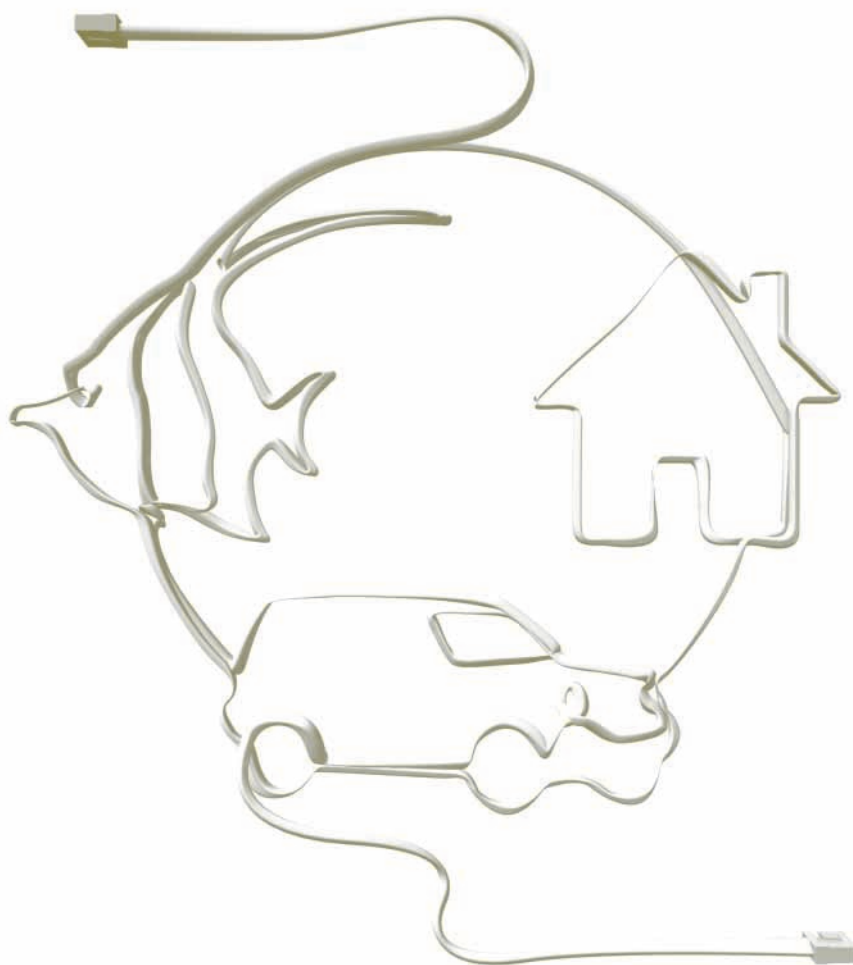


CHINA TELECOM CORPORATION LIMITED



INTERIM REPORT 2003

# Sharing the Very Best of this Information Age



## INTERIM REPORT 2003

The directors (the "Directors") of China Telecom Corporation Limited (the "Company") are pleased to present the unaudited financial statements of the Company and its subsidiaries (the "Group") prepared in accordance with International Financial Reporting Standards for the six months ended 30 June 2003.



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Dear Shareholders,

In the first half of 2003, we achieved a strong financial performance and maintained upward trends in our core businesses. We placed the accelerated expansion of our businesses on top of our agenda and consolidated the implementation of our strategies during this period. While improving our internal management, we fine-tuned our operating tactics in response to market changes. As a result, we maintained healthy and stable growth in our core businesses in the period.

### FINANCIAL RESULTS

In the first half of 2003, our revenue sustained stable growth, increasing 7.2% over the same period last year to a total of RMB39,536 million. Growth was driven by the continued expansion of our local subscriber base, the rapid growth in broadband subscribers, and the advancement of new value-added services. Strengthened management contributed to greater resource utilization and disciplined control over operating expenses. Our operating expenses for the period were RMB27,338 million, representing a 5.3% increase over the same period last year. EBITDA<sup>(1)</sup> grew 10.2% to RMB23,057 million, with an EBITDA margin of 58.3%. Net profit grew 9.2% to RMB9,260 million, with a net profit margin of 23.4%. Capital expenditure was RMB9,553 million in the first half of 2003.

### BUSINESS REVIEW

Our local telephone service sustained rapid expansion of its subscriber base in the first half of 2003, with wireless local access service accounting for a higher percentage of total local telephone subscribers. Our broadband service continued its fast growth and has been an

(1) Our EBITDA represents profit before net finance costs, investment income, share of profit from associates, taxation, depreciation and amortisation and minority interests.

increasingly important contributor to our revenue growth. Long distance services remained stable. Wire-line value-added services and new services experienced noticeable development.

### Local voice service

Local voice service, our pillar product, experienced steady growth in the first half of this year. Local voice revenue increased 5.5% to RMB18,488 million, accounting for 46.8% of our total revenue for the first half of 2003.

Our local subscriber base expanded by 5.34 million, increasing 9.4% from year-end 2002 to 62.20 million. The continually growing local telephone subscriber base constitutes a solid base for all of the services we offer. We intensified our efforts in developing public and enterprise telephone subscribers that yield a greater return on investment than other types of local subscribers, and added 1.03 million such new subscribers, representing 19.4% of total new subscribers, to further improve the structure of our subscriber base.

As an extension of and supplement to our local wire-line telephone service, wireless local access service provides personal communication at an attractive price, thereby enjoying strong demand in niche markets. Wireless local access subscribers reached 5.37 million, representing 8.6% of total subscribers. The continued decline in the price of local wireless access equipment has made this service a more profitable business.

Revenue from local usage increased 2.5% over the same period last year to RMB11,239 million for the first half of 2003. Local voice usage (excluding dial-up Internet access usage) was 88.7 billion pulses, representing a 3.9% increase over the same period last year. Dial-up Internet access usage totaled 22.0 billion pulses, decreased 16.2% from the same period last year.



Increasing local traffic is one of the key means by which we ensure the high quality development in our local business. We will continue to stimulate local traffic and revenue growth through enhancement of our distribution channels, provision of bundled services and flexible pricing packages, as well as the accelerated development of public telephone, calling card and new value-added services.

### Internet and Data services

Internet service performed strongly in the first half of this year. Driven by the rapid growth of our broadband service, our Internet revenue grew 60.3% to RMB2,669 million, representing 6.8% of our total revenue, an increase of 2.3 percentage points compared with the first half of 2002. Internet service has become an increasingly important revenue contributor.

We focused heavily on the development of our broadband service, continuing the implementation of active market development strategies, so as to sustain fast growth. A variety of broadband access service such as "Network Express" (ADSL access service), "Broadband Highway" (FTTX+LAN access service), and "Wing of Sky" (wireless LAN access service) were offered to meet different customers' needs, driving the fast growth of broadband subscribers. We expanded our broadband subscriber base by 85.8% between the end of 2002 and the end of June 2003, adding 1.18 million new subscribers to a total of 2.56 million subscribers. We positioned our broadband service as a premium product and the revenue per user per month remained stable in the period. Centralization of equipment procurement and economies of scale have further reduced per-line investment costs for broadband service. As such, the return on investment for our broadband service continued to increase.

While promoting our various broadband access products, we also placed special emphasis on

broadband content and applications. We strengthened cooperation with Internet content and application providers and computer manufacturers to advance their integration into our CHINAVNET platform. The value chain between end users, content and application providers and us has taken form.

Dial-up Internet subscribers numbered 11.70 million at the end of June this year, up 0.7% from the end of 2002. Total dial-up usage generated from our subscribers declined 20.9% from the same period last year to 16.1 billion minutes. The major reason for this decrease was the migration of high-end narrowband dial-up users to our broadband service. Our dial-up Internet service fosters customers' affinity for the Internet and meets the demand of a specific customer group with its ease and convenience of use. We will focus on achieving concerted development of both our dial-up and broadband services based on the dynamics between them.

Managed data service experienced fast growth over the past six months. Revenue grew 15.1% to RMB974 million, accounting for 2.5% of our total revenue. The bandwidth volume of Digital Data Network (DDN), Frame Relay (FR) and Asynchronous Transfer Mode (ATM) managed data services grew by 41.5%, 54.3% and 20.7%, respectively, over the same period last year.

### Long Distance services

Facing an increasingly competitive market situation, we adopted more flexible and effective marketing strategies for our long distance services in the first half of this year. Total domestic long distance traffic transmitted by us amounted to 19.1 billion minutes, representing a 16.8% increase over the same period last year. Our market share for domestic long distance service was 52.6% for the first half of this year, which was at a similar level to the second half of 2002. Revenue from domestic long distance



service decreased by 2.3% to RMB6,985 million, in line with our expectations. Domestic long distance revenue as a share of our total revenue decreased 1.7 percentage points from the same period last year to 17.7%. We believe the risk in our domestic long distance business was therefore further moderated.

International, Hong Kong, Macau and Taiwan long distance services recorded RMB1,668 million in revenue in the first half of 2003, up 4.2% from the same period last year. Total traffic grew 16.7% to 712 million minutes. We consolidated our market position with a market share of 63.4%, up 4.4 percentage points from the end of 2002.

#### Leased line, Interconnection and VAS services

Revenue from leased line service decreased by 9.4% to RMB1,409 million, representing 3.6% of our total revenue. In the first half of this year, we leased out a total of 88,000 digital circuits (in 2Mbps equivalents), down 6.8% from the same period last year. The major reason for this decrease was the substantial change in the demand structure for our leased line service in the first half of this year: as other telecom operators rolled out their own networks, they reduced the number of circuits leased from us. On the other hand, both the number of non-telecom operator enterprise customers and their usage have increased, partly offsetting the adverse impact of telecom operators' decreased use of our services. The risk in leased line service was reduced.

Revenue from interconnection in the first half of this year was RMB2,253 million, remaining close to the figure for the same period last year and representing 5.7% of our total revenue. Revenue from inbound local calls saw an increase while both revenue from, and expense for, long distance interconnection decreased. As a result, net interconnection income showed an increase over the same period last year.

Our wire-line value-added services experienced noticeable development. We enhanced our promotional activities for caller ID display service and increased its penetration rate by 5.2 percentage points during the first half of 2003. Meanwhile, we also made great efforts to boost our call-up information, information telephone, video conference and 17901 direct dial VoIP services and to introduce new services such as "Telephone QQ" and "Walk With Me". Revenue from value-added services rose significantly and its weight in our total revenue also increased in the first half of this year.

#### SUMMARY AND OUTLOOK

Our major services displayed stable growth trends in the first half of 2003: our local subscriber base experienced fast growth and wireless local access service became a more profitable business. Our broadband service yielded outstanding results. Businesses under heavy competitive pressure, such as long distance services, saw reduced risks and solid market positions for our company. We achieved robust financial performance in the first half of 2003: operating expenses were further optimized while operating profitability was steadily improved with strong free cash flow. In the meantime, we are still facing fierce competition: local voice traffic is affected by greater mobile substitution and long distance market competition is still intensive. We will take full advantage of the opportunities presented by the strong demand for telecom services in China's domestic market and further improve our management system and the execution of our strategies. Having achieved the strong performance in the first half, we intend to continue the development of our services by focusing on the following:

***We will continue to improve our management system and to implement management innovation.*** We will adhere to our market-oriented, customer-centered and return-driven



business model, and strive to realize a business characterized by efficient management, unified and centralized resource deployment, timely response to market developments, and effective incentive schemes. We will further boost our business powered by our reform initiatives.

**We will fine-tune our operating tactics in response to market situations.** While strengthening our distribution channels, we will establish a comprehensive service network that combines distribution channels and network operations and maintenance. We will boost traffic growth through active marketing activities, improve customer satisfaction through quality customer service, and foster new markets for telecom consumption by developing and introducing new products and services, all aimed at maintaining high revenue growth.

**We will adhere to our goals of value creation for shareholders.** We are committed to maintaining rapid revenue growth outpacing growth in our expenses. We will further optimize cost and capital expenditure structures and strive to improve our return on investment.

**We will strengthen the overhaul of our human resource management.** On one hand, we will adopt market practices to recruit the employees necessary for the continued healthy development of our business. On the other hand, we will strengthen our performance evaluation and compensation systems. Our goal is to establish a first-class staff team for the Company.

**We will accelerate our IT systems upgrade.** The upgrading of our MBOSS system will provide the necessary support for our financial management and business operation analysis. Meanwhile, we will continue to improve our front-end business analysis system to help realize improved market responsiveness and higher quality customer service, as well as to support the reinforcement of our distribution channels.

Under adherence to our overriding principle of maximizing shareholder value, we will comprehensively improve our services, making every effort to operate in the best interest of our shareholders.

**Zhou Deqiang**  
Chairman and CEO

Shenzhen, PRC  
10 September 2003



To the Board of Directors of  
**China Telecom Corporation Limited**

## **INTRODUCTION**

We have been instructed by the Company to review the interim financial statements of the Company and its subsidiaries (“the Group”) set out on pages 7 to 20.

## **RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS**

The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of interim financial statements to be in compliance with the relevant provisions thereof and International Accounting Standard 34 “Interim Financial Reporting” promulgated by the International Accounting Standards Board. The interim financial statements are the responsibility of, and have been approved by, the directors.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial statements and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

## **REVIEW WORK PERFORMED**

We conducted our review in accordance with Statement of Auditing Standards 700 “Engagements to review interim financial reports” issued by the Hong Kong Society of Accountants. A review consists principally of making enquiries of Group management and applying analytical procedures to the interim financial statements and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly, we do not express an audit opinion on the interim financial statements.

## **REVIEW CONCLUSION**

On the basis of our review which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial statements for the six-month period ended 30 June 2003.

## **KPMG**

*Certified Public Accountants*

Hong Kong, China  
10 September 2003





## Consolidated Balance Sheet (Unaudited)

at 30 June 2003  
(Amounts in millions)

|   | Note | 30 June<br>2003<br>RMB | 31 December<br>2002<br>RMB<br>(Audited) |
|---|------|------------------------|---|
| <b>ASSETS</b>                                 |      |                        |   |
| <b>Non-current assets</b>                     |      |                        |   |
| Property, plant and equipment, net            |      | 145,344                | 149,165                                 |
| Construction in progress                      |      | 22,706                 | 20,319                                  |
| Lease prepayments                             |      | 2,630                  | 2,644                                   |
| Interests in associates                       |      | 429                    | 429                                     |
| Investments                                   |      | 261                    | 270                                     |
| Deferred tax assets                           |      | 5,322                  | 5,118                                   |
| Other assets                                  |      | 6,386                  | 6,405                                   |
| <b>Total non-current assets</b>               |      | <b>183,078</b>         | 184,350                                 |
| <b>Current assets</b>                         |      |                        |   |
| Inventories                                   |      | 1,153                  | 1,066                                   |
| Accounts receivable, net                      | 3    | 7,431                  | 5,961                                   |
| Prepayments and other current assets          |      | 1,747                  | 1,736                                   |
| Time deposits with maturity over three months |      | 405                    | 1,316                                   |
| Cash and cash equivalents                     | 4    | 17,835                 | 16,423                                  |
| <b>Total current assets</b>                   |      | <b>28,571</b>          | 26,502                                  |
| <b>Total assets</b>                           |      | <b>211,649</b>         | 210,852                                 |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |      |                        |   |
| <b>Current liabilities</b>                    |      |                        |   |
| Short-term debt                               |      | 16,745                 | 19,175                                  |
| Current portion of long-term debt             |      | 1,852                  | 2,219                                   |
| Accounts payable                              | 5    | 11,850                 | 14,399                                  |
| Accrued expenses and other payables           |      | 12,056                 | 10,266                                  |
| Income tax payable                            |      | 2,036                  | 3,842                                   |
| Current portion of deferred revenues          |      | 6,972                  | 7,726                                   |
| <b>Total current liabilities</b>              |      | <b>51,511</b>          | 57,627                                  |
| <b>Net current liabilities</b>                |      | <b>(22,940)</b>        | (31,125)                                |
| <b>Total assets less current liabilities</b>  |      | <b>160,138</b>         | 153,225                                 |

The notes on pages 13 to 20 form part of these interim financial statements.



Consolidated Balance Sheet (Unaudited) (Continued)  
at 30 June 2003  
(Amounts in millions)

|   | <b>30 June<br/>2003<br/>RMB</b> | 31 December<br>2002<br>RMB<br>(Audited) |
|---|---------------------------------|---|
| <b>Non-current liabilities</b>                    |                                 |   |
| Long-term debt                                    | <b>4,937</b>                    | 4,853                                   |
| Deferred revenues                                 | <b>19,580</b>                   | 21,612                                  |
| Deferred tax liabilities                          | <b>851</b>                      | 618                                     |
| <b>Total non-current liabilities</b>              | <b>25,368</b>                   | 27,083                                  |
| <b>Total liabilities</b>                          | <b>76,879</b>                   | 84,710                                  |
| <b>Minority interests</b>                         | <b>1,175</b>                    | 1,134                                   |
| <b>Shareholders' equity</b>                       |                                 |   |
| Share capital                                     | <b>75,614</b>                   | 75,614                                  |
| Reserves  | <b>57,981</b>                   | 49,394                                  |
| <b>Total shareholders' equity</b>                 | <b>133,595</b>                  | 125,008                                 |
| <b>Total liabilities and shareholders' equity</b> | <b>211,649</b>                  | 210,852                                 |

The notes on pages 13 to 20 form part of these interim financial statements.



## Consolidated Statement of Income (Unaudited)

for the six-month period ended 30 June 2003  
(Amounts in millions, except per share data)

|  | Note | Six-month periods<br>ended 30 June |                          |
|--|------|------------------------------------|--------------------------|
|  |      | 2003<br>RMB                        | 2002<br>RMB<br>(Audited) |
| <b>Operating revenues</b>                            | 6    | <b>39,536</b>                      | 36,868                   |
| <b>Operating expenses</b>                            |      |                                    |                          |
| Depreciation and amortisation                        |      | <b>(10,859)</b>                    | (10,030)                 |
| Network operations and support                       |      | <b>(9,693)</b>                     | (10,019)                 |
| Selling, general and administrative                  |      | <b>(5,476)</b>                     | (4,517)                  |
| Other operating expenses                             |      | <b>(1,310)</b>                     | (1,404)                  |
| <b>Total operating expenses</b>                      |      | <b>(27,338)</b>                    | (25,970)                 |
| <b>Operating profit</b>                              |      | <b>12,198</b>                      | 10,898                   |
| Net finance costs                                    | 7    | <b>(176)</b>                       | (421)                    |
| Investment income                                    |      | <b>2</b>                           | 1                        |
| Share of profit from associates                      |      | <b>—</b>                           | 9                        |
| <b>Profit before taxation and minority interests</b> | 8    | <b>12,024</b>                      | 10,487                   |
| Taxation   | 9    | <b>(2,743)</b>                     | (1,965)                  |
| <b>Profit before minority interests</b>              |      | <b>9,281</b>                       | 8,522                    |
| Minority interests                                   |      | <b>(21)</b>                        | (39)                     |
| <b>Profit attributable to shareholders</b>           |      | <b>9,260</b>                       | 8,483                    |
| <b>Basic earnings per share</b>                      | 11   | <b>0.12</b>                        | 0.12                     |
| <b>Weighted average number of shares</b>             |      | <b>75,614</b>                      | 68,317                   |

The notes on pages 13 to 20 form part of these interim financial statements.



## Consolidated Statement of Shareholders' Equity (Unaudited)

for the six-month period ended 30 June 2003  
(Amounts in millions)

|   |      | Share   | Capital | Share   | Revaluation | Surplus | Statutory | Other    | Retained | Total         |
|---|------|---------|---------|---------|-------------|---------|-----------|----------|----------|---------------|
|   | Note | capital | reserve | premium | reserve     | reserve | common    | reserves | earnings | shareholders' |
|   |      | RMB     | RMB     | RMB     | RMB         | RMB     | welfare   | RMB      | RMB      | equity        |
|   |      | RMB     | RMB     | RMB     | RMB         | RMB     | fund      | RMB      | RMB      | RMB           |
| Balance as at 1 January 2003                                |      | 75,614  | 20,955  | 3,362   | 4,144       | 8,121   | 1,624     | 3,984    | 7,204    | 125,008       |
| Net profit  |      | —       | —       | —       | —           | —       | —         | —        | 9,260    | 9,260         |
| Dividends   | 10   | —       | —       | —       | —           | —       | —         | —        | (673)    | (673)         |
| Revaluation surplus realised                                |      | —       | —       | —       | (4)         | —       | —         | —        | 4        | —             |
| Deferred tax on amortisation<br>of land use rights realised |      | —       | —       | —       | —           | —       | —         | (52)     | 52       | —             |
| Balance as at 30 June 2003                                  |      | 75,614  | 20,955  | 3,362   | 4,140       | 8,121   | 1,624     | 3,932    | 15,847   | 133,595       |
| (Audited)   |      |         |         |         |             |         |           |          |          |               |
| Balance as at 1 January 2002                                |      | —       | —       | —       | 4,154       | —       | —         | 4,059    | 89,272   | 97,485        |
| Net profit  |      | —       | —       | —       | —           | —       | —         | —        | 8,483    | 8,483         |
| Balance as at 30 June 2002                                  |      | —       | —       | —       | 4,154       | —       | —         | 4,059    | 97,755   | 105,968       |

The notes on pages 13 to 20 form part of these interim financial statements.



## Consolidated Statement of Cash Flow (Unaudited)

for the six-month period ended 30 June 2003  
(Amounts in millions)

|   | Note | Six-month periods<br>ended 30 June |                          |
|---|------|------------------------------------|--------------------------|
|   |      | 2003<br>RMB                        | 2002<br>RMB<br>(Audited) |
| <b>Net cash from operating activities</b>                   | (a)  | <b>14,516</b>                      | 17,449                   |
| <b>Cash flows from investing activities</b>                 |      |                                    |                          |
| Capital expenditure   |      | (11,347)                           | (11,101)                 |
| Purchase of investments                                     |      | (4)                                | (36)                     |
| Lease prepayments   |      | (17)                               | (26)                     |
| Proceeds from disposal of property, plant and equipment     |      | 18                                 | 59                       |
| Increase in time deposits with maturity over three months   |      | (168)                              | (364)                    |
| Maturity of time deposits with maturity over three months   |      | 1,079                              | 473                      |
| <b>Net cash used in investing activities</b>                |      | <b>(10,439)</b>                    | (10,995)                 |
| <b>Cash flows from financing activities</b>                 |      |                                    |                          |
| Capital element of finance lease payments                   |      | —                                  | (22)                     |
| Proceeds from bank debt                                     |      | 17,900                             | 10,112                   |
| Repayments of bank debt                                     |      | (20,585)                           | (16,192)                 |
| Cash contributions from minority interests                  |      | 20                                 | —                        |
| Cash distributions to owner                                 |      | —                                  | (1,594)                  |
| <b>Net cash used in financing activities</b>                |      | <b>(2,665)</b>                     | (7,696)                  |
| <b>Net increase/(decrease) in cash and cash equivalents</b> |      | <b>1,412</b>                       | (1,242)                  |
| <b>Cash and cash equivalents at 1 January</b>               |      | <b>16,423</b>                      | 3,882                    |
| <b>Cash and cash equivalents at 30 June</b>                 |      | <b>17,835</b>                      | 2,640                    |

The notes on pages 13 to 20 form part of these interim financial statements.



(a) Reconciliation of profit before taxation and minority interests to net cash from operating activities

|  | Six-month periods<br>ended 30 June |                          |
|--|------------------------------------|--------------------------|
|  | 2003<br>RMB                        | 2002<br>RMB<br>(Audited) |
| <b>Profit before taxation and minority interests</b>             | <b>12,024</b>                      | 10,487                   |
| Adjustments for:   |                                    |                          |
| Depreciation and amortisation                                    | <b>10,859</b>                      | 10,030                   |
| Provision for doubtful accounts                                  | <b>319</b>                         | 171                      |
| Investment income  | <b>(2)</b>                         | (1)                      |
| Share of profit from associates                                  | <b>—</b>                           | (9)                      |
| Interest income  | <b>(119)</b>                       | (67)                     |
| Interest expense   | <b>616</b>                         | 656                      |
| Unrealised foreign exchange (gains) / losses                     | <b>(28)</b>                        | 193                      |
| Loss on retirement and disposal of property, plant and equipment | <b>109</b>                         | 434                      |
| Increase in accounts receivable                                  | <b>(1,789)</b>                     | (1,485)                  |
| (Increase)/decrease in inventories                               | <b>(87)</b>                        | 363                      |
| (Increase)/decrease in prepayments and other current assets      | <b>(50)</b>                        | 578                      |
| Decrease/(increase) in other non-current assets                  | <b>50</b>                          | (327)                    |
| Decrease in accounts payable                                     | <b>(417)</b>                       | (386)                    |
| Increase in accrued expenses and other payables                  | <b>818</b>                         | 774                      |
| Decrease in deferred revenues                                    | <b>(2,786)</b>                     | (2,979)                  |
| <b>Cash generated from operations</b>                            | <b>19,517</b>                      | 18,432                   |
| Interest received  | <b>119</b>                         | 67                       |
| Interest paid  | <b>(613)</b>                       | (662)                    |
| Investment income received                                       | <b>13</b>                          | —                        |
| Income tax paid  | <b>(4,520)</b>                     | (388)                    |
| <b>Net cash from operating activities</b>                        | <b>14,516</b>                      | 17,449                   |

The notes on pages 13 to 20 form part of these interim financial statements.



## 1. PRINCIPAL ACTIVITIES, ORGANISATION AND BASIS OF PREPARATION

China Telecom Corporation Limited (“the Company”) and its subsidiaries (hereinafter, collectively referred to as “the Group”) are engaged in the provision of wireline telecommunications and related services in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province of the People’s Republic of China (“the PRC”). The Group offers a comprehensive range of wireline telecommunications services to residential and business customers, including local, domestic long distance (“DLD”) and international long distance (“ILD”) telephone services, Internet and managed data, leased line, and other related services.

The Company was incorporated in the PRC on 10 September 2002 as part of the reorganisation (the “Restructuring”) of China Telecommunications Corporation (“China Telecom” and together with its subsidiaries other than the Company referred to as “China Telecom Group”), a state-owned enterprise which is under the supervision and regulation of the Ministry of Information Industry. The financial information relating to the six-month period ended 30 June 2002 included in these interim financial statements presents the results of the Group as if the Group had been in existence throughout that period and as if the operations that were transferred to the Company in connection with the Restructuring were conducted on 1 January 2002.

These interim financial statements have been prepared in accordance with International Accounting Standard 34 “Interim Financial Reporting” promulgated by the International Accounting Standards Board and the disclosure requirements of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. These interim financial statements reflect the unaudited financial position of the Group as at 30 June 2003 and the unaudited results of operations and cash flows of the Group for the six-month period then ended, which are not necessarily indicative of the results of operations and cash flows expected for the year ending 31 December 2003.

The interim financial statements set out on pages 7 to 20 have been authorised for issue by the Board of Directors on 10 September 2003. These interim financial statements are unaudited, but have been reviewed by the Audit Committee of the Company and by the Company’s international auditors, KPMG, in accordance with Statement of Auditing Standards 700 “Engagements to review interim financial reports”, issued by the Hong Kong Society of Accountants. KPMG’s independent review report to the Board of Directors is included on page 6.

The financial information relating to the financial year ended 31 December 2002 included in these interim financial statements does not constitute the Group’s statutory financial statements for that financial year but is derived from those financial statements. The statutory financial statements for the year ended 31 December 2002 are available from the Company’s registered office. The Company’s international auditors have expressed an unqualified opinion on those financial statements in their report dated 24 April 2003.

The accounting policies adopted in the 2002 annual financial statements have been consistently applied by the Group in preparing these interim financial statements.



## 2. SEGMENTAL REPORTING

A business segment is a distinguishable component of the Group that is engaged in providing products or services and is subject to risks and rewards that are different from those of other segments. For the periods presented, the Group has one operating segment which is the provision of wireline telecommunications services. All the Group's operating activities are carried out in the PRC.

## 3. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net, is analysed as follows:

|                                       | <b>30 June<br/>2003</b> | 31 December<br>2002       |
|---------------------------------------|-------------------------|---------------------------|
|                                       | <b>RMB millions</b>     | RMB millions<br>(Audited) |
| Accounts receivable                   | <b>8,110</b>            | 6,440                     |
| Less: Allowance for doubtful accounts | <b>(679)</b>            | (479)                     |
|                                       | <b>7,431</b>            | 5,961                     |

Amounts due from the provision of wireline telecommunications services to residential and business customers are due within 30 days from the date of billing. Customers who have accounts overdue by more than 90 days will have their services disconnected.

Ageing analysis of accounts receivable from telephone and Internet subscribers is as follows:

|                                       | <b>30 June<br/>2003</b> | 31 December<br>2002       |
|---------------------------------------|-------------------------|---------------------------|
|                                       | <b>RMB millions</b>     | RMB millions<br>(Audited) |
| Current, within 1 month               | <b>5,967</b>            | 5,036                     |
| 1 to 3 months                         | <b>401</b>              | 352                       |
| 4 to 12 months                        | <b>408</b>              | 309                       |
| More than 12 months                   | <b>244</b>              | 130                       |
|                                       | <b>7,020</b>            | 5,827                     |
| Less: Allowance for doubtful accounts | <b>(652)</b>            | (439)                     |
|                                       | <b>6,368</b>            | 5,388                     |





### 3. ACCOUNTS RECEIVABLE, NET (Continued)

Ageing analysis of accounts receivable from other telecommunications operators and customers is as follows:

|                                       | <b>30 June<br/>2003<br/>RMB millions</b> | 31 December<br>2002<br>RMB millions<br>(Audited) |
|---------------------------------------|--|--|
| Current, within 1 month               | <b>758</b>                               | 363  |
| 1 to 3 months                         | <b>130</b>                               | 109  |
| 4 to 12 months                        | <b>142</b>                               | 85   |
| More than 12 months                   | <b>60</b>                                | 56   |
|                                       | <b>1,090</b>                             | 613  |
| Less: Allowance for doubtful accounts | <b>(27)</b>                              | (40)   |
|                                       | <b>1,063</b>                             | 573  |

### 4. CASH AND CASH EQUIVALENTS

|   | <b>30 June<br/>2003<br/>RMB millions</b> | 31 December<br>2002<br>RMB millions<br>(Audited) |
|---|--|--|
| Cash at bank and in hand                        | <b>12,912</b>                            | 11,574   |
| Time deposits with maturity within three months | <b>4,923</b>                             | 4,849  |
|   | <b>17,835</b>                            | 16,423   |

### 5. ACCOUNTS PAYABLE

Accounts payable is analysed as follows:

|                     | <b>30 June<br/>2003<br/>RMB millions</b> | 31 December<br>2002<br>RMB millions<br>(Audited) |
|---------------------|--|--|
| Third parties       | <b>9,203</b>                             | 11,505   |
| China Telecom Group | <b>2,647</b>                             | 2,894  |
|                     | <b>11,850</b>                            | 14,399   |



## 5. ACCOUNTS PAYABLE (Continued)

Amounts due to China Telecom Group are repayable in accordance with normal commercial terms.

Ageing analysis of accounts payable is as follows:

|  | <b>30 June<br/>2003</b> | 31 December<br>2002       |
|--|-------------------------|---------------------------|
|  | <b>RMB millions</b>     | RMB millions<br>(Audited) |
| Due within 1 month or on demand        | <b>1,639</b>            | 1,715                     |
| Due after 1 month but within 3 months  | <b>3,356</b>            | 2,701                     |
| Due after 3 months but within 6 months | <b>4,625</b>            | 3,329                     |
| Due after 6 months                     | <b>2,230</b>            | 6,654                     |
|  | <b>11,850</b>           | 14,399                    |

## 6. OPERATING REVENUES

Operating revenues represent revenues from the provision of wireline telecommunications services, net of PRC business tax and government levies. The components of the Group's operating revenues are as follows:

|                           |               | <b>Six-month periods<br/>ended 30 June</b> |                           |
|---------------------------|---------------|--|---------------------------|
|                           |               | <b>2003</b>                                | 2002                      |
|                           | <i>Note</i>   | <b>RMB millions</b>                        | RMB millions<br>(Audited) |
| Upfront connection fees   | <i>(i)</i>    | <b>2,768</b>                               | 3,058                     |
| Upfront installation fees | <i>(ii)</i>   | <b>573</b>                                 | 467                       |
| Monthly fees              | <i>(iii)</i>  | <b>6,676</b>                               | 6,083                     |
| Local usage fees          | <i>(iv)</i>   | <b>11,239</b>                              | 10,967                    |
| DLD                       | <i>(iv)</i>   | <b>6,985</b>                               | 7,148                     |
| ILD                       | <i>(iv)</i>   | <b>1,668</b>                               | 1,601                     |
| Internet                  | <i>(v)</i>    | <b>2,669</b>                               | 1,665                     |
| Managed data              | <i>(vi)</i>   | <b>974</b>                                 | 846                       |
| Interconnections          | <i>(vii)</i>  | <b>2,253</b>                               | 2,272                     |
| Leased line               | <i>(viii)</i> | <b>1,409</b>                               | 1,555                     |
| Others                    | <i>(ix)</i>   | <b>2,322</b>                               | 1,206                     |
|                           |               | <b>39,536</b>                              | 36,868                    |



## 6. OPERATING REVENUES (Continued)

Note:

- (i) Represent the amortised amount of the upfront fees received for the initial activation of wireline services.
- (ii) Represent the amortised amount of the upfront fees received for installation of wireline services.
- (iii) Represent amounts charged to customers each month for their use of the Group's telephone services.
- (iv) Represent usage fees charged to customers for the provision of telephone services.
- (v) Represent amounts charged to customers for the provision of Internet access services.
- (vi) Represent amounts charged to customers for the provision of managed data transmission services.
- (vii) Represent amounts charged to domestic and foreign telecommunications operators for delivery of calls connecting to the Group's wireline telecommunications networks.
- (viii) 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.
- (ix) Represent primarily revenues from provision of value-added telecommunications services to customers, sale and repairs and maintenance of customer-end equipment.

## 7. NET FINANCE COSTS

Net finance costs comprise:

|  | <b>Six-month periods<br/>ended 30 June</b> |                           |
|--|--|---------------------------|
|  | <b>2003</b>                                | 2002                      |
|  | <b>RMB millions</b>                        | RMB millions<br>(Audited) |
| Interest expense incurred  | <b>616</b>                                 | 656                       |
| Less: Interest expense capitalised*  | <b>(298)</b>                               | (386)                     |
| Net interest expense   | <b>318</b>                                 | 270                       |
| Interest income  | <b>(119)</b>                               | (67)                      |
| Foreign exchange losses  | <b>—</b>                                   | 218                       |
| Foreign exchange gains   | <b>(23)</b>                                | —                         |
|  | <b>176</b>                                 | 421                       |
| * Interest expense was capitalised in construction in progress<br>at the following rates per annum | <b>4.2% to 5.4%</b>                        | 4.4% to 5.6%              |



## 8. PROFIT BEFORE TAXATION AND MINORITY INTERESTS

Profit before taxation and minority interests is arrived at after charging:

|                         | Six-month periods<br>ended 30 June |                           |
|-------------------------|------------------------------------|---------------------------|
|                         | 2003                               | 2002                      |
|                         | RMB millions                       | RMB millions<br>(Audited) |
| Personnel expenses      | 5,091                              | 3,393                     |
| Interconnection charges | 1,289                              | 1,391                     |

## 9. TAXATION

Taxation in the consolidated statement of income comprises:

|                              | Six-month periods<br>ended 30 June |                           |
|------------------------------|------------------------------------|---------------------------|
|                              | 2003                               | 2002                      |
|                              | RMB millions                       | RMB millions<br>(Audited) |
| Provision for PRC income tax | 2,714                              | 2,169                     |
| Deferred taxation            | 29                                 | (204)                     |
|                              | 2,743                              | 1,965                     |

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 and branches of the Group which are taxed at a preferential rate of 15%.

## 10. DIVIDENDS

Pursuant to the shareholders' approval at the Annual General Meeting held on 20 June 2003, a final dividend of RMB0.008897 per share totalling RMB673 million in respect of the year ended 31 December 2002 was declared and was paid on 10 July 2003.

The Board of Directors has resolved not to pay an interim dividend for the year ending 31 December 2003.



## 11. BASIC EARNINGS PER SHARE

The calculation of basic earnings per share for the six-month period ended 30 June 2003 is based on the net profit of RMB9,260 million and the weighted average number of shares in issue during the period of 75,614,186,503 shares. The calculation of basic earnings per share for the six-month period ended 30 June 2002 is based on the net profit of RMB8,483 million divided by 68,317,270,803 shares as if the 68,317,270,803 shares issued and outstanding upon the legal formation of the Company on 10 September 2002 had been outstanding for the six-month period ended 30 June 2002.

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

## 12. CAPITAL COMMITMENTS

As at 30 June 2003, the Group had capital commitments as follows:

|  | <b>30 June<br/>2003</b> | 31 December<br>2002       |
|--|-------------------------|---------------------------|
|  | <b>RMB millions</b>     | RMB millions<br>(Audited) |
| Authorised and contracted for                  |                         |                           |
| Properties                                     | <b>963</b>              | 800                       |
| Telecommunications network plant and equipment | <b>2,634</b>            | 3,439                     |
|  | <b>3,597</b>            | 4,239                     |
| Authorised but not contracted for              |                         |                           |
| Properties                                     | <b>1,126</b>            | 1,359                     |
| Telecommunications network plant and equipment | <b>4,652</b>            | 3,640                     |
|  | <b>5,778</b>            | 4,999                     |



### 13. RELATED PARTY TRANSACTIONS

The principal related party transactions which were carried out in the ordinary course of business with China Telecom Group, are as follows:

|   |       | Six-month periods<br>ended 30 June |                                   |
|---|-------|------------------------------------|-----------------------------------|
|   | Note  | 2003<br>RMB millions               | 2002<br>RMB millions<br>(Audited) |
| Purchases of telecommunications equipment and materials       | (i)   | 45                                 | 87                                |
| Construction, engineering and information technology services | (ii)  | 985                                | 1,112                             |
| Provision of community services                               | (iii) | 571                                | 622                               |
| Provision of ancillary services                               | (iv)  | 409                                | 419                               |
| Operating lease expenses                                      | (v)   | 181                                | 184                               |
| Centralised service expenses                                  | (vi)  | 144                                | 339                               |
| Interconnection revenues                                      | (vii) | 99                                 | 151                               |
| Interconnection charges                                       | (vii) | 280                                | 392                               |

*Note:*

- (i) Represent purchases of telecommunications equipment and materials from China Telecom Group.
- (ii) Represent provision of network construction, engineering and information technology services to the Group by China Telecom Group.
- (iii) Represent amounts paid and payable by the Group to China Telecom Group in respect of cultural, educational, hygiene and other community services.
- (iv) Represent amounts paid and payable by the Group to China Telecom Group in respect of ancillary services such as repairs and maintenance of telecommunications equipment and facilities and certain customer services.
- (v) Represent amounts paid and payable to China Telecom Group for operating leases in respect of business premises and inter-provincial transmission optic fibres.
- (vi) Represent net amount charged by China Telecom to the Group for costs associated with common corporate services and international telecommunications facilities.
- (vii) Represent amounts charged from/to China Telecom for interconnection of domestic long distance telephone calls.

The directors of the Company are of the opinion that the above transactions with related parties were conducted in the ordinary course of business and on normal commercial terms or in accordance with the agreements governing such transactions, and this has been confirmed by the independent non-executive directors.



*Certain statements contained in this Interim Report may be viewed as “forward-looking statements” within the meaning of Section 27A of the U.S. Securities Act of 1933, as amended, and Section 21E of the U.S. Securities Exchange Act of 1934, as amended. Such forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause the actual performance, financial condition or results of operations of the Company to be materially different from any future performance, financial condition or results of operations implied by such forward-looking statements. Further information regarding these risks, uncertainties and other factors is included in the Company’s most recent Annual Report on Form 20-F filed with the U.S. Securities and Exchange Commission (the “SEC”) and in the Company’s other filings with the SEC.*

**The Group’s accounting policies conform with IFRS which differ in certain significant respects from accounting principles generally accepted in the United States of America (“US GAAP”). Differences which have a significant effect on net profit and shareholders’ equity are set out below. The US GAAP reconciliation presented below is included as supplemental information and is not required as part of the basic interim financial statements and has not been subject to independent audit or review.**

### **(a) REVALUATION OF PROPERTY, PLANT AND EQUIPMENT**

In connection with the Restructuring, the property, plant and equipment of the Group were revalued as at 31 December 2001. The net revaluation deficit has been reflected in the consolidated financial statements as at 31 December 2001. Such revaluation resulted in an increase directly to shareholders’ equity of RMB4,154 million with respect to the increase in carrying amount of certain property, plant and equipment above their historical cost bases, and a charge to income of RMB11,930 million with respect to the reduction in carrying amount of certain property, plant and equipment below their historical cost bases.

Under US GAAP, property, plant and equipment are stated at their historical cost less accumulated depreciation unless an impairment loss has been recorded. An impairment loss on property, plant and equipment is recorded under US GAAP if the carrying amount of such asset exceeds its future undiscounted cash flows resulting from the use of the asset and its eventual disposition. The future undiscounted cash flows of the Group’s property, plant and equipment, whose carrying amount was reduced in connection with the Restructuring, exceed the historical cost carrying amount of such property, plant and equipment and, therefore, impairment of such assets is not appropriate under US GAAP. Accordingly, the revaluation reserve recorded directly to shareholders’ equity and the charge to income recorded under IFRS as a result of the Restructuring are reversed for US GAAP purposes.

However, as a result of the tax deductibility of the net revaluation deficit, a deferred tax liability related to the net revaluation deficit is created under US GAAP with a corresponding decrease in shareholders’ equity.

### **(b) DISPOSAL OF REVALUED PROPERTY, PLANT AND EQUIPMENT**

Under IFRS, on disposal of a revalued asset, the related revaluation surplus is transferred from the revaluation reserve to retained earnings. Under US GAAP, the gain and loss on disposal of an asset is determined with reference to the asset’s historical carrying amount and included in current earnings.



## RECONCILIATION OF NET PROFIT AND SHAREHOLDERS' EQUITY UNDER IFRS TO US GAAP

The effect on net profit of significant differences between IFRS and US GAAP for the six-month period ended 30 June 2003 is as follows:

|  | Six-month periods ended 30 June |                      |                      |
|--|---------------------------------|----------------------|----------------------|
|  | 2003<br>US\$ millions<br>(Note) | 2003<br>RMB millions | 2002<br>RMB millions |
| Net profit under IFRS                                  | 1,119                           | 9,260                | 8,483                |
| US GAAP adjustments:                                   |                                 |                      |                      |
| Depreciation on revalued property, plant and equipment | (92)                            | (767)                | (823)                |
| Disposal of revalued property, plant and equipment     | (3)                             | (23)                 | —                    |
| Deferred tax effect of US GAAP adjustments             | 31                              | 260                  | 271                  |
| Net profit under US GAAP                               | 1,055                           | 8,730                | 7,931                |
| Basic earnings per share under US GAAP                 | US\$0.014                       | RMB0.12              | RMB0.12              |
| Basic earnings per ADS* under US GAAP                  | US\$1.39                        | RMB11.55             | RMB11.61             |

\* Basic earnings per ADS is calculated on the basis that one ADS is equivalent to 100 H shares.

The effect on shareholders' equity of significant differences between IFRS and US GAAP as at 30 June 2003 is as follows:

|   | 30 June<br>2003<br>US\$ millions<br>(Note) | 30 June<br>2003<br>RMB millions | 31 December<br>2002<br>RMB millions |
|---|--|---------------------------------|-------------------------------------|
|   | Shareholders' equity under IFRS            | 16,139                          | 133,595                             |
| US GAAP adjustments:  |  |                                 |                                     |
| Revaluation of property, plant and equipment, net of minority interests | 640  | 5,297                           | 6,087                               |
| Deferred tax effect of US GAAP adjustment                               | (215)                                      | (1,779)                         | (2,039)                             |
| Shareholders' equity under US GAAP                                      | 16,564                                     | 137,113                         | 129,056                             |

Note:

Solely for the convenience of the reader, the amounts as at and for the six-month period ended 30 June 2003 have been translated into United States dollars at the noon buying rate in New York City on 30 June 2003 for cable transfers in RMB as certified for custom purposes by the Federal Reserve Bank of New York of US\$1.00=RMB8.2776. No representation is made that the RMB amounts could have been, or could be, converted into United States dollars at that rate or at any other certain rate on 30 June 2003, or at any other date.





## MANAGEMENT DISCUSSION AND ANALYSIS

According to paragraph 40 of Appendix 16 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, save as disclosed herein, the Company confirms that the current company information in relation to those matters set out in paragraph 32 of Appendix 16 has not changed materially from the information disclosed in the Company's 2002 Annual Report.

## INTERIM DIVIDEND

The Board of Directors of the Company has resolved that no interim dividend be paid for the six months ended 30 June 2003.

## PURCHASE, SALE OR REDEMPTION OF SECURITIES

During the period, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

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

As at 30 June 2003, none of the Directors or Supervisors had any interests or short positions in any 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 (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 Hong Kong Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

As at 30 June 2003, none of the Directors or Supervisors and their respective spouses and children under 18 years of age had been granted by the Company or had exercised any rights to subscribe for shares or debentures of the Company or any of its associated corporations.

## INTERESTS AND SHORT POSITIONS OF SUBSTANTIAL SHAREHOLDERS AND OTHER PERSONS IN SHARES AND UNDERLYING SHARES

As at 30 June 2003, the interests and short positions of substantial shareholders (being persons who are entitled to exercise, or control the exercise of, 10% or more of the voting power at any general meeting of the Company) and other persons who are required to disclose their interests pursuant to Part XV of the SFO (other than 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 were as set out below:

### (1) (a) Long positions in ordinary shares of the Company

| Name of shareholder                         | Number and type of shares held | % of issued share capital | Capacity  |
|---|--------------------------------|---------------------------|-----------|
| China Telecommunications Corporation        | 58,809,120,182 ordinary shares | 77.78%                    | Principal |
| Guangdong Rising Assets Management Co., Ltd | 5,658,608,387 ordinary shares  | 7.48%                     | Principal |



**(b) Long positions in underlying shares of the Company**

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

**(2) Short positions in shares and underlying shares of the Company**

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

Save as stated above, as at 30 June 2003, no interests or short positions of any person in the shares or underlying shares of equity derivatives of the Company were recorded in the register required to be kept under Section 336 of the SFO.

**AUDIT COMMITTEE**

The audit committee has reviewed with management and the Company's international auditors, KPMG, the accounting principles and practices adopted by the Group and discussed internal control and financial reporting matters including the review of this Interim Report.

**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 Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, 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 shares are also listed).

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

Shenzhen, PRC  
10 September 2003

**CHINA TELECOM CORPORATION LIMITED**

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