK$1,484.3 million in fiscal 2011 from HK$1,356.1 million in fiscal 2010. The increase was primarily caused by an increase of 12.3% of our FTNS subscription base to 1,247,000 as of August 31, 2011 from 1,110,000 as of August 31, 2010.
  - *Broadband Internet access*. The subscription base for our Internet access services increased by 12.2%, to 590,000 as of August 31, 2011 from 526,000 as of August 31, 2010. During fiscal 2011, despite competitive market environment, we were able to maintain our growth while harvesting the record high broadband subscription growth that we achieved in fiscal 2010 pursuant to the “Member-Get-Member” marketing campaign.
  - *Local VoIP*. The subscription base for our local VoIP services increased by 10.4%, to 476,000 as of August 31, 2011 from 431,000 as of August 31, 2010, mainly due to improved branding that allowed us to increase sales of our VoIP services to subscribers of our Internet access services.
  - *IP-TV*. The subscription base for our IP-TV services increased by 18.3% to 181,000 subscriptions as of August 31, 2011 from 153,000 as of August 31, 2010 because we remained focused on offering mass value. We continued to enhance our channel variety so as to increase the content value to our customers. We currently offer more than 110 channels to our customers.

- **IDD business**. Revenues from our IDD business decreased by 9.8% to HK$197.1 million in fiscal 2011 from HK$218.6 million in fiscal 2010. The decrease was primarily due to the reduction in IDD traffic volume and the decrease in the tariff rate we charged to our customers. Competition during fiscal 2011 intensified as some of our competitors offered international direct dial minutes for free or at significantly lower rates as a marketing incentive to gain local fixed line and mobile market shares. Further, technology from global VoIP providers such as Skype, which offer free PC-to-PC based international calls, was also becoming more prevalent in Hong Kong.

Network costs and costs of sales. Network costs and costs of sales increased by 8.7% to HK$212.3 million in fiscal 2011 from HK$195.3 million in fiscal 2010 mainly due to the increase in the cost of purchasing international bandwidth as a result of the combined effect of the record growth in broadband subscription and the increasing demand of bandwidth from customers as well as the increase in program fees for IP-TV services to enhance the value of content to customers.

Other operating expenses. Other operating expenses decreased by 0.8% to HK$1,097.2 million in fiscal 2011 from HK$1,105.6 million in fiscal 2010 mainly due to the following:

Set forth below is a table summarizing the details of our other operating expenses in fiscal 2010 and 2011:

	For the year ended August 31,		
	2010	*2011*	*2011*
	HK$	HK$	US$
		(Amounts in thousands)	
Talent costs	(301,760)	(311,355)	(39,981)
Advertising and marketing expenses	(372,727)	(344,136)	(44,190)
Depreciation	(199,029)	(218,197)	(28,018)
Others	(232,088)	(223,476)	(28,697)
Other operating expenses	(1,105,604)	(1,097,164)	(140,886)

- *Talent costs*. Talent costs increased by 3.2% to HK$311.4 million in fiscal 2011 from HK$301.8 million in fiscal 2010.
- *Advertising and marketing expenses*. Advertising and marketing expenses decreased by 7.7% to HK$344.1 million in fiscal 2011 from HK$372.7 million in fiscal 2010 due to a decrease in the scale of marketing campaign, especially lower mass media advertising costs after the cessation of the Member-Get-Member campaign in fiscal 2010.
- *Depreciation*. Depreciation increased by 9.6% to HK$218.2 million in fiscal 2011 from HK$199.0 million in fiscal 2010 because of our acceleration in the expansion of our Next Generation Network.

Other income, net. Other income, net decreased to HK$7.2 million in fiscal 2011 from HK$8.0 million in fiscal 2010.

Finance costs. Finance costs decreased by 71.6% to HK$6.3 million in fiscal 2011 from HK$22.2 million in fiscal 2010. The decrease was mainly due to full year impact of the finance cost savings through repurchase and redemption of our 10-year senior notes in fiscal 2010.

Income tax expense. We recorded an income tax expense of HK$59.0 million, which included a non-cash deferred tax expenses of HK$55.3 million in fiscal 2011, compared to an income tax expense of HK$42.7 million in fiscal 2010, which included a non-cash deferred tax expenses of HK$40.1 million.

Net income. For the foregoing reasons, net income increased to HK$313.9 million in fiscal 2011 from HK$216.9 million in fiscal 2010. Net margin increased to 18.7% in fiscal 2011 from 13.8% in fiscal 2010.

Fiscal 2010 Compared to Fiscal 2009

Revenues. Revenues increased by 6.5% to HK$1,574.7 million in fiscal 2010 from HK$1,478.2 million in fiscal 2009, reflecting an increase in revenue from our FTNS business, the effects of which were partially offset by a decrease in revenue from our IDD business and the change in the regulatory regime of mobile interconnection charges summarized below. Revenue contribution from our FTNS business increased to 86.1% in fiscal 2010 from 83.3% in fiscal 2009.

- ***FTNS business***. Revenues from our FTNS business increased by 10.2% to HK$1,356.1 million in fiscal 2010 from HK$1,230.9 million in fiscal 2009. The increase was primarily caused by an increase of 17.7% of our FTNS subscription base to 1,110,000 as of August 31, 2010 from 943,000 as of August 31, 2009.

- *Broadband Internet access*. The subscription base for our Internet access services increased by 34.5%, to 526,000 as of August 31, 2010 from 391,000 as of August 31, 2009. During fiscal 2010, we were able to have a record growth of 135,000 net additions through our Member-Get-Member marketing campaigns which reduced the price of our symmetric 100 Mbps broadband services by half to HK$99 per month if a customer introduces a new customer at HK$99 per month. Such marketing campaigns essentially allowed us to increase our revenues by converting one subscriber at HK$182 per month to two subscribers at a minimum rate of HK$99 per month.
- *Local VoIP*. The subscription base for our local VoIP services increased by 12.8%, to 431,000 as of August 31, 2010 from 382,000 as of August 31, 2009, mainly due to improved branding that allowed us to increase sales of our VoIP services to subscribers of our Internet access services.
- *IP-TV*. The subscription base for our IP-TV services decreased by 10.0% to 153,000 subscriptions as of August 31, 2010 from 170,000 as of August 31, 2009 because we proactively dropped certain free or low paying IP-TV subscribers and redeployed the set-top boxes to higher yielding customers. We continued to enhance our channel variety so as to increase the content value to our customers.

As a result of OFTA's decision on the 2008 Determination in May 2010 as stated above, revenue of HK$19.7 million related to mobile interconnection charges was reversed in fiscal 2010. In addition, prior to April 26, 2009, the mobile network operators were required to pay interconnection charges for all calls originating to and from the mobile users. After April 26, 2009, the chargeability of interconnection charges is subject to commercial negotiation. With the withdrawal of regulatory guidance on FMIC in favor of mobile network operators on April 27, 2009, only an insignificant amount of revenue related to mobile interconnection charges was recognized.

- **IDD business**. Revenues from our IDD business decreased by 11.6% to HK$218.6 million in fiscal 2010 from HK$247.4 million in fiscal 2009. The decrease was primarily due to the reduction in IDD traffic volume and the decrease in the tariff rate we charged to our customers. Competition during fiscal 2010 intensified as some of our competitors offered international direct dial minutes for free or at significantly lower rates as a marketing incentive to gain local fixed line and mobile market shares. Further, technology from global VoIP providers such as Skype, which offer free PC-to-PC based international calls, was becoming more prevalent.

Network costs. Network costs increased by 11.5% to HK$195.3 million in fiscal 2010 from HK$175.1 million in fiscal 2009 mainly due to the increase in the cost of purchasing international bandwidth as a result of the combined effect of the record growth in broadband subscription and the increasing demand of bandwidth from customers as well as the increase in program fees for IP-TV services to enhance the value of content to customers.

Other operating expenses. Other operating expenses increased by 6.5% to HK$1,105.6 million in fiscal 2010 from HK$1,038.0 million in fiscal 2009 mainly due to the following:

Set forth below is a table summarizing the details of our other operating expenses in fiscal 2009 and 2010:

	For the year ended August 31,		
	2009 HK$	*2010* HK$	*2010* US$
		(Amounts in thousands)	
Talent costs	(302,279)	(301,760)	(38,796)
Advertising and marketing expenses	(299,794)	(372,727)	(47,920)
Depreciation	(206,241)	(199,029)	(25,588)
Others	(229,650)	(232,088)	(29,839)
Other operating expenses	(1,037,964)	(1,105,604)	(142,143)

- *Talent costs*. Talent costs decreased by 0.2% to HK$301.8 million in fiscal 2010 from HK$302.3 million in fiscal 2009.
- *Advertising and marketing expenses*. Advertising and marketing expenses increased by 24.3% to HK$372.7 million in fiscal 2010 from HK$299.8 million in fiscal 2009. Our salaries and commissions for our sales and marketing Talents increased by HK$28.5 million due to our growth in broadband subscription base. Moreover, our marketing campaigns resulted in an increase in mass media advertising costs of HK$21.6 million and other advertising costs of HK$14.9 million. In addition, the expansion of our sales channels through opening new shops resulted in an increase of advertising and marketing related expenses of HK$7.9 million.

- *Depreciation*. Depreciation decreased by 3.5% to HK$199.0 million in fiscal 2010 from HK$206.2 million in fiscal 2009. Notwithstanding our purchase of additional fixed assets for our network infrastructure as we increased the scale of operations in our FTNS business, a portion of our owned fixed assets were fully depreciated. As a result, we incurred lower depreciation expenses.

Other income, net. Other income, net decreased to HK$8.0 million in fiscal 2010 from HK$41.5 million in fiscal 2009. The decrease was mainly contributed by the loss on extinguishment of our 10-year senior notes of HK$9.7 million in fiscal 2010 compared to the gain on extinguishment of our 10-year senior notes of HK$31.4 million in fiscal 2009. The effect of which was partially offset by an increase in interest income of HK$10.1 million recognized in relation to mobile interconnection charges in fiscal 2010.

Finance costs. Finance costs decreased by 59.7% to HK$22.2 million in fiscal 2010 from HK$55.1 million in fiscal 2009. The decrease was mainly due to finance cost savings through repurchase and redemption of our 10-year senior notes and interest bearing bank borrowings at a lower interest rate. The effect of which was partially offset by the change in fair value of derivative financial instrument that we did not have in fiscal 2009.

Income tax expense. We recorded an income tax expense of HK$42.7 million, which included a non-cash deferred tax expenses of HK$40.1 million in fiscal 2010, compared to an income tax expense of HK$38.7 million in fiscal 2009, which included a non-cash deferred tax expenses of HK$37.1 million.

Net income. For the foregoing reasons, net income increased to HK$216.9 million in fiscal 2010 from HK$212.8 million in fiscal 2009. Net margin decreased to 13.8% in fiscal 2010 from 14.4% in fiscal 2009. The slight decrease in net margin was primarily due to a higher cost in acquiring new customers.

Recent accounting pronouncements

Recent issued but not yet effective accounting pronouncements under IFRSs have been included in note 31 to our consolidated financial statements.

B. Liquidity and capital resources

We expect cash flow from operating activities to continue to be our principal source of liquidity. As of August 31, 2011, we had cash and bank balances of HK$409.0 million. Our day-to-day operations are also supported by HK$38.9 million banking facilities, of which HK$6.9 million was utilized as of August 31, 2011.

We believe that our current cash and cash equivalents and cash flow from operations will be sufficient to meet our anticipated cash needs, including working capital requirements, capital expenditures, repayment of our indebtedness when fall due and various contractual obligations, for at least the next 12 months. Our cash flows from operations, however, may decrease due to lower customer demand resulting from rapid technological changes, increasing competition resulting from new local and foreign entrants into the market, or our failure to obtain or renew the necessary telecommunication licenses. A decrease in our operating cash flow could adversely affect our ability to make planned capital expenditures, to comply with our obligations under various operating and capital leases and to repay amounts due under banking facilities.

Cash flow

The following table summarizes our cash flows for each of fiscal 2009, 2010 and 2011:

	For the year ended August 31,			
	2009	*2010*	*2011*	*2011*
	HK$	HK$	HK$	US$
	(Amounts in thousands)			
Net cash inflow from operating activities	536,771	485,340	585,899	75,235
Net cash outflow from investing activities	(176,488)	(306,254)	(414,189)	(53,186)
Net cash (outflow)/inflow from financing activities	(561,292)	178,307	(343,112)	(44,059)
(Decrease)/increase in cash and cash equivalents	(201,009)	357,393	(171,402)	(22,010)
Cash and cash equivalents, at the beginning of year	421,610	221,052	578,175	74,243
Effect of foreign exchange rate changes on cash	451	(270)	1,358	174
Cash and cash equivalents, at the end of the year	221,052	578,175	408,131	52,407
Analysis of the balances of cash and cash equivalents				
Cash at bank and in hand	226,416	588,665	408,976	52,516
Bank overdrafts — unsecured	(5,364)	(10,490)	(845)	(109)
	221,052	578,175	408,131	52,407

Operating activities

Our principal source of cash was cash generated from our FTNS business. Net cash inflow from operating activities decreased by 9.6% from HK$536.8 million in fiscal 2009 to HK$485.3 million in fiscal 2010, which was a reflection of a slight increase in our profit before taxation offsetting by lower cash receipt of receivables. Net cash inflow from operating activities increased 20.7% from HK$485.3 million in fiscal 2010 to HK$585.9 million in fiscal 2011, primarily reflecting the increase in our profit before taxation resulting from the continued expansion of our subscription base.

Investing activities

Net cash outflow from investing activities in fiscal 2011 was HK$414.2 million. The net cash outflow was mainly due to the purchase of fixed assets of HK$397.9 million for the development of our Next Generation Network and the purchase of land premium of HK$48.0 million for constructing a multimedia production and distribution centre.

Net cash outflow from investing activities in fiscal 2010 was HK$306.3 million. The net cash outflow was mainly due to our purchase of fixed assets in the amount of HK$349.1 million.

Net cash outflow from investing activities in fiscal 2009 was HK$176.5 million. The net cash outflow was mainly due to our purchase of fixed assets of HK$289.9 million, the effect of which were partially offset by an decrease in pledged bank deposits of HK$72.3 million and net proceeds from maturity of investment in debt securities of HK$28.1 million.

Financing activities

Net cash outflow from financing activities in fiscal 2011 was HK$343.1 million. The net cash outflow was mainly due to our repayment of our bank loan of HK$125 million and payment of cash dividends of HK$219.3 million.

Net cash inflow from financing activities in fiscal 2010 was HK$178.3 million. The net cash inflow was mainly due to the proceeds from the offering of new ordinary shares in the amount of HK$396.4 million and the proceeds from new bank loans of HK$163.4 million, which were partially offset by the repurchase and redemption of our 10-year senior notes of HK$172.4 million and dividend paid of HK$158.4 million.

Net cash outflow from financing activities in fiscal 2009 was HK$561.3 million. The net cash outflow was mainly due to our repurchase of 10-year senior notes for an aggregate consideration of HK$485.8 million (including transaction costs), payment of interest on the 10-year senior notes of HK$52.7 million and payment of cash dividends of HK$23.0 million.

Long-term Indebtedness

As of August 31, 2011, we had outstanding debt of HK$1.2 million.

Banking facilities

As of August 31, 2011, we had available banking facilities and revolving loan facility of HK$38.9 million, of which HK$6.9 million was utilized.

Capital expenditures

In order to further develop our Next Generation Network and continue to increase the scale of operations of our FTNS business, we plan to make a total capital expenditure ranging from approximately HK$320 million to HK$350 million in fiscal 2012 to further increase the coverage of our Next Generation Network. In addition, we plan to invest HK$600 million for a multimedia production and distribution centre within three years.

C. Research and development, patents and licenses

We commit considerable resources to our research and development department in order to continuously improve our services and improve our market position. As of August 31, 2011, our research and development team consisted of approximately 25 Talents experienced in systems design, engineering, telecommunications and computer programming. Our research and development department is primarily responsible for assessing and adapting the technology that we employ in upgrading and expanding our Next Generation Network. To identify and develop new market opportunities, the research and development team assesses new services offered by telecommunications and Internet companies in the United States and elsewhere and works closely with our marketing department. Our research and development expenditures were approximately HK$10.8 million, HK$11.2 million and HK$11.8 million for fiscal 2009, 2010 and 2011, respectively.

D. Trend information

Revenue from our IDD business decreased by 9.8% to HK$197.2 million in fiscal 2011 from HK$218.6 million in fiscal 2010. The principal reason for this decrease was the intense competition, as our key competitors introduced highly aggressive price cuts. Partly as a result, the traffic volume of our IDD business decreased by 11.2% to 412.0 million minutes in fiscal 2011 from 464.0 million minutes in fiscal 2010. We expect competition will continue to increase in the future, creating further pressure on our volume and pricing.

Revenue from our FTNS business grew by 9.5% to HK$1,484.3 million in fiscal 2011 from HK$1,356.1 million in fiscal 2010. The principal reason for this increase was due to the broadband subscription growth of 12.2% to 590,000 subscription accounts as of August 31, 2011 from 526,000 subscription accounts as of August 31, 2010.

The global economic downturn has had a dampening effect on consumer sentiment and business activities across the globe in late 2008 and 2009 and the global economy continues to experience continued market volatility. The impact of the downturn on our operations has been limited because our FTNS and IDD services are “semi-utility” services. However, if the global economic downturn continues to experience significant volatility, demand for our services may be adversely affected.

E. Off-balance sheet arrangements

Other than as described in note 27 to our Consolidated Financial Statements, we have not entered into any off-balance-sheet arrangements with any entities or individuals.