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Goldman Sachs

June 18, 2004

Office of the Telecommunications Authority
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Hong Kong

Attention: Senior Telecommunications Engineer (Technical Regulation) 2

Goldman Sachs (Asia) L.L.C. ("Goldman Sachs") respectfully submits this letter in response to the Office of the Telecommunications Authority's ("TA") Consultation Paper entitled *"Licensing of Mobile Services on Expiry of Existing Licenses for Second Generation Mobile Services"*, issued on 19 March 2004 (the "Consultation Paper").

Goldman Sachs and its affiliates constitute a leading global investment banking, securities and investment management firm that provides a wide range of services worldwide to a substantial and diversified client base that includes corporations, financial institutions, governments and high net worth individuals. In particular, Goldman Sachs and certain of its affiliates have provided extensive underwriting and advisory services to numerous participants in the global telecoms market.

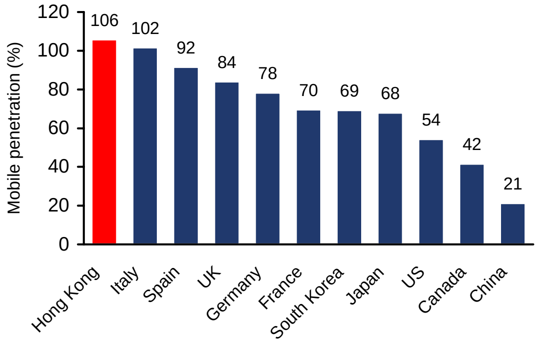
This document sets out Goldman Sachs' observations and comments on the Consultation Paper. Given Goldman Sachs' specific areas of expertise, we have limited our comments and observations in this document to a corporate finance analysis of the financial implications of issuing an additional infrastructure based mobile license in Hong Kong thereby increasing the number of infrastructure based licensees for 3G mobile services from the existing four to five. Capitalized terms in this document bear the same meaning as those in the Consultation Paper.

As recognized by the TA in the Consultation Paper, a key consideration in the future licensing of mobile services is to provide a stable investment environment for industry participants. This objective requires the balancing of various objectives such as promoting and protecting the interests of consumers and fostering the successful development and deployment of new technologies, applications and services while at the same time ensuring that service providers earn economic returns on their investments. To assist the TA in making its recommendations we have set out below our observations of key developments in similar markets and their potential relevance to the Hong Kong mobile market.

Hong Kong – A Vibrant, Competitive Mobile Market

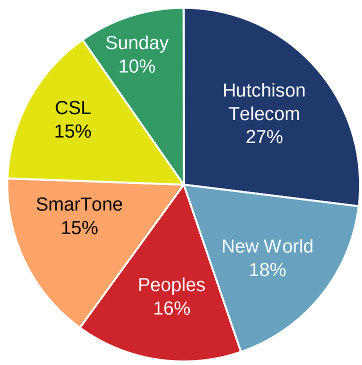
The foresight of the TA and its predecessors combined with the efforts of the local telecommunications industry have resulted in the establishment of a vibrant, competitive mobile industry in Hong Kong. Penetration levels, as illustrated in Exhibit 1 are amongst the highest in the world and both price and service based competition between the six existing 2G operators continue to drive the further development of the industry with subscriber market shares more or less evenly divided between the players as illustrated in Exhibit 2.

Exhibit 1: High Mobile Penetration



Source: ITU 2004, mobile penetration for 2003

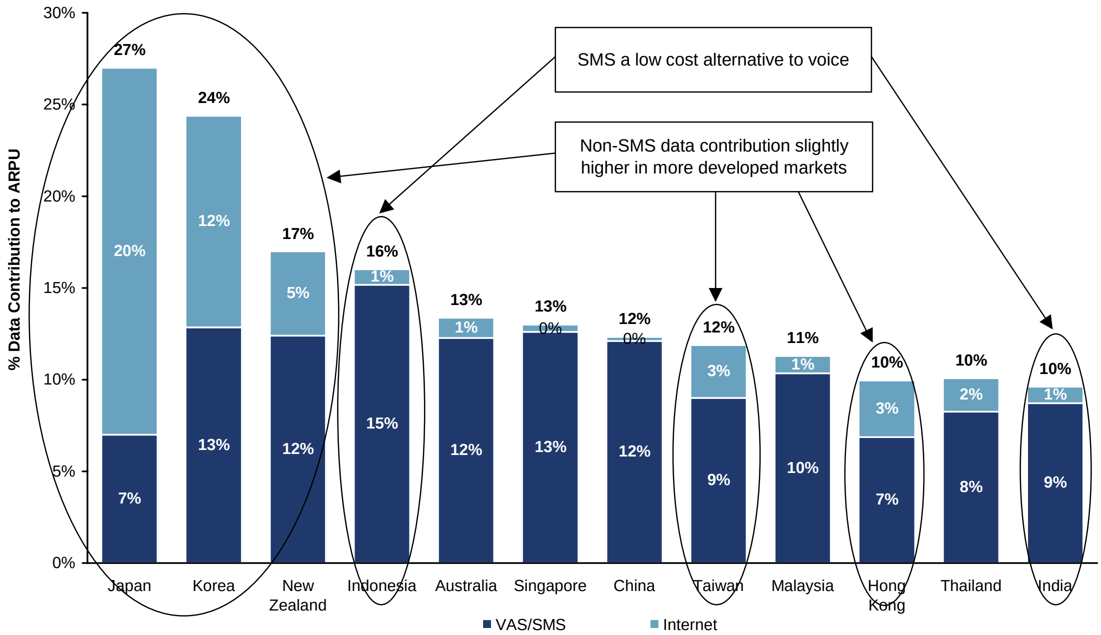
Exhibit 2: Subscriber Market Share By Operator



Source: Annual and interim reports, TA, Peoples' Offering Circular

The vibrancy of the industry is evidenced by take-up rates for mobile data services in Hong Kong which are comparable with those observed in other markets in the Asia Pacific region. As illustrated in Exhibit 3, while the overall rate of mobile data take-up in Hong Kong is somewhat lower than in some markets, take-up rates for advanced mobile data services in Hong Kong are higher than in many other markets in the Asia Pacific region.

Exhibit 3: Status of Data Take-up in Asia Pacific (2003E)



Source: Pyramid Research as of 3Q 2003

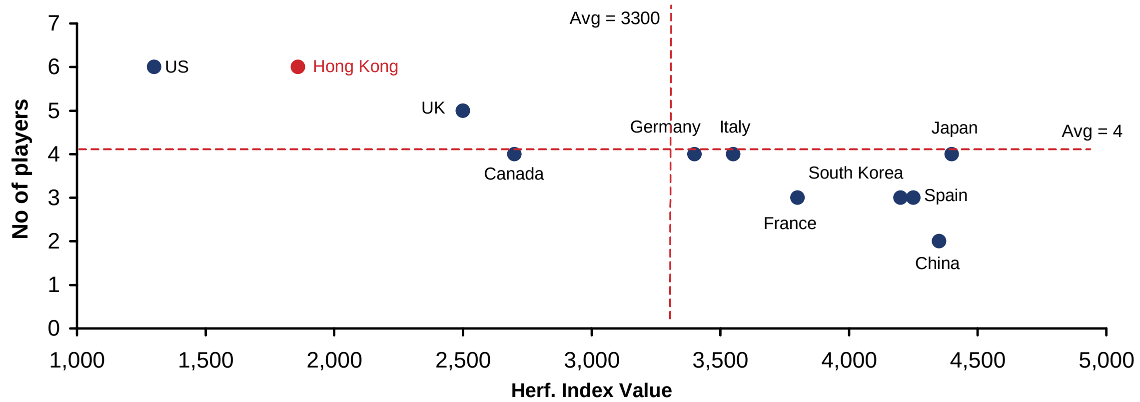
Furthermore, the recent commercial launch of 3G services in Hong Kong by Hutchison Telecom and the impending launch of commercial services by the remaining licensees, is expected to result in widespread acceptance of 3G mobile services over the next few years. This in turn is expected to drive mobile data take-up rates bringing them closer to levels experienced in markets such as Japan and Korea where similar services have been in use for a longer period of time.

The precise speed of adoption of advanced mobile data services are likely be determined by a number of different factors including, the availability of affordable and versatile handsets (in terms of weight, size, battery life and functionality etc), the availability of relevant content and applications, network coverage and quality and attractive pricing models. To successfully bring together all of these key factors, industry players will need to make substantial investments in financial, human and other resources. The extent and magnitude of these investments will be driven partly by operators' views on the ability to make economic returns on their investments by being able to achieve scale and growing their businesses in a timely manner.

The Importance of Scale in a Competitive Marketplace

With six 2G operators and four existing 3G licensees the Hong Kong mobile market is one of the most competitive markets in the world. The intensity of this competition is clearly evident when measured using the Herfindahl Index[1], a common measure of market share concentration as illustrated in Exhibit 4 below.

Exhibit 4: Number of Operators and Herfindahl Index



Source: Company reports and Goldman Sachs Research estimates

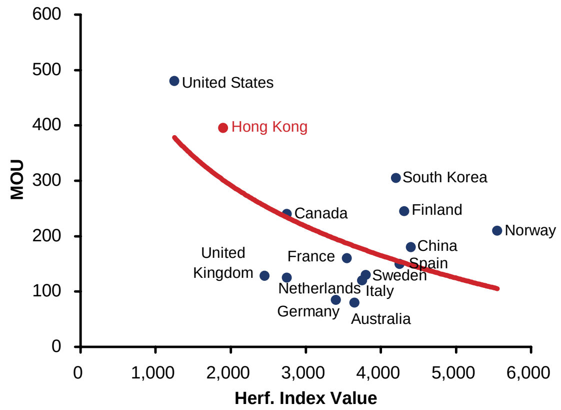
Exhibit 4 shows that both in terms of the number of licensed operators and in terms of the degree of market concentration, the Hong Kong mobile market is an outlier. The number of licensed 2G operators is higher than the average in similarly developed economies while the degree of concentration is substantially lower than the average concentration witnessed in similarly developed economies. The impact of both of these factors is compounded by the fact that unlike some of its other peers, the Hong Kong market in subscriber terms is substantially smaller than its peers.

The lack of concentration of the Hong Kong market versus other similarly developed markets has a number of different effects on operators and their abilities to make returns on investment including: lower tariffs, higher minutes of use ("MOU"), lower yields per minute, higher subscriber acquisition and retention costs, higher churn, higher capital requirements. This combination of factors results in lower margins, cash flow, and ultimately reduced returns on equity and capital invested.

We highlight the impact of market concentration on three of these metrics – MOU, Churn and EBITDA in Exhibits 5, 6 and 7.

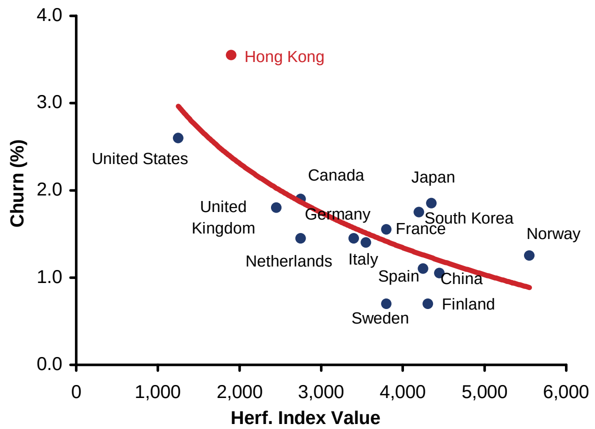
[1] *The Herfindahl-Hirschman Index is a measure of market concentration used by the U.S. Dept. of Justice. The concentration is found by adding the squares of each competitors' market share. A calculation of more than 1,800 is considered concentrated.*

Exhibit 5: MOU vs. Herfindahl Index



Source: Company reports and Goldman Sachs Research estimates

Exhibit 6: Churn vs. Herfindahl Index

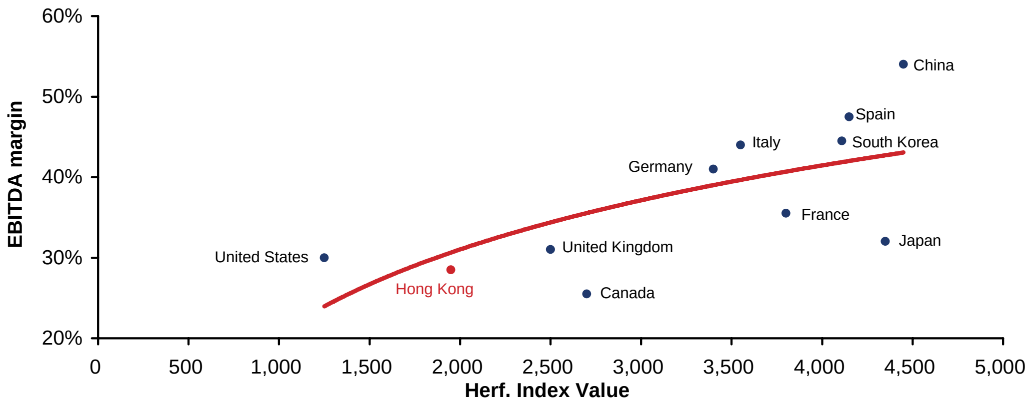


Source: Company reports and Goldman Sachs Research estimates

Exhibit 5 shows that for many markets the higher the intensity of competition, the higher the MOUs that a market witnesses primarily due to lower prices. Exhibit 6 shows the relationship between intensity of competition in a market and churn, where operators in the most highly competitive markets experience higher churn rates than in less competitive markets.

The net impact of lower tariffs, higher MOUs and higher churn is reflect in lower profitability and lower cash flow margins for operators in highly competitive markets as illustrated in Exhibit 7.

Exhibit 7: EBITDA Margin vs. Herfindahl Index

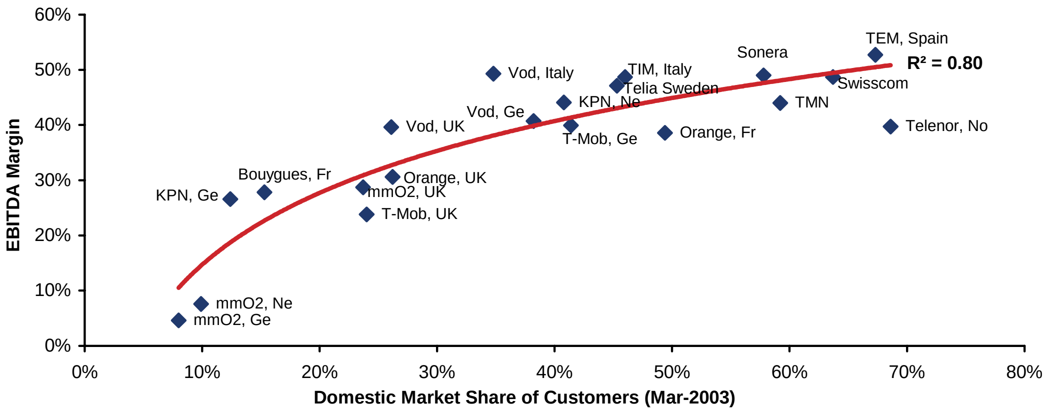


Source: Company reports and Goldman Sachs Research estimates

The benefits of scale to both individual players and thus the industry as a whole are clear: economies in acquiring and retaining customers, in launching and popularizing new and innovative services, in sourcing handsets, and in billing, customer service and other general and administrative costs. The most successful operators are those that are able to achieve economies of scale in all of these categories. Operators that do not gain economies from scale will have to find other economies if they are to generate equal or better returns from their user base relative to those that do.

Looking at the European example, scale has become a significant driver of profitability and returns. A clear relationship exists in Europe between market share and profitability, as seen in Exhibit 8, below.

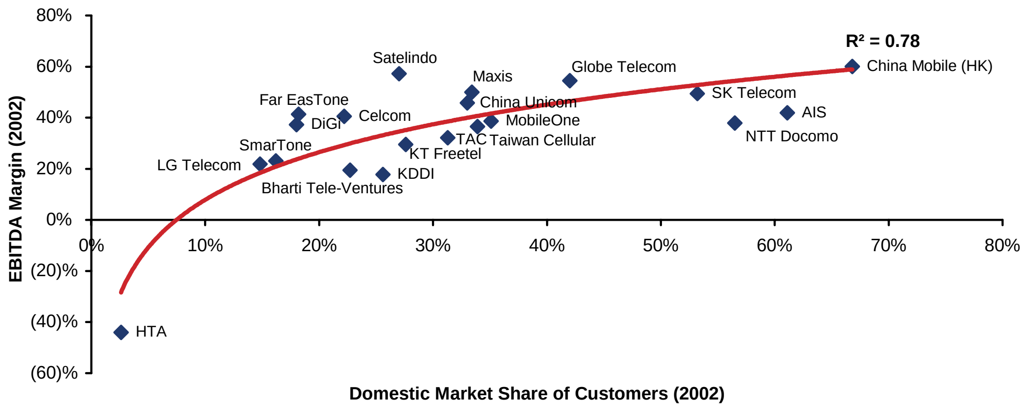
Exhibit 8: European Example – EBITDA Margin vs. Market Share



Source: Company reports and Goldman Sachs Research estimates

A similar relationship is also beginning to emerge in Asia as illustrated by Exhibit 9 below.

Exhibit 9: Asian Example – EBITDA Margin vs. Market Share



Source: Company reports and Goldman Sachs Research estimates

Key Conclusions:

In considering the licensing of mobile services on expiry of existing 2G mobile service licenses, the TA needs to carefully balance its five stated objectives, namely (i) to ensure choice of services; (ii) to provide a stable investment environment; (iii) to ensure efficient use of spectrum; (iv) to ensure continuity to customer service; and (v) to maintain technology neutrality, with ensuring a healthy operating environment for the industry and the long-term profitability of the mobile operators in Hong Kong. In a vibrant and highly competitive mobile market such as Hong Kong, scale is vital for operators to earn economic returns that are commensurate with their investments. In order to ensure that operators are incentivized to continually invest substantial capital in the development of new and innovative services such as 3G for the benefit of consumers, the structure and competitive environment in the market needs to be conducive to earning adequate returns on investment. Accordingly, we would respectfully submit that the TA give due consideration to the impact of increasing the intensity of competition in an already competitive marketplace before finally recommending the issuance of a further 3G license.

We thank you again for the opportunity to provide comments to your consultation paper and will be more than happy to provide further information if required.

Yours faithfully,

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Rajiv Ghatalia
Managing Director