

# Ch. 5

## Operating Strategy

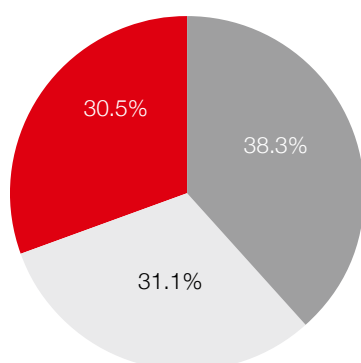
### Macroeconomics

Statistics released by the Directorate General of Budget, Accounting and Statistics (DGBAS) showed that growth in private consumption shrank to 1.5% last year from 2.7% in 2005. Accordingly, the telecom industry saw revenue decline slightly by 2%. With the DGBAS forecast of a private consumption growth rate of 3.2% in 2007, the mobile market is likewise expected to experience a similar growth pattern.

### Industry Developments

#### Focus on more value-added services

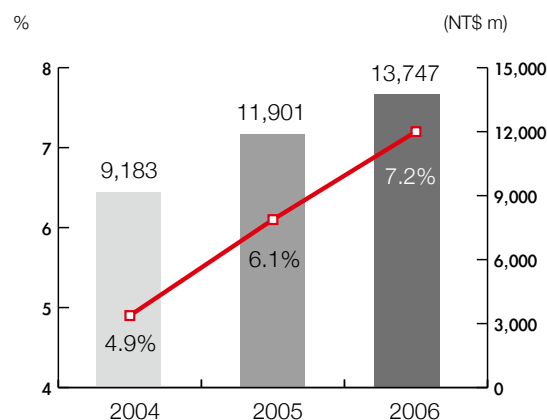
In line with the liberalization of Taiwan's telecommunications industry, 3G and mobile number portability (MNP) services were introduced in 2005, opening the market to new players and ushering in a new wave of competition. Despite the challenge posed by these new rivals, market oligopoly by the three leaders – the Company, Chunghwa Telecom (CHT) and Far EasTone (FET) – remained with each operator maintaining its subscriber base and market share. With growth in the voice services market stabilizing, mobile service operators looked for new avenues of growth, launching diverse multimedia/3G value-added services, including HSDPA (3.5G) service, to level up the options and attractions of data services and raise their average revenue per user (ARPU). These services resulted in a substantial rise in data revenues for each operator in 2006.



Market share by service revenue 2006

■ TWM    ■ CHT    ■ FET

Source:TWM, CHT, FET's fact sheets



Service revenue trend and composition

Source:TWM, CHT, FET's fact sheets

## New telecom regulatory body established

The National Communications Commission (NCC) was established in March 2006 to act as a regulatory agency that would oversee the telecommunications, broadcasting and information services industries. The NCC has promulgated numerous policies to enhance market competition, protect public interest, and spur industrial development. Some of these policies which are pertinent to the Company are as follows:

1. Cutting prices for selective 2G services, i.e., pre-paid calls, fixed-to-mobile calls and highest tariff rate plans, by 4.88% per annum over a period of three years.
2. Encouraging telecom operators to jointly construct and operate base stations to decrease and consolidate the number of stations.
3. Reduce the number of working days for processing MNP applications
4. WiMAX frequency planning and licensing
5. Mobile TV trial run licensing

## Opportunities and challenges

The Company believes that the overall macro environment is still favorable for the growth of the telecommunications industry, with the major positive and negative factors listed as follows:

### 1. Positive factors:

- (1) The oligopoly structure remains intact. Telecom operators have adopted market segmented rate plans to prevent cutthroat competition.
- (2) Mobile number portability has had little effect on the churn rate. As MNP allows consumers to port their numbers to preferred operators, mobile operators with sound operations have benefited.
- (3) 3G and 3.5G high-speed transmission enables mobile contents to be delivered at faster connections with better quality, leading to higher subscriber usage and increased revenue for telecom operators.
- (4) Falling prices but increasing functionality and improving quality of 3G handsets have raised customer usage of data services.
- (5) Central and local governments have been promoting the “M-Taiwan,” or Mobile-Taiwan, project by deploying WiFi technology and “dual-net” (cellular + WiFi) products to allow users the convenience of anytime access.

- (6) The digital era has contributed to the convergence of information, communication and media industries, and telecom companies are poised to play a pivotal role in the delivery of multimedia content to customers.

### 2. Negative factors:

- (1) New policies and regulatory revisions by the NCC have increased the uncertainty of future operations and profitability.
- (2) Limited subscriber growth potential as the market is saturated.
- (3) Requirement of substantial outlays for capex, R&D and marketing during the initial stages of 3G introduction but customer uptake and profitability will take time to materialize.

## Products and Services

Maximizing customer value to increase company value is the Company’s core operating strategy. In 2006, faced with a mature telecommunications market, the Company sought to achieve a win-win situation for both itself and its customers by continuing to expand its market share, improving its client portfolio, catering to local tastes and introducing value-added products and services.

The Company holds a GSM 1800 license and a 3G license to operate mobile phone services nationwide, covering Taiwan, Kinmen, Matsu and all the outlying islands.

The Company provides mobile services with the following prefixes - 0935、0939、0922、0920、0918、0952、0953、0958、0914、0961、0970、0987 - and services, as categorized below:

Type of service	Mobile Phone	Phone Card
	Postpaid subscription	Postpaid vouchers
	Prepaid subscription	Prepaid reload cards

1. Basic telecommunication services, such as calling or receiving calls from local fixed-line, DLD, IDD, mobile phone and pager users
2. Value-added services, including voice mail, call forwarding, call waiting, conferencing, short messaging service, roaming, call barring, video calls, and multimedia & content services (e.g., ringtones, games, screen-savers, MP3, video clips, video streaming)
3. Business solutions, such as enterprise package and mobile virtual private network (MVPN), mobile messaging service (a dedicated platform to deliver cost-effective, high-volume SMS), mobile data service (wireless internet access via GPRS/ 3G/HSDPA, positioning tracking/fleet management via GPS/GPRS) and mobile office (BlackBerry email solutions)

### Revenue breakdown by service

	2006		2005	
	Amount (NT\$'000)	% of total	Amount (NT\$'000)	% of total
Telecommunications service revenues	47,692,697	99.59%	47,216,688	99.60%
Data revenues	3,178,556	6.64%	2,673,438	5.64%
Voice revenues	44,514,141	92.95%	44,543,250	93.96%
Other revenues*	198,592	0.41%	191,884	0.40%
Total revenues	47,891,289	100.00%	47,408,572	100.00%

\* Includes revenues from co-branding agreement with Taipei Fubon Commercial Bank Co., Ltd. and commissions from receipts under custody and payments on behalf of others.

### Revenue for the Past Two Years

	2006			2005		
	Domestic		Overseas	Domestic		Overseas
	Average no. of subscribers	Revenues (NT\$'000)	Revenues (NT\$'000)	Average no. of subscribers	Revenues (NT\$'000)	Revenues (NT\$'000)
Telecommunication services	4,806,275	47,692,697	-	4,671,721	47,216,688	-

Note: Average no. of subscribers = (sum of monthly average no. of subscribers)/12

## Competitive Advantages and Strategies

Backed by a powerful network coverage, extensive after-sales service, continuous product upgrading, and innovative marketing strategies, the Company has been able to generate excellent operating results despite a competitive environment. Over the years, the Company has managed to maintain its competitive edge by improving its client portfolio, enhancing customer services, providing products that fulfill customers' needs, and forming international alliances.

### Improving client portfolio

Aside from expanding its market share, the Company also focuses on improving the quality of its client base. The Company acquired 1.16 million customers in 2006, representing a growth of 40% from 2005. The number of mid-to-high usage customers also expanded by 10% during the same period. This could translate into ARPU growth in the future.

### Best customer service

Creating the best mobile experience is TWM's guiding principle. The Company not only develops products from the customer's perspective, but also ensures accessibility through its wide network of over 480 direct and franchise stores, about 3,000 dealer stores, and over 1,500 customer-care agents at a call center that operates 24-hour to provide quality services. Aside from winning *Global Views Monthly's* "2005 Outstanding Service Award" in the telecommunications category, the Company was also a recipient of *Reader's Digest's* "Gold Trusted Brand Award" for three years in a row.

### Segmentation and localization service

The Company continues to develop and provide products and services that cater to different market segments. The beginning of 2006 saw the launch of "my Zone" rate plans, allowing subscribers to designate one of five regional zones as his/her "my Zone" and enjoy the same on-net and off-net rate when calling from within the zone

to any mobile network in Taiwan. Blackberry services were also launched to provide a total mobile business solution to businesspeople on the go at the end of last year. The Company's in-depth know-how in operating regional-based mobile business gives it an advantage over island-wide operators.

### Leading wireless broadband services

The Company took the lead in launching 3G services in 2005 and 3.5G services at the beginning of 2007. With its flexible rate plans, exclusive handsets, and extensive value-added services, subscribers of the Company, TransAsia Telecommunications and Mobitai can be upgraded seamlessly. The Company exceeded its target last year when its number of 3G subscribers reached 640K with ARPU 1.6 times of 2G subscribers, spurring further the growth of value-added services.

### Expanding resources from international alliances

The Company is the sole Taiwanese member in the "Bridge Alliance," the largest GSM alliance in the Asia Pacific. The alliance consolidates the region's leading telecommunication operators – SingTel of Singapore, Maxis of Malaysia, CSL of Hong Kong, Bharti of India, Telkomsel of Indonesia, Globe of the Philippines, Optus of Australia, CTM of Macau, SKT of South Korea, and Taiwan Mobile – with a combined customer base exceeding 100 million. Having the advantage of economies of scale as well as a regional-based service platform, the Company occupies a leading position and possesses rich resources in procurement, contents, and new technologies.

### Continued value-added services development

The Company is committed to developing value-added services (VAS). In 2006, it completed the VAS platform integration of the Company, TransAsia Telecommunications and Mobitai, which should help the Company generate higher VAS growth momentum and further improve operational efficiency in 2007.

## Operating Status

The Company is focused on strengthening existing customers' loyalty as well as designing voice and data products and services that cater to different customers' needs. The Company also continues to proactively explore new markets that have strong growth potential.

### Postpaid products and services

The Company has continuously maintained a strong competitive advantage in terms of network and product service quality. Despite competition from new entrants, the Company saw its average monthly new subscriber number rise nearly 40% year-on-year in 2006.

The Company offers the widest array of segmented rate plans, including "myfone" price plans and the regional zone-based "my Zone" rate plans, which were launched in 2004 and at the beginning of 2006, respectively. The "my Zone" rate plans are one of the major driving forces in signing up new customers, accounting for more than 50% of monthly subscriber gross adds or some 650,000 new subscribers in 2006.

The Company also has excellent loyalty programs in place to help secure its customer base and effectively minimize churn rates. For high ARPU customers, the Company has an exclusive program called "my VIP." There is also a credit card program that allows customers to earn rebates based on their phone bills.

### Prepaid products and services

A new product called "Fun Heart Prepaid Card – Good Friends Pack" was launched in 2006 to capture the high-usage teenage market segment with its highly exclusive features. The strategy proved to be very successful in boosting sales as well as promoting and enhancing TWM brand awareness. Fun Heart cards were the first prepaid cards that offered young customers discounted rates for connection to his/her circle of friends and discounted hours tailored to teenagers' customary usage.

The Company also enhanced its leading position in the Thai and Vietnamese workers market. In addition, a new exclusive product called "OK Kababayan Card" was introduced to target the Filipino market, which was quite successful in increasing the company's share in this segment.



The “OK Kababayan Card” became the very first transnational prepaid card in Taiwan and was done in collaboration with Globe Telecom of the Philippines, which is also a member of the Bridge Mobile Alliance. In spite of the keen competition and regulatory restrictions on the distribution of prepaid products via third-party dealers, the company still experienced significant growth both in revenues as well as subscriber base compared with a year ago.

### Value-added services

Committed to developing value-added services (VAS), the Company has seen an increase in its VAS user penetration and ARPU. As a market leader in launching innovative products, the Company set several milestones in 2006: 1) the first operator to introduce QR code services and 3G video entertainment portal, 2) the first operator in Taiwan to launch Mobile ESPN through a joint regional marketing campaign of Bridge Mobile Alliance, 3) the first operator to provide mobile stock monitoring and trading services in cooperation with securities houses, 4) the only sponsor and operator to offer 3G live TV for Chien-ming Wang’s games in the 2006 Intercontinental Cup, 5) the first operator to offer handset-based mobile audio guides at Juming Museum, 6) the first operator to launch an exclusive dual-mode GSM/WiFi handset, the TG310, and provide mobile campus packages in cooperation with Acer, and 7) the first operator to introduce Asia’s Near Field Communication (NFC) Mobile PayPass™ handset in cooperation with MasterCard International.

With mobile broadband and multimedia gaining in popularity, the Company is keen to develop and promote diverse services on Mobile Internet to address the different lifestyles and needs of all customer segments. Echoing the Company’s new marketing strategy called Simplicity is the redesigned “Catch” Mobile Internet portal which has been repackaged with new and simple Mobile Internet tariffs together with easy-to-use customized handsets. This not only enabled the Company to differentiate its products and increase customer satisfaction, but also led to exponential growth in data ARPU.

### Enterprise customer services

The Company has developed several enterprise solution packages, including mobile data and mobile office services, to address the need for enterprise mobile services. Launched in December 2006, the widely popular BlackBerry email solution was designed to meet the demand

of multinational corporate employees for a total mobile office solution and help improve their efficiency and competitiveness.

For 2007, the Company aims to continue developing innovative applications for enterprise customers, such as 3G/3.5G data services and new BlackBerry services. Following the trend of IP technology, the Company plans to provide IP-MVPN services to address the needs of small and medium enterprises. The Company is committed to developing new solutions that will facilitate mobile connection and services for enterprise customers.

## Operating Results Review

Affected by weak private consumption growth in 2006, the mobile industry reported a 2% YoY decline in revenues. The Company was nonetheless able to outperform the industry average, with the help of healthy sales momentum and a falling churn rate. Operating costs increased 6% YoY due to continuous 3G network deployment which increased depreciation expenses and base station-related operating costs. Separately, selling expenses rose by 13% YoY, resulted from 37% growth in the number of new subscriber acquired. That said, net income remained flat from the previous year credited to a 66% YoY growth in non-operating income on account of disposal of Chunghwa Telecom (CHT) investments.

Cash from operating activities was used for capital expenditures and settlement of bank loans, resulting in a positive net cash to equity ratio (cash position being greater than loans), a remarkable turnaround from the -11% reported in 2005 which affirms the Company’s sound financial structure.

## Business Development and Strategies

Looking forward, the Company plans to strengthen communications quality, improve customer portfolio, create new sales channels, and provide varied value-added services in order to retain customer loyalty, boost consumption, and raise its overall operating results.

### Short-Term Goals

#### 1. To maintain satisfactory network quality:

Keep a low call blockage, low cut-offs, and wide communication coverage environment.



**2. To build up TWM-owned sales channels to secure sales growth:**

To avoid the intense competition in traditional sales channels, the Company will focus on building up its own network to propel sales growth. TWM will continue to open new company stores in major commercial districts and utilize direct marketing to target specific markets and virtual stores to capture the growing number of Internet shoppers in order to improve subscriber quality and sales momentum.

**3. To provide high-quality Internet access:**

Easy-to-understand rate plans, a good range of customized handsets, and easy-to-use specifically designed contents will help the Company in cultivating customers' trust and maintaining customer loyalty in the wireless and multimedia era.

**4. To develop advanced data services:**

The Company will make use of its advanced technologies in adopting state-of-the-art services, such as IP multimedia subsystem, NFC, digital video broadcast –handheld and assisted global positioning system, to provide customers with the best high-tech experience.

**5. To provide innovative and integrated services to enterprises:**

The Company will address the varying needs of different corporate users by providing specifically designed corporate packages, such as the MVPN, 3G/3.5G mobile data service and BlackBerry service. It will also continue to expand its sales channels for small and medium enterprises. It aims to provide a full range of products that will cater to each type of corporate user, so as to maintain as well as further raise its market share.

**6. To create the best mobile experience:**

With the market flooded with practically the same products, pricing structure and service strategies from different operators, the Company believes that cultivating customer loyalty is the key to maintaining its competitiveness. "Customer experience" is the critical factor that determines customer loyalty, as global surveys have shown. As such, the Company has launched a program called "Excel Customer Experience," which consolidates five cross-functioning initiatives – developing a customer-centric culture, maintaining high network quality, facilitating bills processing, pursuing customer/market segmentation and promoting customer loyalty. With across-the-board commitment from its entire work force, the Company aims to set a top record in customer satisfaction and loyalty to strengthen its long-term competitiveness.

**Long-Term Goals**

Taiwan has one of the highest mobile and broadband penetration rates in the world, with five mobile and four fixed-line service providers competing for the pockets of some 23 million people. Advancements in digital technologies have given rise to telecommunications, computing, electronics and media convergence. Competition is no longer confined to traditionally defined sectors such as mobile or fixed telecommunications. For example, a WiMAX service provider can provide both wireline and wireless services. Telecommunications service has also ceased to be the exclusive domain of conventional telecom operators with the emergence of alternative telecom service providers like Vonage and Skype. To stay competitive in the face



of this technology and service convergence, TWM has drawn up three key strategies in line with its objective of creating the best mobile experience.

**1. To deepen:**

The Company will continue its successful “my Zone” campaign, focusing on different regional sub-markets and tailoring products and services to the needs of these market segments. The Company has developed a flexible operational scheme that includes internal human resource allocation and organizational and functional support to promote brand recognition and competitiveness.

**2. To enrich:**

As technology continues to evolve, markets will experience drastic changes and become even more challenging. To meet these challenges, the Company will aggressively adopt technologies with three objectives in mind: innovation, ease of use, and economic value. The Company will seek alliances with leaders in the field to stay on top of the competition. It will invest aggressively in technologies that can give it the capability to design innovative, yet simple and economical solutions that will help make life better for customers. As wireless technology evolves to become a major

means of access to the Internet, the Company understands the need for partnership with content and application service providers, as well as device, system integration and technology suppliers. It will form strategic alliances that will provide customers with the best end-to-end experience in accessing the Internet any time, anywhere, and in any device.

**3. To broaden:**

TWM aims to be a world-class digital media provider and a market leader in the region. A new world order is emerging as the communications, computer and media industries converge. All forms and types of business information, entertainment and transaction services are going digital. Broadband online communication through cable or wireless connection is the catalyst igniting and fueling this unprecedented growth. Backed by its superior technology know-how, customer understanding and quality operations, TWM is well-positioned in the food chain to reap the fruits of the opportunities offered by the new digital media age. Markets outside of Taiwan will offer even greater opportunities for growth and building strategic long-term value. Through alliances and investments, the Company will extend its position and influence to tap into the Greater China and other markets in the region.





## Major Contracts

Nature	Counterpart	Contract period	Description	Restriction Clauses
Sales & distribution	Synnex Technology	2005.02.01~2006.01.31 *Contract is extended to 2007.01.31	Synnex is authorized to distribute TWM's mobile products and services	Non-disclosure
Communication service agency agreement	TransAsia Telecommunications	2006.01.01~2010.12.31	Provide TransAsia with related telecommunication services	Non-disclosure
	Mobitai Communications	2006.01.01~2010.12.31	Provide Mobitai with related telecommunication services	Non-disclosure
Network interconnection	Chunghwa Telecom	2005.01.01 ~2005.12.31 *New contract under negotiation (Note 1)	Network interconnection	Non-disclosure
	VIBO Telecom	2006.01.16~2007.01.15 *New contract under negotiation (Note 2)	Voice and short messaging service interconnection	Non-disclosure
	New Century InfoComm	2005.05.01 ~2006.04.30 *New contract under negotiation (Note 1)	Network interconnection	Non-disclosure
	Taiwan Fixed Network	2004.07.01 ~2006.06.30 *New contract under negotiation (Note 3)	Network interconnection	Non-disclosure
	Asia Pacific Broadband Telecom	2005.10.15 ~2006.10.14 *New contract under negotiation (Note 1)	Network interconnection	Non-disclosure
	Asia Pacific Broadband Wireless	2003.07.23~date	Voice and short message service interconnection	Non-disclosure
	TransAsia Telecommunications	2004.03.15 ~2005.03.14 *New contract under negotiation (Note 2)	Voice and short message service interconnection	Non-disclosure
	Mobitai Communications	2004.09.13 ~2005.09.12 *New contract under negotiation (Note 2)	Voice and short message service interconnection	Non-disclosure
	Far EasTone Telecommunications	2004.02.10 ~2005.02.09 *New contract under negotiation (Note 2)	Voice and short message service interconnection	Non-disclosure
	KG Telecommunications	2004.03.01~2005.02.28 *New contract under negotiation (Note 2)	Voice and short message service interconnection	Non-disclosure
	First International Telecom	2005.05.01 ~2006.04.30 *New contract under negotiation (Note 2)	Voice and short message service interconnection	Non-disclosure
Office building purchase	Taiwan Fixed Network	2006.12.13	Office building purchase	Non-disclosure
Handset purchase	Synnex Technology	2004.05.01~2005.04.30 *Contract is extended to 2007.04.30	TWM accepts Synnex's consignment to sell handsets and related products	Non-disclosure
Equipment purchase	Nokia Corporation	2006.09.26~2009.12.31	Equipment supply contract for Phase 2 of 3G system	Non-disclosure
Customer service	Taiwan Teleservices & Technologies Co., Ltd.	2006.01.01~2010.12.31	Customer services and product sales for TWM, TransAsia and Mobitai	Non-disclosure, Restriction on competition
Stock selling	Goldman Sachs Morgan Stanley UBS	2006.09.15~2006.09.28	GHT ADR placement	
Syndication loans	ICBC, Industrial Bank of Taiwan and 14 other banks	2000.12.15~2008.06.12 (Settled on Feb. 16, 2006)	NT\$3bn credit and its subordinate debt, such as interest payable	Certain restrictions on debt ratios, current ratios and long-term solvency ratios

Note 1: When the network interconnection contract expires, should the two parties not be able to conclude their negotiations within three months after their commencement, the process shall be as follows:

- (1) If the two parties concur to continue their negotiations, the contract terms will be the same as the originally negotiated terms, until a new agreement is reached.
- (2) Either party can appeal to the Directorate General of Telecommunications for a ruling. Prior to the date of such a ruling, the contract terms shall be the same as those originally negotiated. Following the ruling, the new contract terms will be formed based on the ruling.

Note 2: The negotiation for the agreement for the next year shall commence three months prior to the expiry date of the original agreement. If the negotiation is not finalized prior to the said expiry date, the parties agree to perform their obligations based on the original agreement until such time when the negotiation is finalized by the parties.

Note 3: If both parties do not finalize the signing of the new contract even as the current contract has expired, the current contract will remain valid.