

## REPORT OF THE DIRECTORS

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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 2003.

### ACQUISITION BY THE COMPANY

On 31 December 2003, the Company completed the Acquisition of the Acquired Companies, which are the leading providers of wireline telecommunications services, including wireline telephone, managed data, Internet and leased line services in their service areas.

**DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT OF THE COMPANY**

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

Name	Age	Position in the Company	Date of Appointment
Zhou Deqiang	62	Chairman of the Board of Directors and Chief Executive Officer	10 September 2002
Chang Xiaobing	47	Executive Director, President and Chief Operating Officer	10 September 2002
Wu Andi	49	Executive Director, Executive Vice President and Chief Financial Officer	10 September 2002
Zhang Jiping	48	Executive Director and Executive Vice President	10 September 2002
Huang Wenlin	50	Executive Director and Executive Vice President	10 September 2002
Li Ping	50	Executive Director, Executive Vice President and Company Secretary	10 September 2002
Wei Leping	58	Executive Director and Executive Vice President	10 September 2002
Cheng Xiyuan	60	Executive Director	10 September 2002
Feng Xiong	58	Executive Director	10 September 2002
Zhang Youcai	63	Independent Non-executive Director	10 September 2002
Vincent Lo Hong Sui	56	Independent Non-executive Director	10 September 2002
Shi Wanpeng	67	Independent Non-executive Director	20 June 2003
Wang Qi	49	Controller	10 September 2002

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The following table sets forth certain information concerning the senior management of the Company's provincial subsidiaries:

Name	Age	Position in the Company's Provincial Subsidiaries	Date of Appointment
Cheng Xiyuan	60	Chairman and President of Shanghai Telecom Company Ltd.	28 September 2002
Feng Xiong	58	Chairman and President of Guangdong Telecom Company Ltd.	28 September 2002
Sun Jiuming	57	Chairman and President of Jiangsu Telecom Company Ltd.	19 October 2002
Wang Jirong	50	Chairman and President of Zhejiang Telecom Company Ltd.	10 October 2002
Zhang Jun'an	47	Chairman and President of Anhui Telecom Company Ltd.	19 August 2003
Liu Yaoming	52	Chairman and President of Fujian Telecom Company Ltd.	19 August 2003
Ke Ruiwen	40	Chairman and President of Jiangxi Telecom Company Ltd.	12 September 2003
Sun Junyan	42	Chairman and President of Guangxi Telecom Company Ltd.	19 August 2003
Zou Bingxuan	54	Chairman and President of Chongqing Telecom Company Ltd.	19 August 2003
Sun Kangmin	46	Chairman and President of Sichuan Telecom Company Ltd.	19 August 2003

## SUPERVISORS OF THE COMPANY

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

Name	Age	Position in the Company	Date of Appointment
Zhang Xiuqin	57	Chairperson of Supervisory Committee	10 September 2002
Wang Huanhui	59	Employee Representative Supervisor	1 April 2003
Zhu Lihao	63	Independent Supervisor	10 September 2002
Xie Songguang	55	Supervisor	10 September 2002
Li Jing	38	Supervisor	10 September 2002

### DIRECTORS' AND SUPERVISORS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2003, none of the Directors and Supervisors of the Company had any interests or short positions in the shares, underlying shares of equity derivatives or debentures of the Company or its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)) (the "SFO") as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

As at 31 December 2003, the Company has not granted its Directors or Supervisors, or their respective spouses or children below the age of 18 any rights to subscribe for the shares or debentures of the Company or any of its associated corporations and none of them has ever exercised any such right to subscribe for the shares or debentures.

### DIRECTORS' INTEREST IN CONTRACTS AND SERVICE CONTRACTS

Save for Mr Shi Wanpeng, all the existing Directors have entered into a service contract with the Company for a term of three years. The term for Mr Shi Wanpeng is two years.

Save as the service contracts mentioned above, for the year ended 31 December 2003, the Directors did not have any material interests, whether directly or indirectly, in any material contracts entered into by the Company, any of its holding companies or subsidiaries or subsidiaries of the Company's holding companies.

### EMOLUMENTS OF 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.

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### SHARE CAPITAL

The Company did not issue any new shares in the year of 2003. The share capital of the Company as at 31 December 2003 was RMB75,614,186,503 divided into 75,614,186,503 shares with a par value of RMB1.00 each. As at 31 December 2003, the share capital of the Company comprised:

Shares	Number of shares as at 31 December 2003	Percentage of the total number of shares in issue as at 31 December 2003 (%)
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
Total of H shares (including ADS):	8,027,410,000	10.62
Total	75,614,186,503	100.00

## RESULTS

Results of the Group for the year ended 31 December 2003 and the financial position of the Company and the Group as at that date are set out in the audited financial statements on pages 65 to 121 in this annual report.

## DIVIDEND

The Directors propose to declare a final dividend of HK\$0.065 per share, totalling approximately RMB5,210 million for the year ended 31 December 2003. The dividend proposal shall be submitted for consideration at the annual general meeting to be held on 3 May 2004. 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

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 127 to 128 in this annual report for a summary of the operating results, assets and liabilities of the Group for each of the years in the five-year period ended 31 December 2003.

## 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.

## 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 2003.

## 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 2003.

## TRUST DEPOSITS AND OVERDUE FIXED DEPOSITS

As at 31 December 2003, the Company 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 2003, calculated based on the above and prior to the proposed final dividend for 2003, amounted to approximately RMB14,212 million.

In addition to the allocation to the statutory reserve funds, the Directors propose to make an allocation to a discretionary surplus reserve. The allocation proposal shall be submitted for consideration at the annual general meeting to be held on 3 May 2004.

Please also refer to note 19 of the audited financial statements for details of the movements in the reserves of the Company and the Group for the year ended 31 December 2003.

### DONATIONS

For the year ended 31 December 2003, the Group made charitable and other donations totalling RMB28 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 2003.

### CHANGES IN SHAREHOLDERS' EQUITY

Please refer to the consolidated statement of shareholders' equity contained in the audited financial statements (page 70 of this annual report).

### RETIREMENT BENEFITS

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

### STOCK APPRECIATION RIGHTS

Please refer to note 34 of the audited financial statements for details of the stock appreciation rights plan offered by the Company.

**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 use of the proceeds raised from the global offering of the H shares by the Company in 2002 complies with the purposes disclosed in the Prospectus.

**MAJOR CUSTOMERS AND SUPPLIERS**

For the year ended 31 December 2003, 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 2003, purchases from the five largest equipment suppliers represented an amount not exceeding 30% of the total purchases of the Group.

**CONNECTED TRANSACTIONS**

The following table sets out the connected transactions with respect to the Company (without the Acquired Companies), the related party transactions with respect to the Acquired Companies and the combined ten regions' amounts, respectively during the year ended 31 December 2003. Since the Company's acquisition was only completed on 31 December 2003, prior to the completion of the acquisition, the relevant related party transactions entered into by the Acquired Companies or their subsidiaries with any connected persons of the Company do not constitute connected transactions within the meaning of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (hereinafter referred to "the Listing Rules"). Accordingly, the transaction amounts with respect to the Acquired Companies and the combined 10 regions' amounts are presented for information purpose only and have been disregarded for the purpose of determining whether the annual limits for connected transactions, as set out in the waiver letter dated 28 October 2002 issued by The Stock Exchange of Hong Kong Limited, have been exceeded.



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Transaction	The Company (without the Acquired Companies)	The Acquired Companies	Combined 10 regions' amount	Annual limit for connected transactions <sup>2</sup>
	(in RMB millions)	(in RMB millions)	(in RMB millions)	(in RMB millions)
Payment of costs associated with the provision of corporate management services (part of centralised services)	105	—	105	n/a <sup>1</sup>
Payment of costs associated with international telecommunications facilities (part of centralised services)	264	—	264	n/a <sup>1</sup>
Payment of interconnection fees to China Telecommunications Corporation	685	—	685	n/a <sup>1</sup>
Payment of interconnection fees to the Company by China Telecommunications Corporation	253	—	253	n/a <sup>1</sup>
Leasing of optic fibres from China Telecommunications Corporation	91	—	91	n/a <sup>1</sup>
Provision of engineering services by China Telecommunication Corporation and its subsidiaries (the "China Telecom Group")	3,493	1,787	5,280	4,392
Leasing of properties from China Telecom Group	256	34	290	n/a <sup>1</sup>
Leasing of properties by the Company to China Telecom Group	16	—	16	n/a <sup>1</sup>
Provision of third party property sub-leasing by China Telecom Group	187	60	247	n/a <sup>1</sup>
Provision of IT services by China Telecom Group	100	30	130	n/a <sup>1</sup>
Provision of equipment procurement services by China Telecom Group	171	42	213	n/a <sup>1</sup>
Provision of community services by China Telecom Group	1,403	447	1,850	2,639
Provision of ancillary telecommunications services by China Telecom Group	751	235	986	1,510
Provision of special communications services to China Telecom Group	56	—	56	n/a <sup>1</sup>

1. All these connected transactions have been entered into on normal commercial terms and the transaction amount of each category was not expected to exceed 3% of the book value of the Company's net tangible assets as at 31 December 2003. In accordance with Rule 14.25(1) of the Listing Rules, there shall be no need to apply for any waiver and therefore, no annual limit has been set.
2. The annual limits for the connected transactions are in relation to the connected transactions amounts of the Company (without the Acquired Companies).

For further details of the connected transactions, please refer to pages 51 to 58 of this annual report.

The independent non-executive Directors have confirmed that all connected transactions in the year ended 31 December 2003 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, where applicable; and
3. had been entered into on terms that are fair and reasonable so far as the overall interest of 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;
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 the Group's expenditure for ancillary telecommunications services has not exceeded the limit of RMB1,510 million.

The auditors of the Group have reviewed the connected transactions of the Company (without the Acquired Companies) and confirmed to the Directors that the transactions:

1. have received the approval of the Directors;
2. have been entered into in accordance with the pricing policies as stated in the relevant agreements;

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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 has not exceeded the limit of RMB4,392 million, RMB2,639 million and RMB1,510 million respectively.

### EMPLOYEES

As at 31 December 2003, the Group had 163,874 employees illustrated as follows:

	Number of employees	Percentage
Management, finance and administration	25,077	15.3%
Sales and marketing	73,387	44.8%
Operations and maintenance	64,339	39.3%
Others	1,071	0.6%
Total	163,874	100%

As at 31 December 2003, the Group also had 65,548 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 stock appreciation rights plan (stock 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 key employees.

### 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, except that Mr Tan Ming, a member of the Company's audit committee, is not a non-executive director of the Company. Mr Tan Ming is an employee representative on the Company's audit committee, and his appointment on such committee complies with regulatory requirements in the United States (where the Company's ADS are listed).

## MATERIAL INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES OF THE COMPANY

As at 31 December 2003, the interests or short positions of substantial shareholders who are entitled to exercise or control the exercise of 10% or more of the voting power at any of the Company's general meetings and other persons who are required to disclose their interests pursuant to Part XV of the SFO (including those who are entitled to exercise or control the exercise of 5% or more of the voting power at any of the Company's general meetings, but excluding the Directors and Supervisors) in the shares and underlying shares of equity derivatives of the Company as recorded in the register required to be kept under Section 336 of the SFO are as follows:

### (1) (a) Interests in domestic shares and H shares of the Company

Name of Shareholder	Number and type of shares held	% of the total issued share capital of that type of shares	Capacity
China Telecommunications Corporation	58,809,120,182 domestic shares	87.01%	Principal
Guangdong Rising Assets Management Co., Ltd.	5,658,608,387 domestic shares	8.37%	Principal
The Capital Group Companies, Inc.	783,984,000 H shares	9.77%	Investment manager
Huawei Tech. Investment Co., Limited	737,770,000 H shares	9.19%	Beneficial owner
J.P. Morgan Chase & Co.	681,938,957 H shares	8.50%	Beneficial owner; investment manager; others (shares available for lending)
FMR Corp	484,722,000 H shares	6.04%	Investment manager

### (b) Interests in underlying shares of the Company

In the register required to be kept under Section 336 of the SFO, no long positions of substantial shareholders or other persons who are required to disclose their interests pursuant to Part XV of the SFO were recorded to hold any interests in the underlying shares of equity derivatives of the Company.

### (2) Short position in shares and underlying shares of the Company

In the register required to be kept under Section 336 of the SFO, China Telecommunications Corporation held short positions in 977,004,913 domestic shares which amounted to 1.45% of the total issued domestic shares. This short position is created as part of a reform plan approved by the State Council on the administration of rural telecommunications services, in which China Telecommunications Corporation agreed to transfer 977,004,913 shares of the Company to Fujian Electronic Information (Group) Co., Ltd.. Such transfer will only be made after the satisfaction of certain conditions precedent. The transfer will not be carried out before 10 September 2005.

Save as stated above, as at 31 December 2003, in the register required to be kept under Section 336 of the SFO, no other

persons were recorded to hold any interests or short positions in the shares or underlying shares of the equity derivatives of the Company.

### MATERIAL LEGAL PROCEEDINGS

As at 31 December 2003, as far as the Directors are aware of, the Company was not involved in any material litigation or arbitration and no material litigation claims were pending or threatened or made against the Company.

### AUDITORS

KPMG and KPMG Huazhen were appointed as the international and domestic auditors of the Company respectively for the year ended 31 December 2003. KPMG has audited the accompanying financial statements which have been prepared in accordance with International Financial Reporting Standards. The Company has retained KPMG and KPMG Huazhen since the date of its listing. A resolution for the reappointment of KPMG and KPMG Huazhen as the international and domestic auditors of the Company for the year ending 31 December 2004 will be proposed at the 2003 annual general meeting of the Company to be held on 3 May 2004.

By Order of the Board

**Zhou Deqiang**

*Chairman and Chief Executive Officer*

Beijing, PRC

17 March 2004