



China Telecom Corporation Limited

中国电信股份有限公司

(A joint stock limited company incorporated in the People's Republic of China with limited liability)

(Stock code: 0728)

Announcement of Annual Results for the Year Ended 31 December 2004

HIGHLIGHTS

- Including the amortisation of upfront connection fees
 - Total operating revenue reached RMB161,212 million, up by 6.4%
 - EBITDA reached RMB87,000 million, up by 9.5% with EBITDA margin of 54.0%
 - Net profit reached RMB28,023 million, with earnings per share of RMB0.36
- Excluding the amortisation of upfront connection fees
 - Total operating revenue reached RMB152,754 million, up by 7.7%
 - EBITDA reached RMB78,542 million, up by 12.7% with EBITDA margin of 51.4%
 - Net profit reached RMB19,565 million, with earnings per share of RMB0.25
- Total number of access lines in service reached 187 million, an increase of 25.66 million or 15.9%
- Broadband subscribers reached 13.84 million, an increase of 6.61 million or 91.4%

CHAIRMAN'S STATEMENT

It gives me great pleasure to present my first report to you. Appreciating the trust and the great responsibilities you and my fellow Directors have vested in me, since my appointment as the Chairman and Chief Executive Officer of the Company last year, I have undertaken extensive investigation and examination of the subsidiaries of the Company, communicated and exchanged opinions with the management, employees, customers, business partners of the Company and relevant regulatory authorities. I have gained a better understanding of the operations, corporate management, business strategy, corporate culture and other aspects of the Company. I have full confidence in the Company's fundamentals and its future development.

China Telecom is a long-standing and leading operator in the wireline telecommunications service sector. With a substantial and solid subscriber base, a well recognised brand name, a high quality telecommunications network, a strong management foundation, an outstanding management team and a group of high-calibre employees, the Company has been operating efficiently and performing well.

Our financial performance in 2004 was favourable. We recorded continuous growth in revenue and were successful in managing our operating costs and capital expenditure. The Company's operating revenue reached RMB161,212 million, an increase of 6.4% from last year, of which RMB87,000 million was generated from the amortisation of upfront connection fees. Excluding the upfront connection fees, our operating revenue was RMB152,754 million, an increase of 7.7% from last year. Our EBITDA* was RMB78,542 million, an increase of 12.7% from last year. Our EBITDA margin* was at a relatively high level of 51.4%. Our net profit* (after deduction of deficit on revaluation of property, plant and equipment of RMB1,262 million) was RMB19,565 million. Our earnings per share* reached RMB0.25. (* After incorporating the revenue from the amortisation of upfront connection fees, EBITDA was RMB87,000 million, EBITDA margin was 54.0%, net profit was RMB28,023 million, earnings per share was RMB0.36.)

The Company's strong operating cash flow provides funding for the necessary investment in relation to our long-term development, and it also ensures our shareholders receive a favourable cash return. Taking into consideration of the Company's operational and financial conditions and capital expenditure required for our future business expansion, in particular, the investment necessary for our future strategic transformation, the Board of Directors will propose to declare a dividend in the amount equivalent to HK\$0.065 per share in the upcoming Annual General Meeting, so that we can retain sufficient financial flexibility, with a view to achieving the best return to our shareholders.

Our businesses grew steadily in 2004. Our local telephone subscriber base increased by 25.66 million, to 187 million, of which 42.17 million was made up of local wireless access subscribers, with an increase of 16.60 million. Such growth made an important contribution to the increase in the usage volume and our operating revenue. Long distance services developed better than previous years, recording a revenue growth of 2.1%. Revenue generated from Internet services sustained rapid growth and accounted for 9.2% of our operating revenue (excluding the revenue from amortisation of upfront connection fees), an increase of 2.2 percentage points over 2003. This increase in revenue generated from Internet services contributed to the increase in operating revenue (excluding the revenue from amortisation of upfront connection fees) of 2.9 percentage points. Broadband subscribers increased by 6.61 million to 13.84 million. Value-added services continued to grow steadily and showed a strong potential for further growth. At the same time, the contribution of non-voice services to revenue growth was increasing.

Our Company has always attached great importance to corporate governance and business integrity to ensure its sustainable development. We shall continue to improve our corporate governance and increase the transparency of the Company in accordance with the requirements of relevant regulatory authorities (in particular the requirements promulgated under the United States *Sarbanes-Oxley Act of 2002*) and generally accepted international best practice. We shall continue our efforts in promoting and improving our operations and information disclosure internal control systems. The Board of Directors has already approved the optimisation of the Company's internal controls in accordance with COSO framework, and the establishment of an integrated multi-level internal and external assessment system with a view to further improving operational efficiency and information quality and to better managing financial risks to preserve shareholders' interests.

While the Company performed well in general, it faced a number of challenges: the growth in the wireline telephone subscriber base has slowed down; the wireline telecommunications services have witnessed substantial substitution by the mobile services; revenue growth rate has been declining. As a result of the intense competition, marketing costs increased continuously, putting pressure on growth of profits. Due to the lack of new prominent growth-driving products, the disadvantages of providing only wireline telecommunications services became increasingly apparent. The Company's network resources have yet to be fully exploited.

We see valuable growth opportunities in the future. China's GDP per capita has exceeded a momentous US\$1,000. Benefiting from the positive effect of macro economic measures of China and improving living standards of the Chinese people, demand in the telecommunications market is continuously expanding. With the growing popularity of information technology, customers' demands for one-stop overall solutions for integrated services and information provision are increasing.

In general, China Telecom Corporation Limited faces both opportunities and challenges, with opportunities outweighing challenges. As the wireline telecommunications business enters into a maturing phase worldwide, we have realised the risks inherent in operating only wireline telecommunications business. Following a comprehensive review of the history, current situation and prospects of the telecommunications industry as well as the development direction of the Company, we have decided that, from 2005, our strategy will be to transform from a traditional network operator into a modern integrated information services provider.

We shall continue to pursue the operation of mobile business proactively so as to realise potential synergies by operating both mobile and wireline businesses. Simultaneously, we shall actively promote the establishment of orderly competition through co-competition. Based on a win-win business model, we shall actively explore the development of IP-based multimedia services by leveraging our telecommunications network resources. We shall strengthen co-operation with content providers with a view to extending the value chain. We shall seek to work with IT service providers to provide differentiated total solutions for our enterprise customers. In addition, the Company will fully exploit the development potential of rural telephony, value-added services, leased line and other services with a view to creating new revenue growth drivers. The Company will also strive to transform our networks into intelligent broadband and IP based networks, and to enhance the development and convergence of multi-terminals and multi-businesses. In addition, we shall leverage tariff advantages to deliver integrated information services and to ensure the Company's sustainable development.

To ensure our successful business transformation, we shall implement precision management at all levels of the Company, so that quantitative standards will be adopted with reduced data deviations in all aspects of management on an integrated basis covering marketing activities, network operations, allocation of financial resources and human resources.

As a telecommunications operator conscious of its social responsibilities, the Company has launched the "Green Internet" project to clean up Internet content to protect the well being of youngsters. The Company has also made great efforts to promote the establishment of the "Green Dynamic" Internet cafe chain for the purpose of creating a good and healthy Internet access environment for the public. In addition, the Company has taken active measures to provide humanitarian aid to tsunami victims in the Indian Ocean region and other regions, to subsidise children who are unable to attend school owing to financial difficulties, and to help underprivileged people in society.

We are confident in our future. By leveraging our strategic transformation and competitive edge, and seizing the opportunities brought by China's economic growth and new technology, we shall endeavour to provide our customers with modern integrated information services of high quality, and provide an even better return to our shareholders.

Finally, on behalf of the Board of Directors of the Company, I would express our gratitude to Mr. Zhou Deqiang and Mr. Chang Xiaobin for their significant contribution to China Telecom Corporation Limited during their time with us, and at the same time welcome Mr. Long Guangqun, Mr. Yang Jie, Mr. Sun Kangmin and Mr. Li Jiming to join the Board of Directors of the Company. I also would like to take this opportunity to express my sincere appreciation to all of our shareholders, directors, members of the supervisory committee, employees and customers.

Wang Xiaochu
Chairman and Chief Executive Officer

Beijing, PRC
31 March 2005

GROUP RESULTS

China Telecom Corporation Limited (the "Company") is pleased to announce the consolidated results of the Company and its subsidiaries (the "Group") for the year ended 31 December 2004 extracted from the audited financial statements of the Group as set out in its 2004 annual report.

CONSOLIDATED STATEMENT OF INCOME

For the year ended 31 December 2004
(Amounts in millions, except per share data)

	Note	2004 RMB	2003 RMB
Operating revenues	2	161,212	151,553
Operating expenses		(46,597)	(46,597)
Depreciation and amortisation		(43,018)	(41,118)
Network operations and support		(27,003)	(24,810)
Selling, general and administrative		(4,139)	(3,176)
Other operating expenses		—	—
Total operating expenses		(121,382)	(118,701)
Operating profit		39,830	32,852
Deficit on revaluation of property, plant and equipment		(1,262)	(14,832)
Net finance costs	3	(5,340)	(3,606)
Investment income/(loss)		1,192	(42)
Share of profit from associates		29	35
Profit before taxation and minority interests		33,263	14,407
Taxation	4	(5,187)	(469)
Profit before minority interests		28,076	13,938
Minority interests		(53)	(56)
Profit attributable to shareholders		28,023	13,882
Basic earnings per share	5	0.36	0.18
Weighted average number of shares		78,840	75,614

CONSOLIDATED BALANCE SHEET

at 31 December 2004
(Amounts in millions)

	2004 RMB	2003 RMB
ASSETS		
Non-current assets		
Property, plant and equipment, net	320,179	309,896
Construction in progress	29,450	31,617
Lease prepayments	4,830	4,485
Interests in associates	511	513
Investments	200	206
Deferred tax assets	10,805	10,523
Other assets	13,063	13,609
Total non-current assets	379,038	370,849
Current assets		
Inventories	2,767	3,253
Accounts receivable, net	13,921	12,951
Prepayments and other current assets	3,064	3,695
Time deposits with maturity over three months	315	473
Cash and cash equivalents	13,465	12,721
Total current assets	33,532	33,093
Total assets	412,570	403,942

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities		
Short-term debt	65,976	56,243
Current portion of long-term debt	11,842	13,957
Accounts payable	33,658	35,629
Accrued expenses and other payables	27,531	26,004
Income tax payable	1,192	3,395
Current portion of finance lease obligations	156	50
Current portion of deferred revenues	11,589	13,857
Total current liabilities	151,944	149,135
Net current liabilities	(118,412)	(116,042)
Total assets less current liabilities	260,626	254,807
Non-current liabilities		
Long-term debt	72,366	68,632
Finance lease obligations	157	43
Deferred revenues	25,182	32,744
Deferred tax liabilities	2,302	1,325
Total non-current liabilities	100,007	102,744
Total liabilities	251,951	251,879
Minority interests	1,413	1,269
Shareholders' equity		
Share capital	80,932	75,614
Reserves	78,274	75,180
Total shareholders' equity	159,206	150,794
Total liabilities and shareholders' equity	412,570	403,942

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

For the year ended 31 December 2004
(Amounts in millions)

	Note	Share capital RMB	Capital reserve RMB	Share premium RMB	Revaluation reserve RMB	Surplus reserves RMB	Statutory common welfare fund RMB	Other reserves RMB	Retained earnings RMB	Total shareholders' equity RMB
Balance as at 1 January 2003, as previously reported		75,614	20,955	3,362	4,904	8,121	1,624	31,064	7,204	152,848
Adjusted for the Second Acquisition	1	—	—	—	—	—	—	34,177	—	34,177
Balance as at 1 January 2003, as adjusted		75,614	20,955	3,362	4,904	8,121	1,624	65,241	7,204	187,025
Net profit		—	—	—	—	—	—	—	13,882	13,882
Contributions from China Telecom		—	—	—	—	—	—	—	4,309	4,309
Distributions to China Telecom		—	—	—	—	—	—	—	(1,234)	(1,234)
Assets distributed to China Telecom in connection with the Second Acquisition		—	—	—	—	—	—	—	(10,762)	(10,762)
Revaluation surplus		—	—	—	1,537	—	—	—	—	1,537
Recognition of deferred tax assets		—	—	—	—	—	—	2,209	—	2,209
Elimination of deferred tax liabilities		—	—	—	—	—	—	—	150	150
Transfer from retained earnings to other reserves		—	—	—	—	—	—	—	(11,812)	(11,812)
Consideration for the acquisition of the First Acquired Group	1	—	—	—	—	—	—	—	(45,649)	(45,649)
Transfer from other reserves to capital reserve		—	(14,388)	—	—	—	—	—	14,388	—
Appropriations		—	—	—	—	7,340	1,748	—	(9,088)	—
Dividends		—	—	—	—	—	—	—	(673)	(673)
Revaluation surplus realised		—	—	—	(17)	—	—	—	—	—
Deferred tax on land use rights realised		—	—	—	—	—	—	—	(131)	131
Balance as at 31 December 2003		75,614	6,567	3,362	6,424	15,461	3,372	24,246	15,748	150,794
Issue of shares, net of issuing expenses of RMB294 million		5,318	—	7,384	—	—	—	—	—	12,702
Net profit		—	—	—	—	—	—	—	28,023	28,023
Contributions from China Telecom		—	—	—	—	—	—	—	100	100
Transfer from retained earnings to other reserves		—	—	—	—	—	—	2,653	(2,653)	—
Consideration for the acquisition of the Second Acquired Group	1	—	—	—	—	—	—	—	(27,800)	(27,800)
Transfer from other reserves to capital reserve		—	(9,371)	—	—	—	—	—	9,371	—
Revaluation surplus		—	—	—	—	—	—	—	—	—
Deferred tax on revaluation surplus of property, plant and equipment		—	—	—	1,233	—	—	—	—	1,233
Appropriations		—	—	—	—	10,168	2,421	—	(12,589)	—
Dividends	6	—	—	—	—	—	—	—	(5,224)	(5,224)
Effect of change in tax rate		—	—	—	—	—	—	—	(244)	(244)
Revaluation surplus realised		—	—	—	(72)	—	—	—	—	72
Deferred tax on land use rights realised		—	—	—	—	—	—	—	(165)	165
Balance as at 31 December 2004		80,932	(2,804)	10,746	7,585	25,629	5,793	7,683	23,642	159,206

CONSOLIDATED STATEMENT OF CASH FLOW

For the year ended 31 December 2004
(Amounts in millions)

	Note	2004 RMB	2003 RMB
Cash flows from operating activities	(a)	66,078	58,392
Cash flows from investing activities		(56,446)	(57,692)
Capital expenditure		(42)	(485)
Purchase of investments		(444)	(355)
Lease prepayments		42	52
Proceeds from disposal of investments		379	348
Proceeds from disposal of property, plant and equipment		(325)	(466)
Purchase of time deposits with maturity over three months		483	1,504
Maturity of time deposits with maturity over three months		—	—
Net cash used in investing activities		(56,353)	(57,094)
Cash flows from financing activities		12,702	(210)
Proceeds from issue of shares, net of issuing expenses		(50)	(210)
Capital element of finance lease payments		77,120	83,472
Proceeds from bank and other loans		(81,070)	(86,147)
Repayments of bank and other loans		(5,224)	(673)
Payment of dividends		91	(27)
Cash contributions from/(distributions to) minority interests		—	(11,000)
Cash payment for the acquisition of the First Acquired Group		100	3,461
Cash payment for the acquisition of the Second Acquired Group		—	(196)
Cash contributions from China Telecom		—	—
Cash distributions to China Telecom		—	—
Net cash used in financing activities		(8,981)	(11,320)
Net increase/(decrease) in cash and cash equivalents		744	(10,022)
Cash and cash equivalents at beginning of year		12,721	22,743
Cash and cash equivalents at end of year		13,465	12,721
(a) Reconciliation of profit before taxation and minority interests to cash flows from operating activities			
Profit before taxation and minority interests		33,263	14,407
Adjustments for:			
Depreciation and amortisation		17,170	16,597
Deficit on revaluation of property, plant and equipment		4,262	14,832
Provision for doubtful accounts		1,121	1,037
Investment (income)/loss		(46)	42
Share of profit from associates		(29)	(35)
Interest income		(231)	(331)
Interest expense		5,367	3,340
Unrealised foreign exchange losses		152	495
Loss on retirement and disposal of property, plant and equipment and impairment loss		961	1,628
Increase in accounts receivable		(2,091)	(2,383)
Decrease/(increase) in inventories		486	(687)
Decrease in prepayments and other current assets		481	116
Decrease in other non-current assets		297	12
Increase/(decrease) in accounts payable		55	(335)
Increase in accrued expenses and other payables		1,517	34
Decrease in deferred revenues		(9,830)	(9,320)
Cash generated from operations		79,945	69,449
Interest received		231	331
Interest paid		(6,824)	(4,944)
Investment income received		173	17
Income tax paid		(7,317)	(6,461)
Cash flows from operating activities		66,078	58,392

Notes:

1. Basis of presentation

Since China Telecommunications Corporation ("China Telecom") controlled the Predecessor Operations transferred to the Company and continues to control the Company, the consolidated financial

2. Operating revenues

Operating revenues represent revenues from the provision of wireline telecommunications services. The components of the Group's operating revenues are as follows:

		The Group 2004	2003
	Note	RMB millions	RMB millions
Upfront connection fees	(i)	8,458	9,771
Upfront installation fees	(ii)	2,865	2,643
Monthly fees	(iii)	29,827	27,499
Local usage fees	(iv)	47,646	45,815
DLD	(iv)	26,231	25,460
ILD	(iv)	3,788	3,943
Internet	(v)	14,109	10,007
Managed data	(vi)	3,015	3,210
Interconnections	(vii)	10,719	8,365
Leased line	(viii)	4,154	5,103
Others	(ix)	10,400	9,737
		<u>161,212</u>	<u>151,553</u>

- Represent the amortised amount of the upfront fees received for initial activation of wireline services.
- Represent the amortised amount of the upfront fees received for installation of wireline services.
- Represent amounts charged to customers each month for their use of the Group's telephone services.
- Represent usage fees charged to customers for the provision of telephone services.
- Represent amounts charged to customers for the provision of Internet access services.
- Represent amounts charged to customers for the provision of managed data transmission services.
- Represent amounts charged to domestic and foreign telecommunications operators for delivery of calls connecting to the Group's wireline telecommunications networks.
- Represent lease income from other domestic telecommunications operators and business customers for the usage of the Group's wireline telecommunications networks and is measured by the number of lines leased and the agreed upon rate per line leased. The lease arrangements are primarily on a year to year basis.
- Represent primarily revenues from provision of value-added telecommunications services to customers, sale and repairs and maintenance of customer-end equipment, and lease of telecommunications network facilities.

3. Net finance costs

Net finance costs comprise:

	The Group 2004	2003
	RMB millions	RMB millions
Interest expense incurred	6,834	4,948
Less: Interest expense capitalised	(1,467)	(1,608)
Net interest expense	5,367	3,340
Interest income	(231)	(331)
Foreign exchange losses	207	647
Foreign exchange gains	(3)	(50)
	<u>5,340</u>	<u>3,606</u>

4. Taxation

Taxation in the consolidated statement of income comprises:

	The Group 2004	2003
	RMB millions	RMB millions
Provision for PRC income tax	5,114	6,014
Deferred taxation	73	(5,545)
	<u>5,187</u>	<u>469</u>

A reconciliation of the expected tax with the actual tax expense is as follows:

	The Group 2004	2003
	RMB millions	RMB millions
Profit before taxation and minority interests	33,263	14,407
Expected PRC income tax expense at statutory tax rate of 33%	10,977	4,754
Differential tax rate on subsidiaries' income	(1,608)	(314)
Non-deductible expenses	294	515
Non-taxable income	(3,266)	(3,659)
Tax credit for domestic equipment purchases	(1,210)	(827)
Income tax	5,187	469

- The provision for PRC current income tax is based on a statutory rate of 33% of the assessable income of the Group as determined in accordance with the relevant income tax rules and regulations of the PRC, except for certain subsidiaries of the Company which are taxed at a preferential rate of 15%.
- Amounts represent personnel and other miscellaneous expenses in excess of statutory deductible limits for tax purpose.
- Amounts primarily represent connection fees received from customers which are not subject to income tax.

5. Basic earnings per share

The calculation of basic earnings per share for the year ended 31 December 2004 is based on the net profit of RMB28,023 million and the weighted average number of shares in issue during the year of 78,839,968,917 shares. The weighted average number of shares in issue for the year ended 31 December 2004 reflects the issuance of 5,318,181,818 new H shares in May 2004. The calculation of basic earnings per share for the year ended 31 December 2003 is based on the net profit of RMB13,882 million and the weighted average number of shares in issue during the year of 75,614,186,503 shares.

The amount of diluted earnings per share is not presented as there were no dilutive potential ordinary shares in existence for all periods presented.

6. Dividends

Pursuant to a resolution passed at the Directors' meeting on 31 March 2005, a final dividend of equivalent to HK\$0.065 per share totalling approximately RMB5,576 million for the year ended 31 December 2004 was proposed for shareholders' approval at the Annual General Meeting. The dividend has not been provided for in the consolidated financial statements for the year ended 31 December 2004.

Pursuant to the shareholders' approval at the Annual General Meeting held on 3 May 2004, a final dividend of RMB0.069083 per share totalling RMB5,224 million in respect of the year ended 31 December 2003 was declared and was paid on 20 May 2004.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

Overview

On 30 June 2004, the Company completed its acquisition from China Telecommunications Corporation of the entire equity interests in Hubei Telecom Company Limited, Hunan Telecom Company Limited, Hainan Telecom Company Limited, Guizhou Telecom Company Limited, Shaanxi Telecom Company Limited, Yunnan Telecom Company Limited, Gansu Telecom Company Limited, Qinghai Telecom Company Limited, Ningxia Telecom Company Limited, Xinjiang Telecom Company Limited (hereinafter referred to collectively as the "Acquired Companies"). Since the Company and the Acquired Companies were under the common control of China Telecommunications Corporation, our acquisition of the Acquired Companies has been treated as a "combination of entities under common control", and was accounted for in a manner similar to a pooling-of-interests ("as-if-pooling-of-interests accounting"). Accordingly, the assets and liabilities of the Acquired Companies have been accounted for based on their historical amounts and our financial statements for the period prior to the acquisition have been restated to include the financial position and results of operations of the Acquired Companies on a combined basis. Unless otherwise indicated in this section, our financial data for the period prior to the acquisition are presented based on those restated amounts.

In 2004, our operating revenue increased steadily while our operating expenses were kept under effective control. Our profit increased and our cash flow was strong. Through our acquisition of the Acquired Companies, we successfully achieved our external expansion and created more growth opportunities.

Our total operating revenue in 2004 grew 6.4% from 2003 to RMB161,212 million. Our operating expenses increased from 2003 by 2.3% to RMB121,382 million in 2004. Our net profit⁽³⁾ was RMB28,023 million and our earnings per share were RMB0.36 for 2004. Our EBITDA⁽⁴⁾ was RMB87,000 million in 2004, with an EBITDA margin of 54.0%.

Excluding the amortisation of upfront connection fees of RMB8,458 million, our operating revenue in 2004 was RMB152,754 million, an increase of 7.7% from 2003; our net profit was RMB19,565 million, our earnings per share were RMB0.25; our EBITDA was RMB78,542 million and EBITDA margin was 51.4%.

Operating Revenue

Our total operating revenue in 2004 was RMB161,212 million, an increase of 6.4% from 2003. Excluding the amortisation of upfront connection fees, the operating revenue in 2004 increased by RMB10,972 million or 7.7% from 2003, reaching RMB152,754 million. As the main sources for the growth in our operating revenue, local telephone services revenue, Internet services revenue and interconnection revenue increased by RMB4,381 million, RMB4,102 million, and RMB2,354 million, respectively, from 2003. Our long distance services revenue increased by 2.1% from 2003, while revenue from our managed data and leased line services decreased.

The following table sets forth a breakdown of our operating revenue for 2003 and 2004, together with their respective rates of change:

	For the Year Ended 31 December		
	2004	2003	Rate of Change
	(RMB in millions, except percentage data)		
Wireline telephone services ⁽⁵⁾			
Local			
Installation fees	2,865	2,643	8.4%
Monthly fees	29,827	27,499	8.5%
Local usage fees	47,646	45,815	4.0%
Sub-total	80,338	75,957	5.8%
Domestic long distance ⁽⁶⁾	26,231	25,460	3.0%
International, Hong Kong, Macau and Taiwan long distance ⁽⁶⁾	3,788	3,943	(3.9%)
Interconnections	10,719	8,365	28.1%
Upfront connection fees	8,458	9,771	(13.4%)
Sub-total	49,196	47,539	3.5%
Internet	14,109	10,007	41.0%
Managed data	3,015	3,210	(6.1%)
Leased line services	4,154	5,103	(18.6%)
Others ⁽⁷⁾	10,400	9,737	6.8%
Operating revenue (Excluding amortisation of upfront connection fees)	152,754	141,782	7.7%
Total operating revenue	161,212	151,553	6.4%

Local Telephone Services

Revenue from our local telephone services grew by 5.8% from RMB75,957 million in 2003 to RMB80,338 million in 2004, which contributed 49.8% to our total operating revenue or 52.6% of our operating revenue excluding amortisation of upfront connection fees. This was primarily due to continued growth in our subscriber base and growth in our local usage volume.

Installation Fees. Upfront installation fees will be amortised over the expected customer relationship period of 10 years. Revenue from amortisation of upfront installation fees increased by 8.4% from RMB2,643 million in 2003 to RMB2,865 million in 2004.

Monthly Fees. Revenue from monthly fees increased by RMB2,328 million, or 8.5%, from RMB27,499 million in 2003 to RMB29,827 million in 2004, which was primarily due to the sustained increase in the number of our local telephone subscribers. The number of subscribers for our access lines increased by 25.66 million or 15.9% from 160.99 million in 2003, reaching 187 million as of the end of 2004.

Local Usage Fees. Revenue from local usage fees was RMB47,646 million, increased by 4.0% from RMB45,815 million in 2003, primarily due to an increase in local usage volume. In 2004, despite the intensifying mobile substitution, we successfully increased our local usage volume usage by 11.6% from 2003 to 429,150 million pulses in 2004, through our marketing channels and various marketing tactics like integrated marketing and sales packaging.

Long Distance Telephone Services

Revenue from our long distance telephone services increased by 2.1%, from RMB29,403 million in 2003 to RMB30,019 million in 2004, representing 18.6% of our total operating revenue or 19.7% of our operating revenue excluding amortisation of upfront connection fees.

Domestic Long Distance Services. Domestic long distance revenue increased by 3.0% from RMB25,460 million in 2003 to RMB26,231 million in 2004, primarily due to the rapid increase in domestic long distance usage volume. In 2004, we seized the opportunity brought by strong market demands and took an active and flexible approach towards the competition. As a result, our total domestic long distance usage volume increased by 21.8% from 2003 to 81,960 million minutes in 2004, fully offsetting the negative influence from price decreases, and the declining trend in the revenue from domestic long distance services in recent years was reversed.

International, Hong Kong, Macau and Taiwan Long Distance Services. International, Hong Kong, Macau and Taiwan long distance services revenue decreased by 3.9%, from RMB3,943 million in 2003 to RMB3,788 million in 2004. The transmission volume of our international, Hong Kong, Macau and Taiwan long distance services was 1,654 million minutes in 2004, which was similar to that in 2003. The decrease in revenue was attributable to the decrease in prices. We plan to adopt a more flexible marketing strategy to stimulate growth in usage volume.

Internet Services

Revenue from our Internet services increased by 41.0%, from RMB10,007 million in 2003 to RMB14,109 million in 2004, representing 8.8% of our total operating revenue or 9.2% of our operating revenue excluding amortisation of upfront connection fees. Driven by the rapid development of broadband services in recent years, our Internet services revenue recorded a sustained and rapid growth. The number of our broadband subscribers increased by 6.61 million from the end of 2003 to 13.84 million as of the end of 2004. We believe that there is still great potential for development in our broadband services.

Managed Data Services

Revenue from our managed data services decreased by 6.1%, from RMB3,210 million in 2003 to RMB3,015 million in 2004. This decrease was primarily due to the decrease in prices as a result of the intensifying competition.

Leased Line Services

Revenue from leased line services decreased by 18.6%, from RMB5,103 million in 2003 to RMB4,154 million in 2004. The major reason for this decrease was that the unit price dropped as a result of the intensifying market competition.

Interconnection Services

Revenue from interconnection services increased by 28.1%, from RMB8,365 million in 2003 to RMB10,719 million in 2004, representing 6.6% of our total operating revenue or 7.0% of our operating revenue excluding amortisation of upfront connection fees. This growth was primarily attributable to an increase in interconnection volume as a result of the expansion in the domestic telecommunications services subscriber base.

Other Businesses

Revenue from our other businesses increased by 6.8%, from RMB9,737 million in 2003 to RMB10,400 million in 2004, representing 6.5% of our total operating revenue or 6.8% of our operating revenue excluding amortisation of upfront connection fees. This growth was primarily due to the increase in revenue from value-added services, including calling display service and telephone message service.

Upfront Connection Fees

Upfront connection fees represent the amortised amount of the upfront fees received for the initial activation of wireline services, amortised over the expected customer relationship period of 10 years. Effective as of 1 July 2001, we ceased charging new subscribers upfront connection fees. Consequently, the amortised amount decreased by 13.4%, from RMB9,771 million in 2003 to RMB8,458 million in 2004.

The table below sets forth the amortisation of our upfront connection fees for each year from 2005 to 2011 based on a 10-year estimated amortisation period (with 2011 as the end of the amortisation period):

	2005	2006	For the Year Ending 31 December				
			2007	2008	2009	2010	2011
	(RMB in millions)						
Amortisation of upfront connection fees	6,782	4,965	3,295	2,022	1,151	497	98

Operating Expenses

In 2004, our operating expenses were RMB121,382 million, representing an increase of 2.3% from 2003. The ratio of our operating expenses to total operating revenue decreased from 78.3% in 2003 to 75.3%, or decreased from 83.7% in 2003 to 79.5% of our operating revenue excluding amortisation of upfront connection fees. Our network operations and support expenses decreased and our depreciation and amortisation expenses increased slightly in 2004. Our selling, general and administrative expenses, personnel expenses, interconnection and other operating expenses also increased.

The following table sets forth a breakdown of our operating expenses for 2003 and 2004, together with their respective rates of change:

	For the Year Ended 31 December			Rate of Change		
	2004	2003		2004	2003	
	(RMB in millions, except percentage data)					
Depreciation and amortisation	47,170	46,597		1.2%		
Network operations and support	27,611	31,338		(11.9%)		
Selling, general and administrative	19,229	16,778		14.6%		
Personnel	23,233	20,812		11.6%		
Interconnection and other operating expenses	4,139	3,176		30.3%		
Total operating expenses	121,382	118,701		2.3%		

Depreciation and Amortisation. Our depreciation and amortisation expenses were RMB47,170 million in 2004, an increase of 1.2% from 2003, representing 29.3% of our total operating revenue. The depreciation and amortisation expenses as a percentage of our operating revenue excluding amortisation of upfront connection fees decreased from 32.9% in 2003 to 30.9% in 2004.

Network Operations and Support. Our network operations and support expenses (excluding related personnel expenses) decreased by 11.9%, from RMB31,338 million in 2003 to RMB27,611 million in 2004, primarily due to a decrease in repair and maintenance expenses as a result of our centralised management of network maintenance and resources allocation. Our repair and maintenance expenses decreased by 9.4% from 2003 to RMB12,217 million in 2004.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses (excluding related personnel expenses) increased by 14.6%, from RMB16,778 million in 2003 to RMB19,229 million in 2004. Our selling expenses in 2004 increased by 42.5% from 2003, due to the reinforcement of our marketing strength to cope with increasingly intensified market competition. However, with our proper control, the growth rate of such expenses in the whole year was remarkably lower than that of the first half of 2004. At the same time, we continued to achieve savings in administrative expenses.

Personnel Expenses. Our personnel expenses increased by 11.6%, from RMB20,812 million in 2003 to RMB23,233 million in 2004. The Company established a performance-linked remuneration scheme, which played an important role in attracting and retaining talented employees and incentivising employees.

Interconnection and Other Operating Expenses. Our interconnection and other operating expenses in 2004 increased by RMB963 million, or 30.3%, from RMB3,176 million in 2003 to RMB4,139 million in 2004. The significant increase in inter-network traffic led to the corresponding increase in interconnection expenses. The net interconnection revenue (interconnection revenue minus interconnection expenses) in 2004 was RMB6,624 million, representing an increase of 25.9% from 2003.

Net Finance Costs

Our net finance costs increased by 48.1%, from RMB3,606 million in 2003 to RMB5,340 million in 2004. The Company acquired the telecommunications businesses in the six regions as of 31 December 2003 and the ten regions as of 30 June 2004 respectively, and the purchase considerations included deferred payments totalling RMB50,150 million. The interest expense incurred therefrom was the main reason for the increase in our finance costs.

Deficit on Revaluation of Property, Plant and Equipment

According to our accounting policy, revaluation of property, plant and equipment should be carried out at least once every three years. In 2004, we carried out a revaluation on our property, plant and equipment and a revaluation deficit of RMB1,262 million was recorded.

Income Tax

Our statutory tax rate is 33%. In 2004, our income tax expense was RMB5,187 million, representing an effective tax rate of 15.6%. The difference between the statutory tax rate and our effective tax rate was primarily due to the exclusion of the upfront connection fees from taxable revenue and the preferential income tax rate of 15% applied to some of our subsidiaries located in special economic zones and the western part of China. Another reason for our effective tax rate being lower than the statutory tax rate was that some of our operating subsidiaries received tax credits of RMB1,210 million in 2004 on the purchases of domestic equipment. As the tax credits on purchases of domestic equipment are subject to various restrictions, we cannot reasonably foresee their impacts on effective tax rates in future years.

Net Profit

In 2004, our operating effectiveness and profit level continued to grow and our net profit reached RMB28,023 million. Excluding amortisation of upfront connection fees, our net profit in 2004 was RMB19,565 million. Our net profit for 2003 was RMB13,882 million and our net profit excluding amortisation of upfront connection fees was RMB4,111 million. During the reorganisation of telecommunications businesses in the ten regions in 2003, we carried out a revaluation of the relevant property, plant and equipment in accordance with the relevant regulations and a revaluation deficit of RMB14,832 million was resulted. This was one of the reasons for the substantial increase in our net profit in 2004 from that of 2003.

Capital Expenditure

In 2004, we continued to implement our prudent policy on capital expenditure. Our capital expenditure decreased by 8.6%, from RMB61,587 million in 2003 to RMB56,307 million in 2004. Seizing the opportunity brought along by urbanisation, we maintained our leading position in access network. We also made efforts to transform existing networks into intelligent, broadband and IP based networks, and at the same time made preparations for the construction of the next generation network.

Our planned capital expenditure for 2005 is RMB55,800 million. We expect to fund our capital expenditure needs through a combination of cash flows generated from our operating activities, short-term and long-term bank loans and other debt and equity financing. We believe we will have sufficient resources to meet our capital expenditure requirements for the foreseeable future.

Cash Flows and Capital Resources

Cash Flow

Our net cash inflow was RMB744 million in 2004, as compared with a net cash outflow of RMB10,022 million in 2003. The main reason for the increase in our net cash flow was the substantial growth in cash flow generated from our operating activities and our successful issue of additional H shares.

The following table presents our cash flows for 2003 and 2004:

	For the Year Ended 31 December	
	2004	2003
	(RMB in millions)	
Net cash flows from operating activities	66,078	58,392
Net cash used in investing activities	(56,353)	(57,094)
Net cash used in financing activities	(8,981)	(11,320)
Net increase/(decrease) in cash and cash equivalents	744	(10,022)

Our net cash flows from operating activities were RMB66,078 million in 2004, an increase of RMB7,686 million from RMB58,392 million in 2003. This increase reflected the steady development of the Group's business and improvement in operational efficiency.

We achieved saving in capital expenditure for 2004. Net cash used in investing activities was RMB56,353 million, decreased by RMB741 million from that of 2003.

Our net cash used in financing activities was RMB8,981 million in 2004, as compared with a net cash outflow of RMB11,320 million in 2003. In May 2004, the Company raised net proceeds of RMB12,702 million from the global offering of its H shares, which were used to settle part of the purchase consideration on the acquisition of the Acquired Companies. On the other hand, we continued to repay certain amounts of our loans in 2004. Our net cash outflow used for the repayment of loans (the difference between the proceeds from loans and the cash repayment for such loans) increased from RMB2,675 million in 2003 to RMB3,950 million in 2004. In addition, the amount of dividends paid by the Company in 2004 increased by RMB4,551 million.

Working Capital

Our working capital (total current assets minus total current liabilities) deficit was RMB118,412 million as of 31 December 2004, representing an increase of RMB2,370 million, compared with the deficit of RMB116,042 million in 2003. The increase in our working capital deficit was primarily due to the fact that in accordance with its credit level and in order to control risk, the Company had increased its short-term loans with lower interest rates.

As of the end of 2004, our cash and cash equivalents reached RMB13,465 million, of which 99.2% was denominated in RMB.

Indebtedness

Our indebtedness as of the end of 2003 and 2004 was as follows:

	As of 31 December	
	2004	2003
	(RMB in millions)	
Short-term debt	65,976	56,243
Long-term debt maturing within a year	11,842	13,957
Long-term debt (excluding current portion)	72,366	68,632
Total debt	150,184	138,832

Our total debt was RMB150,184 million as of the end of 2004, increased by RMB11,352 million from that of 2003, primarily due to the deferred consideration of RMB4,150 million for our acquisition of the Acquired Companies from China Telecommunications Corporation in 2004. The debt-to-asset ratio (total debt divided by total assets) was therefore increased to 36.4% as of the end of 2004 from 34.4% as of the end of 2003. Excluding the deferred considerations of RMB50,150 million payable to China Telecommunications Corporation for the two acquisitions, our loans would be decreased from RMB103,832 million as of 31 December 2003 to RMB100,034 million as of 31 December 2004. We believe we maintained a solid capital structure.

Substantial business revenue and expenses of the Company were denominated in Renminbi, where Renminbi cannot be completely exchanged into foreign currencies freely. Of our total debt as of 31 December 2004, 95.2%, 2.1%, 1.9% and 0.8% were denominated in Renminbi, Japanese yen, U.S. dollars and Euros, respectively. 59.8% of the Group's total debt was with fixed interest rate terms.

Contractual Obligations

The following table sets forth our contractual obligations as of 31 December 2004:

	Total	2005	Payable in 2006	2007	2008	After 2008
	(RMB million)					
Short-term debt	65,976	65,976	—	—	—	—
Long-term debt	84,208	11,842	10,022	8,343	552	53,449
Operating lease commitments	1,285	369	187	137	124	468
Capital commitments	4,865	4,865	—	—	—	—
Total contractual obligations	156,334	83,052	10,209	8,480	676	53,917

PURCHASE, SALE OR REDEMPTION OF SHARES

For the year ended 31 December 2004, neither the Company nor its subsidiaries has purchased, sold or redeemed any of the Company's listed shares.

COMPLIANCE WITH CODE OF BEST PRACTICE

None of the Directors is aware of any information that would reasonably indicate that the Company is not, or was not during the period, in compliance with the Code of Best Practice as set out in Appendix 14 of the Listing Rules.