

Attention: Senior Telecommunications Engineer (Technical Regulation) 2
Office of the Telecommunications Authority
29/F Wu Chung House
213 Queen's Road East
Wanchai
Hong Kong

19th June 2004

Dear Sir

Licensing of Mobile Services on Expiry of Existing Licenses for Second
Generation (2G) Mobile Services

ABN AMRO is a leading international bank and operates one of the largest wholesale banking businesses globally with operations in over 50 countries. We have focused on combining specialist industry sector knowledge with in-depth product expertise across the full spectrum of corporate and investment banking products to deliver high quality advice and services to our corporate and institutional client base. The telecommunications sector is an area where we have had significant focus and success acting on a wide range of transactions for a large number of telecommunications companies across all global geographies and across all major industry sub-sectors. Notably this year we advised KG Telecommunications in Taiwan on its US\$1.3bn merger with FarEasTone in Taiwan, the largest regional acquisition in the mobile sector, which was driven by the pressures of excess competition in a highly penetrated (over 100%) mobile market. Against this brief background we have an interest in providing some brief comments with respect to the consultation process on the Expiry of Existing 2G Licenses. It should be noted that we have acted in the past and expect to act in the future as adviser and/ or finance provider for a number of the existing telecommunications service providers in Hong Kong.

We have grouped our comments around key considerations highlighted by the Telecommunications Authority (TA) in its consultation paper with regard to future licensing and in response to commentary already submitted thereon.

Choice of Services

Hong Kong is one of the most competitive telecommunications markets, particularly in the mobile sector in the world with 6 network operators vying for customers in a territory with a population of approximately 7 million, over 11 2G networks in addition to 4 new 3G networks currently in various stages of being deployed and launched. The consumer in Hong Kong has a variety and choice of services, technology platforms and service providers that is without precedent in other markets.

Herfindahl Hirschman Index (HHI) analysis, which compares relative levels of competition across the Asian region, confirms that Hong Kong is one of the most competitive markets in Asia with a score of 0.20, representing what would be considered "perfect competition". The table below indicates HHI scores by market for comparative purposes.

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Globally we have seen a growing trend across the mobile sector for consolidation amongst operators as penetration levels have reached saturation levels and markets have become driven by competitive churn rather than organic customer growth. Consolidation has not occurred to any great extent in Hong Kong where the consumer continues to have one of the widest selections of mobile service providers and service offerings anywhere in the world for a market of this profile. In our opinion issuing a new licence will not materially improve the choice for consumers. Indeed, there is the potential that increased competition may result in a reduced ability for all operators to innovate in product and service offerings as the total customer base is spread even more thinly than at present with a consequent financial impact on all operators limiting their investment spend on new product development.

Stable Investment Environment

Predictability, clarity and consistency of the regulatory and investment climate for the telecommunications sector are essential to maintain the confidence of both investors and providers of finance in the sector and

encourage them to continue their support of the operators deploying and operating the mobile networks over which services are offered to the consumer.

The perspective of investors, banks and other providers of finance is global and they will assess Hong Kong relative to their global experience. In discussions with a number of international telecommunications operators about potential interest in entering the Hong Kong market as a new operator or through the acquisition of an existing operator there has been consistent feedback to the effect that Hong Kong is already seen as too competitive for a new market entrant to be able to justify an investment and achieve minimum hurdle rate financial returns. Further the absolute size of the market is not seen as large enough to drive overriding strategic attractions. The issue of another 3G licence is likely to reduce further interest from strategic investors.

With respect to financing from banks, it is already challenging for a number of the existing mobile operators to obtaining financing for their businesses without shareholder support in some form and the addition of more competition will increase this challenge, particularly in relation to new 3G network build. The approach that the TA is currently considering in terms of the issue of a new licence is likely to have negative implications for the telecommunications market as a whole with consequent impact on the financeability of the sector. There remains the opportunity for new service providers to participate in the industry as virtual operators (MVNOs) or resellers, which should add to consumer choice without the additional financing burden of deploying a new network by a new operator.

Efficient Use of Spectrum

The TA rightly states that spectrum is a scarce resource and it is accordingly obligated to ensure that it is used efficiently. However, the TA appears to have reached a conclusion on the inefficient use of the CDMA/TDMA band spectrum based on a declining subscriber trend and low absolute subscribers on these networks, relative to those on the GSM/ PCS networks. We believe there are a number of reasons behind this, including:

Large travelling population in Hong Kong and a preference for mobile roaming capability, which has been significantly more limited on CDMA than GSM

Initially CDMA handsets were not SIM card based requiring the purchase of a new handset to switch networks, which was encouraged with the introduction of number portability, resulting in potential higher cost for consumers.

This should not distract attention from the fact that the existing CDMA/TDMA operators have invested significantly to build and run these networks and continue to do so even with a low customer base, in recognition of their obligations to their customers. Given the high fixed cost base of operating a mobile network the existing operators are unlikely to be maintaining service on these networks for purely financial reasons, but rather to service their customers. Both of the existing CDMA/TDMA operators operate CDMA networks in other countries where they have also invested significantly to build these and remain fully committed to these technologies as a service platform. Against this background, it seems inconsistent that the TA is proposing a different approach to the licence renewal for the CDMA/ TDMA operators versus the GSM/ PCS operators when all have been supporting the development of the mobile industry in Hong Kong for many years.

To the extent a first right of refusal on licence renewal is offered it should be offered consistently to all existing network operators unless they have specifically breached the terms of their existing licences. To approach licence renewal otherwise is to undermine the reputation of the TA for consistency of approach.

Continuity of Customer Service

While there are only small numbers of customers on the CDMA/ TDMA networks they have remained as customers despite the opportunity to move to other operators/ networks, which would suggest this is a customer choice, which the TA would effectively be removing by the withdrawal of the existing CDMA/ TDMA licence. While service continuity is possible with the forced migration of these customers to another service provider, this will

inevitably come at a cost to the consumer, directly or indirectly.

Issue of a new 3G licence

The TA has indicated that in the event of the introduction of a new 3G licence this would be "to enable the introduction of advanced and innovative mobile services to benefit consumers, spawn new industries and enhance Hong Kong's status as a mobile hub in Asia." The existing 2G and 3G operators are already providing advanced and innovative mobile services to benefit consumers and it is already a mobile hub with the one of the first operating 3G networks in Asia. Assuming the deployment and launch of the other 3G networks over the next few months, by 2005 Hong Kong will have 4 operating 3G networks, which is likely to be globally without precedent for any market. The introduction of a new potential 5th 3G license at this stage of industry development brings with it significant risks for the industry as a whole without any definitive reasons to believe it will meet the underlying objective behind this of increasing data content and applications at faster rate than is likely to occur through service deployment by the existing 3G licensees.

Further there was weak response to the licensing of the existing 3G licensees, other international markets have seen the return of 3G licenses by operators unable to support the investment and business case for service deployment, and 3G network investment and roll-out has not met original forecasts due to combination of technical, financing and consumer adoption reasons. Issuing a further 3G license against this background is likely to add further uncertainty to the successful take-up of 3G services in Hong Kong.

Conclusion

In summary we believe that there are a number of risks to the telecommunications market in Hong Kong and the consumer experience in the event that the TA proceeds with the licensing plan as currently envisaged in the consultation.

Yours Faithfully

Neil Galloway

Managing Director, Head of Asia Telecommunications

ABN AMRO Asia

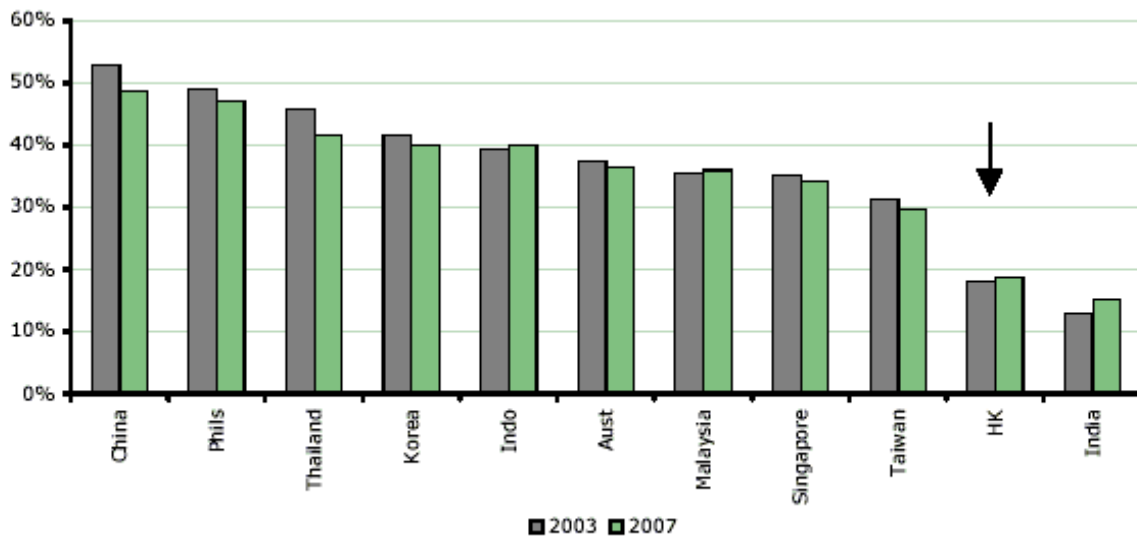
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Source: ABN AMRO estimates