
Final Transcript

BAY CREST PARTNERS: SENIOR MANAGEMENT OF CITY TELECOM

June 24, 2010/10:00 a.m. EDT

SPEAKERS

Chris Dearborn – Director, Corporate Access, Bay Crest Partners

NiQ Lai – Chief Financial Officer, Head of Talent Engagement, City Telecom, Ltd.

Joe Ferrara – Research Manager, Bay Crest Partners

PRESENTATION

C. Dearborn Good day, ladies and gentlemen. This is Chris Dearborn of Bay Crest Partners. I want to welcome you to today's conference call with City Telecom, Ltd., featuring Mr. NiQ Lai, Chief Financial Officer and Head of Talent Engagement.

It's now my pleasure to turn the call over to Mr. NiQ Lai, Chief Financial Officer and Head of Talent Engagement.

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N. Lai Thank you, Chris. Welcome everyone, and thank you for attending this call. I will move straight into the key slides of our presentation.

Slide 3: We think differently in the telco space. We do not think like a typical telco incumbent because we have a different infrastructure. Basically, if you look at our business, it's like comparing a digital camera versus a film camera. If you look at the camera costs they're actually the same. But if you look at the capacity of a digital camera today, it's say 15,000 photos per memory stick versus a static 36 photos per film roll, obviously the cost per photo for digital cameras is a fraction of the cost per photo for a film camera.

That's the competitive advantage that we have today with our fiber network competing against a copper-based DSL broadband network and that's why you will see throughout the whole theme of this presentation and the whole business case we're about proactively driving commoditization.

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When you have a cost basis as low as us, then we want to drive commoditization. This is contradictory to what most incumbents around the world, such as Verizon, AT&T or our local incumbent, PCCW say. Typically incumbents talk about defending value, avoiding commoditization, avoiding over the top content providers.

We disagree with all of that. We are building a massive highway to your home in terms of bandwidth, unlimited bandwidth, essentially. And we would want to commoditize bandwidth and make 1Gbps to the home the industry norm in Hong Kong. And we are proactively doing that today.

You saw in our business we have launched 100Mbps for US\$13/month in November 2009; I believe that's the cheapest in the world. And we now have a 1Gbps, that is 1,000Mbps service for US\$26/month. In most cases around the rest of the world, the 1Gbps service not even available yet.

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Slide 4: Moving on to the next slide, I think anyone looking at the telecom industry would have seen similar demonstrations like this of, say, a 1Gbps download versus a DSL download at 6Mbps. I will not show that to you on this presentation because there is a link here that you can go to YouTube and have a look at the video yourself. But my emphasis here is that this is not a demonstration. This is a commercially launched service in Hong Kong. You will see that for our service, if you look at the demo itself, it takes 15 seconds to download a 1.8 BG high definition concert video. Our friends on sDSL will take over an hour to download this. So, that's the competitive advantage we enjoy. My point here is this is not a demonstration; this is a commercially available in Hong Kong today for US\$26 a month.

Slide 5: A little bit about our corporate history; we are a company with an 18-year corporate track record of which the last ten years we've been listed on NASDAQ. So, we are not a concept company; we've been around for quite a while and we have been executing our business plan.

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What I would emphasize is that it's a very long-term business plan. We came to NASDAQ in November 1999 at the peak of the TMT bubble and raised capital to build out our fiber network and we have stuck to the game plan. After ten years, we are delivering on the game plan. It took us seven years to hit positive free cash flow, so this is an extremely long-term business.

What I would emphasize now is that if you join us now ten years into our game plan, most of the conceptual risk has already passed. We are now moving into the execution stage and we are doing quite well with the execution today.

Slide 6: Today there are three key investment highlights I'd like to walk you through. One is that we have the leading fiber infrastructure in Hong Kong in the residential space. Second, we have a compelling value proposition and a structural cost advantage. We can deliver much more bandwidth at lower cost than any other copper-based operator, similar to comparing cost per photo for the digital camera to the film camera. And third, we have a very clear growth execution path over the next

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five years and we're very excited by the opportunities within Hong Kong.

What I want to emphasize is we are no longer talking about concept of bandwidth demand taking off. When you talk about bandwidth you can look around us and we're seeing the demands of bandwidth skyrocket. Look at drivers like iPhone, iPad, high definition YouTube, over the top content like Hulu. These are all commonly available and very popular today, so we are no longer talking about content that we were dreaming about ten years ago. We are talking about execution.

Slide 6: In Verizon's case in the U.S. you're already seeing the copper-based DSL declining as Fios fiber substitutes the copper network. The primary difference between our business model and Verizon is that we're about one-fifth, maybe even one-tenth the cost of Verizon's cost.

I believe in the U.S. most people who are on Verizon's FiOS fibre love the service. However, investors don't like the service

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because of the cost of build out. We have the benefit of both. Our consumers love our service; our shareholders should also like our service too, because we're running at one-fifth the capex cost per subscriber in Hong Kong due to the density of Hong Kong. Our home pass cost is about US\$200 per home pass, versus US\$2,000 to US\$4,000 per home pass in the U.S.

Similarly, you see the case in Japan, except Japan is even further ahead. Fiber has already overtaken copper today in Japan. In fact, if you look at the global ranking for fiber to the home deployment, Hong Kong is third in the world behind only Korea and Japan. And we've made a major contribution to this success.

Slide 8: The title is Hong Kong's Extreme Density. The key point is that Hong Kong is a city with a lot of rich people living in a vertical, dense environment. So, we have 16,000 people per square mile versus 80 people per square mile in the States. And this is why we have a fraction of the cost base on a cost per home path. When you build a fibre network, basically you just look at the number of people you can cover for every mile

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of fiber you roll out and arguably, Hong Kong is the most attractive fiber market in the world in terms of addressable income per fiber mile.

Slide 9: On the next slide, we discuss the high barriers to entry. It has taken us ten years to get to where we are today. There is a lot of congestion inside buildings. The last mile is the hardest part of the network to build, as there is a lot of congestion in here. In 2000, we were first to market with our fiber network deployment and now the congestion makes it very difficult for any other operator to replicate our business model. I believe it will take years for anyone to try and replicate our business model and the multiple of the costs that we put down.

Hong Kong, I would emphasize, has one regulatory difference that is very compelling relative to the U.S. As a telecom licensed operator, which we are, we have a utility access right into the buildings. So we can put our active equipment inside buildings without paying rental. This is unlike the U.S. I think the building owners can negotiate for entry terms, be it revenue share or rental, for telecom operators who come into their

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buildings. In Hong Kong if it is a publicly owned building and the apartments are being sold to the public, then the common areas are considered utility access space. So, this is one of the key regulatory differences that have enabled our business model.

What I would emphasize is that this regulatory situation is available to the whole industry, but we're the first carrier to really take advantage of it starting 10 years ago.

Slide 10: Another point of difference, most new entrants, around the world and not just in Hong Kong, when they enter the market they target the corporate market thinking that's where the profitability is. We disagree. When we looked at our bandwidth advantage we felt that people at home, residential users, actually use a lot more bandwidth than we do in the office.

Think about this, in the office we use very light applications, like e-mail, PowerPoint. Etc. We sent a big PowerPoint file,

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maybe 10 megabytes. In the home environment ..., we watch high definition video; we may download a Blu-Ray video. One Blu-Ray movie is 25 GB; that's an equivalent of a year's worth of e-mails in the normal corporate environment. So, one Blu-Ray movie is equivalent to a full year of Outlook kind of usage.

And that's why bandwidth is so much more compelling in the home environment, i.e. in the mass residential environment, than the corporate environment and this is where we excel. 83% of our revenue base comes from the mass residential market.

Today we have already built out about 1.7 million homes out of a target of two million homes that we're targeting in Hong Kong. Two million homes will cover the far majority of Hong Kong. So, we are just towards the end of our rollout program after which we expect capex to fall substantially.

Slide 11: Once again, I recall the picture of the very beginning, a digital camera versus a film camera. If you look at the cost

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per photo in the digital environment versus the cost per photo in the film environment, it's a huge competitive advantage. That's exactly what we enjoy with our fiber versus our competitors copper network.

For example, we are offering today 100 Mbps symmetric service for US\$13. The same US\$13 can only buy an 8Mbps service on the incumbent's legacy network. So, which service do you think consumers will go for? And that's why we are the fastest growing broadband operator in the last three years in Hong Kong.

Our cost per bit is US\$0.01 to US\$0.06 on our two services, 1Gbps and 100Mbps. The incumbent ranges between US\$0.40 to US\$1.40 per bit. So, we're talking about a quantum gap; not a mild advantage, similar to a digital camera versus a film camera.

Slide 12: In November 2009, so this has already been launched approaching a year and this is our most popular

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service, our symmetric 100 Mbps for US\$13 per month. As a comparison, Verizon's FiOS service, their fastest speed is a 50 Mbps service and they price it at US\$150, so they half the speed, but ten times the price.

As I mentioned the local comparison is the same price, but for one-tenth the speed on the incumbent. We really want to change people's mindset by commoditizing bandwidth. At US\$13 per month everybody can afford it. We want to change people from asking "Why do I need 100 Mbps?" to, "At US\$13, why not 100 Mbps?" So, change the question around. Don't worry about whether you need this or not as its priced at such a compelling price point, why don't I get the extra bandwidth and play with it as I see fit with my iPad on a wireless WiFi connection at home, multiple PCs, etc etc. Today, most families have multiple devices sharing the home broadband connection. Remember, Internet devices are only as good as the internet connection they have access to.

Another key point is that we recognize that our two key competitors, incumbent PCCW and the i-Cable do have better

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pay TV content so they try and bundle around their strength, i.e. their pay TV. What we are doing is by pricing 100 Mbps at such a compelling price is to unbundle their bundle. Because now consumers can afford to have our competitors content and then separately use our broadband line as a second line into the home. For an incremental US\$13/month, consumers enjoy by far the best broadband service in town, irrespective of whom they go with for pay-TV services.

Slide 13: In April of this year we launched our 1Gbps, or 1000Mbps to the home service. I believe this is among the world's first. We have over a thousand users on this and this makes us one of the largest residential 1Gbps carriers in the World.. For US\$26/month, from a consumer's perspective, this is ten times the bandwidth for two times the cost. From our investors' perspective this is actually an effective tariff increase, as the infrastructure that we deliver the service is actually the same infrastructure that would deliver the 100 megabit service; it's just uncapped. It's just like taking the speed limiter of your Porsche cut off so that you can go beyond the 250 kilometer limit that the speed limiter may set.

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Lets think about households have changed over the last five years. Today most households have multiple devices that access the Internet. Normally, you have a couple of PCs, a couple of laptops, you have Smartphones with WiFi capability. When we have multiple devices at home, sharing a 1Gbps can be very compelling.

Slide 14: We are one of the best known brands in Hong Kong. We are everywhere. We have blanketed the city with our advertising campaign consistently for the last 18 years. Some of these billboards are in the most high traffic destinations in Hong Kong. We also have very compelling television commercials, radio, bus stops, online, everything. So, we're a full marketing machine.

Slide 15: We recently won Asia's best fixed line and broadband carrier awarded by the most read industry magazine in Asia, *TelecomAsia* magazine. This is a pan Asian award, i.e. this is not a Hong Kong award. We're very proud of this achievement.

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Slide 16: Having talked about the whole landscape let me just share with you the specific numbers on slide 16. If you look at slide 16 the incumbent growth was now actually in negative territory for the first time in history whereas we're just the mirror image of that.

Last year we added 75,000 subscribers, net subscriptions over 12 months and that was our record year at the time. This year we added 73,000 subscribers in the first six months of this year alone. So, you can see an acceleration in our market take up and most of our customers are coming from existing operators.

So, we are taking market share. I believe we are the only carrier to be gaining market share over the last few years and we're seeing this repeat itself around the world in terms of a fiber substitute of copper networks.

Slide 17: I mentioned at the beginning that we have a lower cost base. We run a local area network (LAN). It's one of the

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largest single LAN deployments by Cisco globally. We buy these Cisco routers that have 24 ports in them and they retail for a list price of about US\$1,000. So, we're looking at about US\$50 per port and this can deliver 100 megabits symmetric to the home. For our service there is no customer end equipment, it's just an Ethernet port, similar to what you have in your office or what you use when you are in a hotel. In fact, it's exactly the same set up as what people will have in their office environment.

If you compare this with a traditional legacy copper-based DSL network, we estimate their cost at list-price around US\$200/port. Hence, compared to a legacy copper xDSL operator, we are a quarter of the capex/port cost and a multiple of their capabilities. The xDSL the standard speed is about 10 Mbps. You can push it up to an extreme, to say maybe 30 Mbps, if you shorten the copper loop, but we can do 100 Mbps symmetric at one quarter of the price. And this is the reason why we are proactively commoditizing bandwidth.

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Slide 18: In addition to the network advantage we believe we have an opex advantage with half our people, more than any of our competitors in terms of proportion, in Guangzhou.

Guangzhou is a three-hour train ride north of the border in China and the salary base in Guangzhou is about one-third the salary base in Hong Kong and we can keep our cost base compellingly low because of this structure.

How it works is that when we acquire a subscriber, it takes Hong Kong-based people and we spend about 30% of our contract revenue for acquisitions. Two years later, when we do retention, we use our Guangzhou call center and spent about 10% of the contract sum renewal. We should see a natural margin expansion as we move from acquisition heavy to retention based business over time as our business grows and matures.

Slide 19: In November 2006 we set a Big, Hairy Audacious Goal, called BHAG, to become the largest IP provider in Hong Kong by 2016. We want to become the incumbent in 2016.

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This is our not our slogan, rather this is in our compensation packages so we are very serious about this.

We worked out that we needed 75,000 subscribers, net additions every year for ten years to become the largest operator in Hong Kong. So far, four years into our game plan we are doing better than expected. Last year we added 75,000 subscribers. As I mentioned in the first six months of this year we added 73,000. So we are well on track to hit our ten year, Big, Hairy, Audacious Goal.

Slide 20: This slide gives you some further statistical data on how we are achieving and moving towards this goal. Basically our business is very long-term. A typical contract life in Hong Kong is two years, even when we our fiber arrives in a new residential area, it takes a couple of years to ramp up our subscription base.

So, if you analyze our profile in areas where we have more than five years of track record, say in the 1.2 million homes that

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were in existence since five years ago, we have an average customer penetration pick up of 38%. If you consider there are four operators in Hong Kong that makes us one of the largest, if not the largest, in this four player environment.

Slide 21: In short, we are very excited by the growth opportunity in Hong Kong. The incumbent's enterprise value is about US\$6 billion; we're only US\$400 million. If we execute well over the next few years we think we can get to at least one quarter or one third of the incumbent's enterprise value. That would make us compared to our current US\$400 million market cap, and five to six bagger.... We believe we have a very good chance of doing this by executing well within Hong Kong. We do not need to look outside of Hong Kong for growth. Hong Kong can be very compelling and it has an upside of five to six times our current market cap through good execution. Of course, we will keep our eyes open for regional expansion. So far we have not seen anything as compelling as the Hong Kong environment for us to continue.

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If I walk you through some of the specifics, the key excitement in our business model is our improved free cash outlook after our network expansion is completed by calendar 2011. At that point we expect capex for sales to fall from 20% today to about 10%. Once we reach two million homes we're going to pretty much stop the rapid expansion in the network and just grow with the population growth.

Our capex to sales should halve from 20% now to 10% and this should double our free cash flow margin from about 12% today to about 25% a couple of year out from now and we will continue to pay out most of the free cash flow in dividends. We currently pay out about 75% of our free cash flow in dividends.

Slide 22: Just to put into graphical form why we're so excited by the opportunity in Hong Kong, if you look at the revenue potential we're US\$190 million revenue company today. The incumbent is US\$2.4 billion, so there's plenty of revenue pie for us to take. The enterprise side, we already mentioned they're a lot larger than we are.

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Slide 23: Another key difference that we have, and I think this is our key competitive advantage, is that as a management team we are also the majority shareholders. In fact, our co-founders, Ricky Wong and Paul Cheung – they are cousins – just by themselves own the majority of the company, 51% of the company. This is what allows us to take these long-term investments. I emphasize that it took us seven years to hit positive free cash flow. We started investing in the year 2000 and it was 2007 before we hit profit free cash flow. Most companies with paid CEOs would have turned over their CEOs a number of times in this period and would have to change the business model. We stuck to our vision in terms of building up the incumbent fiber network in Hong Kong. Because we own the majority, we have that ability to make and deliver upon long term decisions.

Slide 24: That's today. Moving into the future, we are very forward-looking. I am looking for my upgrade today in the next 15 to 20 years time. We have an annual program called "CXO of the Future" where we try and hire the best graduate

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management trainees to join our company to nurturing them to become our CEO, CFO or CTO, etc. in 10 to 15 years time.

The minimum requirement that we have for this, pass the CFA Level I, run a half marathon and read a book a month during the 18-month program. This year we have 793 applicants. Last week we made an offer to one. So, we're taking roughly one from 800 applicants to join our management trainee program.

Slide 25: We put a huge amount of resources to develop our Talent. Salary cost is our single largest cash expense. We spend more on people than we spend on capex. So that's why we need to be so focused on developing our people.

For over a decade, we have consistently gone every couple of years on a management off site to develop teamwork and to broaden the perspective of our management team. This year we went to Germany. This slide shows some of the wide range of exposures that we gave our management team from wine

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tasting in a vineyard, to visiting a Porsche factory, to visiting Dachau concentration camp, to joining in a Harley Davidson festival.

The key reason for this is we want to broaden our manager's exposure, get them to experience out-of-the-box exposure so that when we come back to our work we should also be willing to try out-of-the-box ideas.

Slide 26: This is what you are paying for. This is our management team, i.e. our top 70 people in the company.

Slide 28: Wrapping up with a financial review, for FY2009, you can see our revenues grew by 13%, EBITDA by 35%, net profit by 70% and dividend by about 200%. Clearly you can see us leveraging the business as the business gains critical mass and we are now beyond the breakeven point. We are now in the harvesting phase of our investment rollout.

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Slide 29 & 30: you can see all the key metrics heading in the right direction and graphically you can see the operational leverage, i.e. net income growing much quicker than the revenue line. We have been positive free cash flow since 2007 and today we have a net cash position of about US\$50 million, which puts us in a very strong position given the economic uncertainties of the global environment we're looking at.

Slide 31: You can see we have consistent growth across our three product lines – broadband, voice and IPTV. What I would like to emphasize is that you see a growth acceleration with an inflection point in 2007 because that's when we completed the end-to-end fibre network. It took us seven years to really complete this network; before we had links missing or incomplete and a network is only as good as its weakest link.

In 2007, our network was completed and then you can see the inflection point in terms of profitability and growth, etc. One of the key metrics that we look at is customer churn and we're happy to report a churn rate of less than 1% per month, about half of typical competitive industry norm.

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We have an average holding life for our customers of seven years, which gives us very secure cash flow backlog. In terms of the outlook for this year, we expect to have record growth. We'll plan to take our subscriber base from 390,000 to 510,000 during the financial year. Normally in a year when we have record subscriber growth we also have record acquisition cost and that's put pressure on earnings. Despite that we are looking to deliver a flat core EBITDA by driving down our cost base.

So if can deliver record subscriber growth, and still maintain core EBITDA this year of HK\$477 mn, I believe that's a good set of results. Our capex will continue at the level of our guidance, HK\$300 to HK\$350 million Hong Kong dollars per year, which is well below our EBITDA, so we will continue to be in a positive free cash flow position.

Slide 33: For benchmarking we currently trade at about 6.7x EBITDA. Given our ownership of the last mile fibre bottleneck,

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that we have built over the last ten years, I would compare ourselves to the American Wireless Tower companies and these companies trade at close to 15 to 20 times.

Slide 34: In conclusion, we have the leading fiber infrastructure in Hong Kong. We have a compelling value proposition in terms of cost advantage and what we can deliver to the consumer. And, finally, we're very excited by the growth opportunities within Hong Kong. We will look overseas, but we do not need overseas expansion to tap for growth given the potential that we see in Hong Kong.

Thank you very much. Chris, that's the end of the presentation.

C. Dearborn NiQ, than you very much. I'm going to turn the call over to Joe Farrar, Manager of Research for Bay Crest Partners to kick off the Q&A. Joe.

J. Ferrara I'd like to touch a little bit on the competitive environment or the wireless space versus your business. Do you guys see any

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threats coming from the wireless space with the growing popularity? You touched a little bit on the iPad and the iPhone and maybe the increasing consumer demand to be mobile. Do mobile carriers have enough access to the residential space to possibly encroach on this market?

N. Lai We believe not, especially in Hong Kong. Why? Because the cost of fiber rollout due the density of Hong Kong is so low versus the cost of mobile rollout. If you want high bandwidth, fiber makes a lot more sense in Hong Kong. In other markets, like the U.S. where geographically the region is spread, then wireless at times can be cost competitive to fiber but not so in Hong Kong.

Wireless is not designed for the kind of bandwidth we're talking about, i.e. 1Gbps to the home. Simply look at the AT&T Wireless network in the U.S. They already overloaded and congested by iPhones today. That is why AT&T Wireless has been forced to move from unlimited wireless data rate plans to a capped rate plan.

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So, even AT&T wireless in the U.S. cannot handle it. Don't expect our mobile carriers to be able to deliver the kind of bandwidth that fibre consumers are asking for in Hong Kong. We do see them as complementary. I did mention the iPhone, iPad because, when you come home you want a great WiFi experience, rather than a slow mobile network experience.

J. Ferrara Okay, great, thank you. Operator, Can we see if we have a question in the queue please?

Moderator Yes, you have a question from the line of Paul Saferstein of Asian Century Quest. Please proceed.

P. Saferstein Thank you. Hi, NiQ. Could you just give us an update with your new price points, if there's been any other response from PCCW in terms of price promotion or otherwise? Thanks.

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N. Lai Our HK\$99/month 100Mbps service was launched in November of 2009, so it's been around and its now become the industry standard. The day after we launched, our competitors matched our price, but what the competitor cannot do, is match us on bandwidth and coverage. For the incumbent, their most popular services is still limited to 8Mbps or below.

Consumers have basically have two choices at HK\$99/month: our symmetric 100 megabit service or incumbent 8Mbps down and 1Mbps up service. Furthermore, at this point we don't see much more price competition because HK\$99/month is the psychological level. Cutting prices further is not going to generate price elasticity.

P. Saferstein With your net add expectations how much of PCCW's base is on some sort of two-year contract that would kind of dictate the ability to pull share?

N. Lai Yes, far majority are on two-year contracts, but none-the-less, a large number of their customer contracts come up for expiry

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every month. The far majority of our new adds come from other operators.

P. Saferstein Great. And I'm assuming it's predominantly residential usage?

N. Lai Yes, 83% of our revenue base is from residential.

P. Saferstein Right. And are you seeing any movement competitively by Hutch?

N. Lai They do not have as comprehensive coverage as we do, so in certain areas they can't offer 100 megabits and match our HK\$99/month. If you look at their subscriber base, their last reported broadband subscriber base was 250,000 subscribers, whereas, we are approaching 500,000 subscribers.

P. Saferstein Great. Thanks so much.

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J. Ferrara Great, thank you. NiQ, I was wondering if you could touch on the free TV topic here. You know free TV certainly seems to present an attractive opportunity for your firm. Right now you seem to be in a race with iCable and PCCW, who applied not long after you did I believe.

Is it a given that you will be approved before them since you were submitted first and maybe do you happen to know where you and the others are in the application process?

N. Lai Let me just paint a little bit of the background and then I'll try and address that. In Hong Kong, there is no limit on the number of free TV operators is our understanding. Traditionally nobody has applied for a new license because the spectrum was fully utilized so there's no free spectrum available.

Now, our application is for a free TV license, but over fiber, not over the air. So in a couple of year's time our fiber will reach, say, two million homes. We're looking to deliver free TV over

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fiber. Technically there should be no limit on the number of free TV licenses that the government can issue.

So, we have applied for one. I believe that we meet all the checkpoints. We are going through the public consultation process in Hong Kong and we hope to hear positively either late this year or maybe even early next year, but hopefully this year.

So, it's not a competition between the new bidders. It's a matter of how many licenses the government would like to issue.

J. Ferrara Okay, great. When both of you are done you'll kind of being going head-to-head with not only i-Cable and PCCW, but also TVB, whom are entrenched in the TV space, pay and free respectively. What challenges do you see in this regard and do you have a game plan or a time line to take on these challenges?

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N. Lai I think as you look at us, we have an 18-year track record of competing against incumbents. We took on Hongkong Telecom in the 1990's, whom has now evolved into PCCW. Hongkong Telecom's revenue base was five times larger than TVB's revenue base today so arguably Hongkong Telecom was a larger incumbent and more difficult to compete against, but I think we've done okay so far.

Disrupting the landscape is something that's in our DNA. Turning the landscape upside down is something that's in our DNA.

J. Ferara Okay, great. Thank you. Let's go to some of your financial statements, I think on the topic of being first mover advantage and, like you said, that kind of being in your DNA. It certainly takes substantial capital spending to maintain your technology lead over your competitors.

Are you comfortable enough with the economic picture to maintain the level of capex going forward into fiscal year 2011?

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N. Lai Yes. Let me challenge that point. It does not take substantial capital investment to upgrade our network. That's because the most expensive part of our network is a passive element. That's the fiber and digging up the road, the physical installation of the fiber.

The active element of our network is only about 25% of the US\$400 million that we invested to date. Every few years, every five or six years you probably have to upgrade the active element and then you get a logarithmic increase in the performance.

Today, we going from 100Mbps to 1Gbps, i.e. 10x increase with minimal incremental investment. It is like upgrading the memory card on a Digital Camera. That's the advantage of a new generation network. Similar to a camera; remember a couple of years ago we had 8MB memory sticks and now we're talking about 64 gigabyte memory sticks. And it doesn't cost

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you any more than what the memory sticks cost a couple of years ago.

That's the competitive advantage that we will continue to leverage and that is why we want to commoditize bandwidth and surf on this advantage.

C. Dearborn I've got a general question that kind of drools down a little bit to the business model in Hong Kong. It relates to the housing market. The market's been kind of erratic over the last two years in Hong Kong, as opposed to everywhere else. You're up 27% this year after kind of like falling out of bed over the last year or so. What effect does that have on the client base for telecom and how does that possibly affect potential new clients as they move in and out of the apartments in Hong Kong, etc.

N. Lai The situation is we are offering a new utility-like service so we're way up there in terms of the importance to the household

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spend. Having a broadband connection is similar to electricity, to food and water; not quite there, but very close.

In fact, our service can actually be more resilient than even an electric utility company. Why? We saw in 2008 during the economic crisis, that people would go home and turn off their lights and turn off the air conditioner and try and save electricity, but for our broadband connection, it's a fixed monthly fee. You can't turn off a broadband connection because it's a fixed monthly fee and you need to keep that as you look for jobs or watching movies on the Internet, spending more time at home than going out etc, etc. So, what we saw – this is not conceptual, this is reality – in 2008 we had record subscriber growth punching through the economic crisis and that surprised even us.

C. Dearborn So, do you track occupancy rates in Hong Kong yourself or do you wait for official statements to come out?

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N. Lai We don't see that much people moving around in Hong Kong. I mean, the ex-pat community, a small group of people do have a high turnover, but the local community is relatively stable.

C. Dearborn All right. So, I guess current trends, really, as I believe the house pricing gains coming back and forth they've been pretty substantial, like we said before, over the last couple of quarters. And your infrastructure, as you said, is kind of more like a utility base where the fiber cable is laid in most of the buildings as it is already. How do you see expansion or what time frame do you see expansion to reaching your big hairy audacious goal?

N. Lai We're now at 1.7 million home pass and it's taken 10 years to get here. We're looking to reach two million home paths by calendar year 2011. There are 2.3 million homes in Hong Kong, so we will cover roughly about 90% of Hong Kong and we will stop there.

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Lets look at our economics, if you live in a dense apartment complex, it's much cheaper for us to build out than if you're a rich person living at the top of the peak in a large mansion. We will still get the same HK\$99/month to HK\$199/month per household, whether you live in a mansion or in an apartment complex. This is why we cherry pick the economically most attractive areas for us, which is about 90% of Hong Kong's total homes and then we'll leave the rest unserved. In fact, we joke that "We don't service rich people in Hong Kong."

C. Dearborn I guess that hypothetically leads into another question. Is that model replicable in other Chinese cities, Shanghai, Beijing or maybe cities outside of China, such as Kuala Lumpur or Bangkok?

N. Lai I think around the world countries and governments are doing fiber rollouts aggressively. For example, you may have heard of the National Broadband Project in Singapore and Australia. In many cases those kinds of areas need government subsidy or public funding, some sort of subsidy to build out a fiber

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network because the cost structure is much higher whereas in Hong Kong it's pure economics.

The economics for us in Hong Kong is compelling and that's why we're doing it. We're not doing it just as social good rather we see an economic incentive in delivering a social good. But nonetheless you're seeing fiber build deployment throughout the world, which eventual contributes to a positive networking effect for all of us. In the US, you have, for example, Verizon doing it and also Google testing fiber rollout, which is for us very, very interesting.

C. Dearborn Agreed. And I think one of your competitors, PCCW, is mostly in copper if I'm not mistaken and that should be a direct competitive advantage for you going forward with the fiber and the capability of fiber over copper.

N. Lai Yes.

C. Dearborn Great. Operator, I see we have a question in the queue?

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Moderator Yes, we do. We have a follow-up from the line of Paul Saferstein of Asian Century Quest. Please proceed.

P. Saferstein Hi, again, thank you. NiQ, could you just give your personal view or color as to PCCW's fiber? Their capex right now is running at a fraction of their depreciation rates. Do you see them kind of upping their ability to offer broadband speeds closer to yours, irrespective of the fact that they're less competitive on a cost basis?

N. Lai I prefer not to comment on our competitor's strategy but I can give you the facts. Two years ago their capex to sales was 15% and it was cut to 8% last year and I believe 8% is the guidance for this year. I can only give the facts.

P. Saferstein Okay, but in terms of maybe just broadening your first comment that they're offering the same price at 8Mbps on copper. What is essentially their positioning against 1Gbps HK\$199/month price point?

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N. Lai I think they charge about HK\$2,000/months plus for their 1Gbps service versus our HK\$199/month, so they're more than ten times the price.

P. Saferstein And do you have an estimate of how many homes are qualified for their 1Gbps service that they offer?

N. Lai Well, I think the price point shows whether they're priced to sell or priced for positioning. They also have 100 Mbps service but priced at over HK\$500/month which is over 5x our HK\$99/month. So, that gives you an idea of the relative pricing.

P. Saferstein Got it, okay, thank you.

J. Ferrara NiQ, I just have a couple of quick questions and then I think based on time we'll wrap it up. You guys just raised your dividend again. This is up I think about 200% since last year or in this past year. Just curious, your comments on is there still

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room to grow your dividend or where do you guys stand on your policy?

N. Lai Just to clarify, last year in FY2009, in the second half of the year we raised our dividend payout ratio from about 30% to 75% of our free cash flow. Free cash flow we define as EBITDA minus capex minus net funding cost. So, it was a mid-year change. This year we're consistently paying 75% throughout the whole year, so that's why it looks like there's a big increase. But net-net the policy is stable. We're likely to continue to pay in the range of 50% to 75% of our free cash flow.

J. Farrar Okay, great.

N. Lai You can work out the estimate based on our guidance of flat core EBITDA and capex of HK\$300 million to HK\$350 million.

J. Ferrara Okay. The one final question I have here. I saw the interview that you recently gave with Jim Kramer. In it you spoke about

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offering free TV service and chasing advertising dollars. I'm assuming this program hasn't begun yet because we're still in the licensing process, but curious if you could touch on what type of market share gains you expect from this program?

N. Lai Free TV, it's a little bit early to go into detail as we haven't gotten the license yet. We're still in the application phase. But the way we see it is that basically the free TV is dominated one operator, i.e. TVB, so very similar to the telecom industry in the early 90s. So we see a lot of scope for innovation because the market, from the beginning of time to now, been too much a monopoly-like industry.

I would reference Google TV as some very interesting concepts that can certainly be enhanced and delivered once you have a fiber network in place.

C. Dearborn All right, great.

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C. Dearborn Thank you. I have another question. It's just kind of a naïve fact of myself regarding the free TV market like we were talking before. In the U.S. a free TV enterprise distribute content usually through a third party or a Content Delivery Network (CDN). Are you thinking of maybe using that same model whereby you contract the CDN to send content to your customers over fiber or do you think you have any plans to roll out an in house CDN network?

N. Lai Well, our key competence is building fibre, offering unlimited bandwidth to your home. We are not very good in the sexy part of the business, i.e. making movies and making content, so we will stick with our key competency of just building a massive tollway into your home. I'm sure the rest of the world can come up with innovations in terms of what kind of content they can push down our tollway.

In fact, you can have some glimpses of the future. We just came back from visiting a carrier in Europe and they're already watching Soccer World Cup and the French Open Tennis in 3D.

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C. Dearborn Agreed. Do we have any other questions into the queue?

Moderator We have no audio questions at this time.

N. Lai Thank you.

C. Dearborn NiQ, thank you very much. Joe, thank you. Ladies and gentlemen, this is Chris Dearborn for Bay Crest. I want to thank you very much for everyone's time today. If you have any questions or require follow-up, please feel free to reach out to us and we'll make best efforts to get everything answered for everyone.

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