

## REPORT OF THE DIRECTORS



The directors (the “Directors”) of China Telecom Corporation Limited (the “Company”) are pleased to present their report together with the audited financial statements of the Company and its subsidiaries (the “Group”) prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2002.

### PRINCIPAL ACTIVITIES

We are the leading provider of wireline telecommunications services in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province in China. Our scope of business includes the following:

- (1) operating a variety of domestic wireline telecommunications networks and facilities (including wireless local loops);
- (2) operating voice, data, image, multimedia and other information services mainly based on the wireline networks;
- (3) conducting accounts settlement relating to international telecommunications services in accordance with state regulations; and

- (4) dealing with system integration, technological development, technical services, information consulting, telecommunications equipment design together with manufacture, implementation and sales.

### CORPORATE GOVERNANCE

We have made efforts to optimise our corporate governance structure, regulate internal management practises, and improve the transparency of information disclosure.

Our shareholders’ meetings, the Board of Directors and its respective committees, the Supervisory Committee and the management team check and balance the powers of each other and discharge their functions in a regulated matter.

We conduct our business in strict compliance with our Articles of Association in order to be accountable to all our shareholders. All directors have performed their duties conscientiously and diligently. Our Board of Directors consists of two independent non-executive directors who are experienced in terms of corporate management and reputable in the community. The independent non-executive directors have provided a check and balance to decisions made by the Board of Directors and thus effectively guarded the interest of minority shareholders.

We have established an audit committee and a remuneration committee in 2002 and 2003 respectively. The two committees have two independent non-executive directors and one employee representative. The audit committee is primarily responsible for the accuracy of the financial information and is required to opine on the fairness and reasonableness of the connected

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transactions. The remuneration committee is primarily responsible for the determination of remuneration packages for managerial officers and to ensure the fairness of the remuneration policy with the purpose of incentivising the employees.

Being a H share company, we have complied with the PRC laws to establish a Supervisory Committee. The Supervisory Committee has supervised the legality and regularity of the Company's financial affairs, the performance of our Directors and senior management.

We aim to improve our corporate transparency in order to strengthen the confidence of investors. The Company has established various departments to focus on secretarial matters of the Board of Directors and investors' relationship. These departments are primarily responsible for the development of a communication channel with the investors and information disclosure. Simultaneously, pursuant to the relevant laws and regulations, internal control and information disclosure systems have been strengthened in order to enhance corporate transparency.

### DIRECTORS AND SENIOR MANAGEMENT OF THE COMPANY

The following table sets forth certain information concerning the Directors and senior management of the Company.

<b>Name</b>	<b>Age</b>	<b>Position in the Company</b>	<b>Date of Appointment</b>
Zhou Deqiang	61	Chairman of the Board of Directors and Chief Executive Officer	10 September 2002
Chang Xiaobing	46	Executive Director and President	10 September 2002
Wu Andi	48	Executive Director, Executive Vice President and Chief Financial Officer	10 September 2002
Zhang Jiping	47	Executive Director and Executive Vice President	10 September 2002
Huang Wenlin	49	Executive Director and Executive Vice President	10 September 2002
Li Ping	49	Executive Director, Executive Vice President and Company Secretary	10 September 2002
Wei Leping	57	Executive Director and Executive Vice President	10 September 2002
Cheng Xiyuan	59	Executive Director	10 September 2002
Feng Xiong	57	Executive Director	10 September 2002
Zhang Youcai	62	Independent Non-executive Director	10 September 2002
Vincent Lo Hong Sui	55	Independent Non-executive Director	10 September 2002
Sun Jiuming	56	Chairman and President of Jiangsu Telecom Corporation Limited	19 October 2002

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Name	Age	Position in the Company	Date of Appointment
Wang Jirong	49	Chairman and President of Zhejiang Telecom Corporation Limited	10 October 2002
Wang Qi	48	Controller of China Telecom Corporation Limited	10 September 2002

The executive Directors of the Company also hold executive positions with China Telecommunications Corporation.

### SUPERVISORS

The following table sets forth certain information concerning the Supervisors of the Company:

Name	Age	Position in the Company	Date of Appointment
Zhang Xiuqin	56	Chairperson of Supervisory Committee	10 September 2002
Tan Ming <sup>1</sup>	49	Supervisor	10 September 2002
Zhu Lihao	62	Independent Supervisor	10 September 2002
Xie Songguang	54	Supervisor	10 September 2002
Li Jing	37	Supervisor	10 September 2002

<sup>1</sup> Mr. Tan Ming resigned from his position as Supervisor effective on 1 April 2003, and has been replaced by Mr. Wang Huanhui.

### DIRECTORS' INTEREST IN AND RIGHT TO ACQUIRE SHARES

As at 31 December 2002, none of the Directors of the Company had any interest in any shares or debentures of the Company or any associated corporation (as defined in the Securities (Disclosure of Interest) Ordinance of Hong Kong (the "SDIO")) as recorded in the register required to be kept under section 29 of the SDIO, or as otherwise notified to the Company and the HKSE pursuant to the Model Code for Securities Transactions by Directors of Listed Companies or, in the case of Supervisors, which would be required to be notified as above if they had been Directors.

As at 31 December 2002, the Company has not granted its Directors, or their respective spouses or children below the age of 18 any rights to subscribe for its equity securities.

### DIRECTORS' INTEREST IN CONTRACTS AND SERVICE CONTRACTS

Each of the existing Directors entered into a service contract with the Company for a term of three years.

Save as the service contracts mentioned above, for the year ended 31 December 2002, the Directors did not have any material interests, whether directly or indirectly, in any contracts of significance entered into by the Company, any of its holding companies or subsidiaries or subsidiaries of the Company's holding company.

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### EMOLUMENTS OF THE DIRECTORS AND SUPERVISORS

Please refer to note 25 of the audited financial statements for details of the emoluments of the Directors and Supervisors of the Company.

### SHARE CAPITAL

The Company was incorporated on 10 September 2002 with a registered share capital of 68,317,270,803 ordinary domestic shares with a par value of RMB1.00 each. Such shares were issued to China Telecommunications Corporation in consideration for the transfer of the wireline telecommunications businesses and related operations in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province to the Company. As part of a reform plan approved by the State Council with respect to the administration of rural telecommunications services, China Telecommunications Corporation transferred 5,719,768,087 shares, 975,047,636 shares and 2,177,711,698 shares to Guangdong Rising Assets Management Co., Ltd., Jiangsu Guoxin Investment Group Co., Ltd. and Zhejiang Financial Development Company, respectively.

Pursuant to the global offering of the Company's H shares conducted in 2002 (the "Global Offering"), the Company issued 6,868,767,600 H shares (including H shares underlying American Depositary Shares ("ADSs")) in November 2002 and a further 428,148,100 H shares in December 2002. The Company's controlling shareholder, China Telecommunications Corporation, and each of Guangdong Rising Assets Management Co., Ltd., Jiangsu Guoxin Investment Group Co., Ltd. and Zhejiang Financial Development Company, sold 598,327,900 H shares, 57,571,100 H shares, 9,814,100 H shares and 21,919,300 H shares, respectively, in November 2002 and a further 37,295,300 H shares, 3,588,600 H shares, 611,700 H shares and 1,366,300 H shares, respectively, in December 2002. After the completion of the Global Offering, 8,027,410,000 H shares were held by the public, representing approximately 10.62% of the issued share capital of the Company. The Company's H shares and ADSs were listed on The Stock Exchange of Hong Kong Limited (the "HKSE") and the New York Stock Exchange (the "NYSE") on 15 November 2002 and 14 November 2002, respectively.



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The share capital of the Company in issue as fully paid or credited as fully paid as at 31 December 2002 was 75,614,186,503 shares with a par value of RMB1.00 each. As at 31 December 2002 the share capital of the Company comprised:

Shares	Number of shares as at 31 December 2002	Percentage of the total number of shares in issue as at 31 December 2002 (%)
Domestic shares (total):	67,586,776,503	89.38
Domestic shares held by:		
China Telecommunications Corporation	58,809,120,182	77.78
Guangdong Rising Assets Management Co., Ltd.	5,658,608,387	7.48
Jiangsu Guoxin Investment Group Co., Ltd.	964,621,836	1.27
Zhejiang Financial Development Company	2,154,426,098	2.85
H shares (including H shares underlying ADSs)	8,027,410,000	10.62
Total	75,614,186,503	100.00

### RESULTS

Results of the Group for the year ended 31 December 2002 and the financial position of the Company and the Group as at that date are set out in the audited financial statements on pages 64 to 109 in this annual report.

### DIVIDEND

The directors propose to declare a final dividend for the year ended 31 December 2002 on the basis of HK\$0.065 per share, pro-rated based on the number of days the Company's shares have been listed during the year, representing a total of approximately RMB672 million. The dividend proposal shall be submitted for consideration at the annual general meeting to be held on 20 June 2003. Dividends will be denominated and declared in Renminbi. Dividends on domestic shares will be paid in Renminbi and dividends on H shares will be paid in Hong Kong dollars. The exchange rate for dividends to be paid in Hong Kong dollars will be the mean of the average rate of Hong Kong dollars

to Renminbi as announced by the People's Bank of China for the week prior to the date of declaration of dividends.

### PURCHASE, SALE AND REDEMPTION OF SHARES

Except for the issue of shares in connection with the Global Offering, the Company has not purchased, sold or redeemed any securities of the Company during the reporting period.

### SUMMARY OF FINANCIAL INFORMATION

Please refer to pages 115 to 116 in this annual report for a summary of the operating results and financial condition of the Group for each of the years in the four year period ended 31 December 2002.

### BANK LOANS AND OTHER BORROWINGS

Please refer to note 13 of the audited financial statements for details of bank loans and other borrowings of the Group.

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### CAPITALISED INTEREST

Please refer to note 23 of the audited financial statements for details of the Group's capitalised interest for the year ended 31 December 2002.

### FIXED ASSETS

Please refer to note 3 of the audited financial statements for movements in the fixed assets of the Group for the year ended 31 December 2002.

### TRUST DEPOSITS AND OVERDUE FIXED DEPOSITS

As at 31 December 2002, the Group did not have any trust deposits or any overdue fixed deposits with financial institutions or any other units.

### RESERVES

Pursuant to Article 147 of the Company's articles of association (the "Articles of Association"), where the financial statements prepared in accordance with PRC accounting standards and regulations materially differ from those prepared in accordance with either international accounting standards, or those of the place outside the PRC where the Company's shares are listed, the distributable profit for the relevant accounting period shall be deemed to be the lesser of the amounts shown in those respective financial statements. Distributable reserves of the Company as at 31 December 2002, calculated based on the above and prior to the proposed final dividend for 2002, amounted to approximately RMB6,497 million.

In addition to the allocation to the statutory reserve funds, the Directors propose to allocate RMB6,497 million to a discretionary surplus reserve. The allocation proposal shall be submitted for consideration at the annual general meeting to be held on 20 June 2003.

Please also refer to note 19 of the audited financial statements for details of the movements in the reserves of the Company and of the Group for the year ended 31 December 2002.

### DONATIONS

For the year ended 31 December 2002, the Group made charitable and other donations totaling RMB23 million.

### SUBSIDIARIES AND ASSOCIATED COMPANIES

Please refer to notes 5 and 6 of the audited financial statements for details of the Company's subsidiaries and the Group's interests in associated companies as at 31 December 2002.

### CHANGES IN SHAREHOLDERS' EQUITY

Please refer to page 68 of this annual report for the consolidated statement of shareholders' equity.

### RETIREMENT BENEFITS

Please refer to note 33 of the audited financial statements for details of the retirement benefits of the Group.



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### PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights in the Articles of Association requiring the Company to offer new shares to the existing shareholders in proportion to their shareholdings.

### USE OF PROCEEDS

The net proceeds from the Global Offering, after deduction of fees and expenses, amounted to RMB10,659 million. As at 31 December 2002, these proceeds have been deposited in interest-bearing accounts as short-term deposits and will be used for the expansion and upgrading of the Company's telecommunications network infrastructure, the improvement of the Company's business operation supporting systems and the development of telecommunications applications and technologies

### CONNECTED TRANSACTIONS

During the year ended 31 December 2002, the Group had the following connected transactions expenditures:

Transaction	Amount (in RMB millions)	Annual limit (in RMB millions)
Payment of costs associated with the provision of management services (part of centralised services)	69	N/A <sup>1</sup>
Payment of costs associated with international telecommunications facilities (part of centralised services)	414	N/A <sup>1</sup>
Payment of interconnection fees to China Telecommunications Corporation	687	N/A <sup>1</sup>
Payment of interconnection fees to the Company by China Telecommunications Corporation	302	N/A <sup>1</sup>
Leasing of optic fibers from China Telecommunications Corporation	102	N/A <sup>1</sup>
Provision of engineering services by China Telecom Group	3,243	4,392
Leasing of properties from China Telecom Group	266	N/A <sup>1</sup>

as originally proposed in the Company's prospectus. The remaining amount will be used to fund potential acquisitions from China Telecommunications Corporation and its subsidiaries ("China Telecom Group") and strategic investments in the telecommunications industry in China that are consistent with our business strategies and for general corporate purposes.

### MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2002, sales to the five largest customers represented an amount not exceeding 30% of the operating revenue of the Group.

For the year ended 31 December 2002, purchases from the five largest equipment suppliers represented an amount not exceeding 30% of the total purchases of the Group.

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Transaction	Amount (in RMB millions)	Annual limit (in RMB millions)
Leasing of properties by the Group to China Telecom Group	3	N/A <sup>1</sup>
Provision of third party property sub-leasing by China Telecom Group	321	N/A <sup>1</sup>
Provision of IT services by China Telecom Group	151	N/A <sup>1</sup>
Provision of equipment procurement services by China Telecom Group	78 <sup>2</sup>	N/A <sup>1</sup>
Provision of community services by China Telecom Group	1,291	2,639
Provision of ancillary telecommunications services by China Telecom Group	1,219	1,510
Provision of special communications services to China Telecom Group	28	N/A <sup>1</sup>

1 Since these transactions are all on normal commercial terms in which the total consideration of each transaction is not expected to exceed 3 percent of the book value of the net tangible assets of the Company as at 31 December 2002 and therefore Rule 14.25(1) of the Listing Rules shall apply. Since no waivers have been applied for, no specific annual limits have been set.

2 Following the transfer of China Telephony Directory Company in September 2002 from China Telecom Group to China Netcom Group, which is not a connected party, the Company has subsequently adjusted the amount incurred under the equipment procurement agreements.

For further details of the connected transactions please refer to pages 44 to 50 of this annual report.

The independent non-executive Directors have confirmed that all connected transactions in the year ended 31 December 2002 to which the Group was a party:

1. had been entered into, and the agreements governing those transactions were entered into, by the Group in the ordinary and usual course of business;

2. had been entered into either:

(i) on normal commercial terms; or

(ii) where there was no available comparison to judge whether they are on normal commercial terms, on terms no less favourable than those available to or from independent third parties; and

3. had been entered into on terms that are fair and reasonable so far as the independent shareholders of the Company are concerned.

The independent non-executive Directors have further confirmed that:

1. the aggregate annual value of the Group's expenditure for engineering services has not exceeded the limit of RMB4,392 million;

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2. the aggregate annual value of the Group's expenditure for community services has not exceeded the limit of RMB2,639 million; and
3. the aggregate annual value of ancillary telecommunications services has not exceeded the limit of RMB1,510 million.

The auditors of the Group have reviewed the connected transactions and confirmed to the Directors that the transactions:

1. have received the approval of the Directors of the Company;
2. have been entered into in accordance with the pricing policies as stated in the relevant agreements, where applicable;
3. have been entered into in accordance with the terms of the agreements governing such transactions; and
4. the aggregate annual value of the Group's expenditure for engineering services, community services and ancillary telecommunications services, respectively, has not exceeded the limits of RMB4,392 million, RMB2,639 million and RMB1,510 million, respectively.

### EMPLOYEES

As at 31 December 2002, the Group had 102,647 employees illustrated as follows:

	Number of employees	Percentage
Management, finance and administration	18,200	17.7
Sales and marketing	27,263	26.6
Operations and maintenance	52,581	51.2
Others	4,603	4.5
<b>Total</b>	<b>102,647</b>	<b>100.0</b>

As at 31 December 2002, the Group also had 39,714 temporary employees.

The Company has implemented a short-term and long-term combined incentive remuneration scheme: the primary components of an employee's remuneration include basic salary, bonus based on performance, compensation based on seniority and share appreciation rights (share appreciation rights are exclusively for senior management and senior technological experts). In addition, the Company also emphasises the importance of employee training and uses various means of training to improve the quality and capability of its employees.

### COMPLIANCE WITH CODE OF BEST PRACTICE

Throughout the period commencing from the date of the listing of the Company's H shares on The Stock Exchange of Hong Kong Limited on 15 November 2002 through to 31 December 2002, the Company was in compliance with the Code of Best Practice as set out in the Listing Rules.

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### SUBSTANTIAL INTERESTS IN THE SHARE CAPITAL OF THE COMPANY

The Company has been notified of the following interests in the Company's issued shares as at 31 December 2002 amounting to 10% or more of the ordinary shares in issue:

	Ordinary shares held	Percentage of Total Issued Shares
China Telecommunications Corporation	58,809,120,182	77.78%

Apart from the foregoing, no person or corporation had any interests in the share capital of the Company as recorded in the register required to be kept under section 16(1) of the SDIO as having an interest in 10% or more of the issued share capital of the Company.

### MATERIAL LEGAL PROCEEDINGS

As at 31 December 2002, as far as the Directors are aware of, the Group was not involved in any material litigation or arbitration and no material litigation claims were pending or threatened or made against the Group.



### AUDITORS

KPMG Huazhen and KPMG were appointed as the domestic and international auditors of the Company respectively for the year ended 31 December 2002. KPMG has audited the accompanying financial statements which have been prepared in accordance with International Financial Reporting Standards. The Company has retained KPMG Huazhen and KPMG since the date of its listing. A resolution for the reappointment of KPMG Huazhen and KPMG as the domestic and international auditors of the Company for the year ending 31 December 2003 will be proposed at the annual general meeting of the Company to be held on 20 June 2003.

By Order of the Board  
**Zhou Deqiang**  
*Chairman*

Beijing, PRC  
24 April 2003