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## CHAIRMAN'S STATEMENT

Dear Shareholders,

In the first half of 2004, driven by the sustained and rapid growth of the Chinese economy, the demand for telecommunications services continued to grow with a steady increase in the total volume of voice services, further expansion of Internet services and more opportunities for the development of value-added services. At the same time, competition within the telecommunications market further intensified. Voice services were the key focus of such competition as mobile substitution became more visible. While the increased market demands have provided us with new opportunities for development, the intensified competition among telecommunications operators has brought about new challenges to us.

Faced with this challenge, we adhered to our core value of "Innovation and Solid Execution", focussed on improving our operational systems and enhancing corporate management, and consistently promoted our "market-oriented, customer-centred and return-driven" business model throughout the organisation. These measures improved our market responsiveness, product development, marketing capabilities and our ability to thrive in the market place, increasing our profitability and shareholders' value. In the first half of 2004, our local wireline services subscriber base increased by 17.51 million, reaching 178 million at the end of June and our broadband subscriber base increased by 3.66 million, reaching 10.89 million at the end of June. Driven by the strength in our local voice services and broadband Internet services, we recorded a steady growth in operating revenue which reached RMB80,217 million, an increase of 8.3% over the same period in 2003. Our EBITDA was RMB43,991 million and our net profit was RMB14,708 million, of which RMB4,236 million was generated from amortisation of connection fees.

In the first half of this year, we successfully completed the acquisition of telecommunications businesses in ten provinces. To fund the acquisition, we raised net

proceeds of approximately US\$1.5 billion through a successful offering of new H shares. With the implementation of our management system, all levels of management of the newly acquired subsidiaries have been geared towards achieving their business and financial objectives. The growth rates of these companies increased and their operating and capital expenditures were effectively controlled, thus improving their profitability. In the first half of this year, our newly acquired telecommunications subsidiaries in the ten provinces generated revenue of RMB17,916 million from their operations, an increase of 10.0% from the same period last year, and realised net profit of RMB2,553 million, of which RMB818 million was generated from amortisation of connection fees. After the Acquisition, our basic earnings per share reached RMB0.19, representing an increase of 11.8% over the same period last year. We now enjoy better growth prospects.

In the first half of this year, we further improved the management of our distribution channels, implemented the revenue-and-service-accountability system and improved the efficiency of the distribution channels, whereby a client-focussed, full coverage distribution channel system was established which has helped to stabilise the usage from our existing customers and played an important role in driving revenue growth. At the same time, we made substantial adjustments to our marketing operation management model applied by head office, including strengthening the market strategy planning and unifying brand management, unifying customer service interface and reinforcing the sales planning function. In addition, a product development centre was set up to strengthen our business innovation capability.

Since our initial public offering, our financial management has been improving continuously. The key importance of financial management in various aspects of the business continued to be emphasised, overall budget control has been more stringently implemented



and cost control has been further improved. With more centralised network maintenance and higher efficiency, our network operations and support expenses have decreased. Following our philosophy of “running the enterprise in an industrious and economical way”, we have focussed effort in cutting our administrative expenses. As a result, our management and administrative expenditure continued to decrease. However, in order to ensure the continuing growth of our core business in a competitive environment, our sales expenses increased. Capital expenditure is expected to be more proportionate between the first half and second half of this year. The first half of this year recorded a total capital expenditure of RMB25,018 million, an increase of 12.4% from the same period last year.

In the first half of this year, we continued to focus our effort on centralising our network resources management and network maintenance. A centralised control and maintenance system covering various telecommunications networks was preliminarily established in all our local branch companies. We have further centralised the management of local branch companies' resources. A transmission resources management system has been established and a conduit resources management system is taking shape. These measures will help us to realise dynamic deployment and distribution of our network resources, effectively increase the efficiency of our network operations and maintenance, and improve our market responsiveness.

In the first half of this year, Business Process Re-engineering (“BPR”) has been extensively implemented throughout the Company. 212 out of our 228 local branch companies have adopted or are adopting BPR. With BPR as our platform to implement various new management measures, we were able to expand our process management over a wider area, implement process management reform at all levels of the

business. In particular, we have made substantial progress in our process-based and integrated management of distribution channels. The implementation of BPR has accelerated the establishment of a market-oriented, process-based management system, and further enhanced our local branch companies' overall marketing abilities, market responsiveness, provisioning capabilities and network management. This has in turn improved our operating efficiency and profitability.

Further progress has been made with the development of CTG-MBOSS, an information technology platform for our businesses. The management support system (“MSS”), one of the three sub-systems of CTG-MBOSS, has been successfully launched on a trial basis at Guangdong Telecom and Shanghai Telecom. Such system will be further implemented in these two subsidiaries and extended to subsidiaries in other provinces in the second half of this year. The implementation of MSS will enable us, through information sharing, to improve our operating efficiency and financial management and standardise the management of our internal control, thus effectively minimising business risks.

## BUSINESS REVIEW

In the first half of this year, our major business lines continued to grow. The subscriber base for our local telephone services expanded rapidly and the volume of our local voice services also increased substantially. The wireless local access service made an important contribution to the growth of our business. Broadband services continued to develop at high growth rates and revenue generated therefrom accounted for a higher proportion of our total operating revenue. The domestic long distance services recorded positive growth both in terms of volume and revenue.

### Local Telephone Services

As our core business, local telephone services recorded RMB40,527 million in revenue, an increase of 7.7% from the same period last year. Local telephone revenue accounted for 50.5% of our total operating revenue, which was similar to that of last year.

As at the end of June, our local telephone subscriber base increased by 17.51 million and by 10.9% from the end of last year, reaching 178 million. The growth in wireless local access subscribers and public telephone users was particularly strong with the total number of subscribers increasing by 10.91 million and 1.43 million, respectively, from the end of last year, reaching 36.47 million and 11.03 million, respectively. Their semi-annual growth rates were 42.7% and 14.8%, respectively.

By leveraging the strengths in our distribution channels and further promoting our packaged products in the first half of this year, we generated local telephone usage fees of RMB24,072 million, an increase of 7.1% from the same period last year. At the same time, the total usage of local voice service reached 210.7 billion pulses, an increase of 13.6% from the same period last year.

The steady and rapid increase in the number of wireless local access subscribers has effectively mitigated the pressure from mobile substitution. The packaging of wireless local access with residential and business wireline services has created synergies and increased the value of wireline services. We have reduced the investment cost of the wireless local access service per subscriber by approximately 10% and have increased the utilisation of the network by approximately 3%, thus maintaining a desirable level of investment return on such business.

### Internet Services

In the first half of this year, the revenue generated from Internet services reached RMB6,602 million, an increase of 51.6% from the same period last year, and accounted for 8.2% of our total operating revenue, which increased by 2.4 percentage points over the same period last year. This line of revenue has contributed substantially to our overall growth in revenue. As at the end of June, our subscriber base for the broadband access service reached 10.89 million, an increase of 3.66 million from the end of last year or a semi-annual growth rate of 50.6%, hence strengthening our leading position in the broadband market.

We have focussed our attention on capitalising the strength of our full service portfolio. We combined broadband access with other wireline services and broadband application services and launched flexible tariff packages to create and satisfy different customer demands. The marketing strength of our broadband access products has been improved as we extended our distribution channels to full coverage. At the same time, based on "ChinaVnet" platform, we strengthened the integration of broadband application resources to encourage third party providers to join efforts in expanding the spectrum of the broadband content and applications market. As at the end of June 2004, the number of registered subscribers for "ChinaVnet" reached 4.66 million and over 200 broadband content providers nationwide joined "ChinaVnet".

While the number of broadband subscribers was increasing rapidly, their ARPU value was kept at a relatively high level. Benefiting from economies of scale and centralised procurement, the investment cost per subscriber for broadband ADSL was reduced by approximately 5%, thus maintaining a relatively high investment return rate.



### Long Distance Services

In the first half of this year, our revenue generated from domestic long distance services was RMB13,145 million, an increase of 3.6% from the same period last year. The total transmission volume for our domestic long distance services reached 39.4 billion minutes, an increase of 21.4% from the same period last year. We continued to maintain our leading position in this area.

While benefiting from increasing demands in the domestic long distance services market which was stimulated by the rapid growth of the Chinese economy, we adopted a flexible and efficient marketing strategy in the face of market competition. We maximised revenue from the domestic long distance services by adopting appropriate pricing strategies. Sales efforts were tailored to customers based on our detailed customer segmentation. For instance, we increased the density of public telephone outlets and strengthened our control over and further motivated the agency channels. These measures enabled us to maintain our strong position in the rapidly growing long distance services market for mobile population.

Revenue from international, Hong Kong, Macau and Taiwan long distance services decreased by 2.3% from the same period last year to RMB1,906 million in the first half of this year. The volume of international long distance usage was 812 million minutes, approximately the same as that of last year.

### Managed Data and Leased Line Services

In the first half of this year, revenue generated from our managed data services was RMB1,524 million, a reduction of 6.4% from the same period last year, which accounted for 1.9% of our total operating revenue. Benefiting from the accelerating progress in the use of information technology by the general

public, the leasing of standard ports of DDN, FR and ATM increased by 3.3%, 35.6% and 1.3%, respectively, from the end of 2003. On the other hand, under the pressure of competition within the market, the unit prices for our managed data services decreased.

We generated RMB2,112 million from our leased line services in the first half of this year, a reduction of 19.0% from the same period last year, which accounted for 2.6% of our total operating revenue. As at the end of June 2004, the total number of 2M digital lines leased was 146,200, a reduction of 10.4% from the end of 2003. This decrease was mainly due to the reduction in demand for leased lines from other domestic telecommunications operators.

### Interconnection Services

In the first half of this year, revenue from interconnection services was RMB5,013 million, an increase of 22.4% from the same period last year. The net interconnection revenue was RMB3,240 million, an increase of 25.0% from the same period last year. Driven by the continuous expansion of our subscriber base and the overall growth in the domestic telecommunications market, the volume of inbound local calls reached 46.2 billion minutes in the first half of this year, an increase of 32.4% from the same period last year. The volume of inbound long distance calls also increased compared to the same period last year.

### Value-added Services

We continued our efforts to develop wireline value-added services in the first half of this year and substantially increased the revenue generated from them. As at the end of June 2004, our subscribers for the caller ID service reached 98.19 million, representing a penetration rate of 55.0%, an increase of nearly 4 percentage points from the end of 2003. The semi-

annual usage volume for our telephone information service reached 1,038 million minutes, an increase of 35.0% from the same period last year. Since the launch of the SMS over wireless local access service in the first half of this year, the volume of its usage has increased substantially and the service has demonstrated great potential for further development. As an important component of wireline services, value-added services continue to be one of our key focuses and an important source of our future growth.

#### OUTLOOK FOR THE SECOND HALF OF THE YEAR

In the second half of 2004, sustained, rapid, healthy and coordinated growth of the Chinese economy is expected. Accelerating adoption of information technology in the Chinese economy will continue to drive greater demands for telecommunications services. The increasing competition in the telecommunications market will become a significant factor in our operations in the second half of 2004.

We plan to fully explore the development potential of wireline services as our pillar business, conduct comprehensive network optimisation for the wireless local access network to improve our network quality and capability of developing new businesses. Furthermore, we will consistently develop our broadband access service, expand the market for broadband applications, strengthen the development of value-added services and continuously explore new areas for our services.

We will continue to strengthen the capacities of, and improve the management of, our distribution channels. We will also continue to harmonise the relationship between marketing, products development, distribution and customers, effectively improve marketing design and planning, and improve our brand management to enhance our brand value.

We intend to continue transforming our business towards a value-driven growth model. We will also continue to improve overall budget control and budget implementation accountability, optimise cost structure, enhance management of capital expenditure and achieve a more even distribution of capital and operating expenditure. Moreover, we will further implement BPR to establish a process-based management system with a long standing effect. We will strengthen our internal control system to achieve the international best practice, so as to mitigate business risks. We will also speed up the establishment of CTG-MBOSS to provide effective IT support for our marketing and sales, operational management and internal control.

With a view to improving our human resources capital, we will continue with our human resources reforms and implement a merit-based appointment system. We will expand our talented team consisting of professional business managers, technical specialists, skilful marketing and maintenance personnel and professional administrative personnel.

We will pay close attention to new developments in the regulation of the telecommunications industry. Based on our in-depth understanding of regulatory policies, we will continue to comply with all regulatory requirements and foster a favourable business environment. Based on a win-win philosophy and through the creation of a favourable competitive environment, we will promote the healthy development of the industry.

In summary, we will adhere to our goal of becoming “a world-class telecommunications operator”. Focussing on rapid development, continued business reform, effective management and human-resources-based

strategy, we will strive to achieve the sustainable and sound development of the business and maximise shareholders' value.

**Zhou Deqiang**

*Chairman and CEO*

Beijing, PRC

1 September 2004



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 9 to 30.

## 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 “Engagement 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 2004.

**KPMG**

*Certified Public Accountants*

Hong Kong, China  
1 September 2004

## CONSOLIDATED BALANCE SHEET (UNAUDITED)

*at 30 June 2004  
(Amounts in millions)*

		30 June 2004 RMB	31 December 2003 RMB
	<i>Note</i>		
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment, net		303,725	309,896
Construction in progress		39,522	31,617
Lease prepayments		4,555	4,485
Interests in associates		500	513
Investments		237	206
Deferred tax assets	9	10,662	10,523
Other assets		13,323	13,609
<b>Total non-current assets</b>		<b>372,524</b>	<b>370,849</b>
<b>Current assets</b>			
Inventories		3,227	3,253
Accounts receivable, net	4	15,186	12,951
Prepayments and other current assets		3,715	3,695
Time deposits with maturity over three months		350	473
Cash and cash equivalents	5	16,710	12,721
<b>Total current assets</b>		<b>39,188</b>	<b>33,093</b>
<b>Total assets</b>		<b>411,712</b>	<b>403,942</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current liabilities</b>			
Short-term debt	6	65,511	56,243
Current portion of long-term debt	7	14,970	13,957
Accounts payable	8	34,591	35,629
Accrued expenses and other payables		30,300	26,004
Income tax payable		3,664	3,395
Current portion of finance lease obligations		117	50
Current portion of deferred revenues		12,656	13,857
<b>Total current liabilities</b>		<b>161,809</b>	<b>149,135</b>
<b>Net current liabilities</b>		<b>(122,621)</b>	<b>(116,042)</b>
<b>Total assets less current liabilities</b>		<b>249,903</b>	<b>254,807</b>

The notes on pages 15 to 30 form part of these interim financial statements.

CONSOLIDATED BALANCE SHEET (UNAUDITED) – (CONTINUED)

at 30 June 2004  
(Amounts in millions)

	<i>Note</i>	<b>30 June 2004 RMB</b>	31 December 2003 RMB
<b>Non-current liabilities</b>			
Long-term debt	7	<b>72,491</b>	68,632
Finance lease obligations		<b>155</b>	43
Deferred revenues		<b>29,219</b>	32,744
Deferred tax liabilities	9	<b>1,575</b>	1,325
<b>Total non-current liabilities</b>		<b>103,440</b>	102,744
<b>Total liabilities</b>		<b>265,249</b>	251,879
<b>Minority interests</b>		<b>1,349</b>	1,269
<b>Shareholders' equity</b>			
Share capital	10	<b>80,932</b>	75,614
Reserves		<b>64,182</b>	75,180
<b>Total shareholders' equity</b>		<b>145,114</b>	150,794
<b>Total liabilities and shareholders' equity</b>		<b>411,712</b>	403,942

The notes on pages 15 to 30 form part of these interim financial statements.

## CONSOLIDATED STATEMENT OF INCOME (UNAUDITED)

*for the six-month period ended 30 June 2004  
(Amounts in millions, except per share data)*

	<i>Note</i>	<b>Six-month periods ended 30 June</b>	
		<b>2004</b>	2003
		<b>RMB</b>	RMB
<b>Operating revenues</b>	11	<b>80,217</b>	74,068
<b>Operating expenses</b>			
Depreciation and amortisation		<b>(23,255)</b>	(22,666)
Network operations and support		<b>(20,325)</b>	(20,767)
Selling, general and administrative		<b>(14,105)</b>	(10,866)
Other operating expenses		<b>(1,796)</b>	(1,541)
<b>Total operating expenses</b>		<b>(59,481)</b>	(55,840)
<b>Operating profit</b>		<b>20,736</b>	18,228
Net finance costs	12	<b>(2,341)</b>	(1,728)
Investment loss		—	(85)
Share of profit from associates		<b>6</b>	—
<b>Profit before taxation and minority interests</b>	13	<b>18,401</b>	16,415
Taxation	14	<b>(3,681)</b>	(3,333)
<b>Profit before minority interests</b>		<b>14,720</b>	13,082
Minority interests		<b>(12)</b>	(24)
<b>Profit attributable to shareholders</b>		<b>14,708</b>	13,058
<b>Basic earnings per share</b>	16	<b>0.19</b>	0.17
<b>Weighted average number of shares</b>		<b>76,725</b>	75,614

The notes on pages 15 to 30 form part of these interim financial statements.

## CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (UNAUDITED)

for the six-month period ended 30 June 2004  
(Amounts in millions)

	Note	Share capital RMB	Capital reserve RMB	Share premium RMB	Revaluation reserve RMB	Surplus reserves RMB	Statutory common welfare fund RMB	Other reserves RMB	Retained earnings RMB	Total shareholders' equity RMB
Balance as at 1 January 2003, as previously reported		75,614	20,955	3,362	4,904	8,121	1,624	31,064	7,204	152,848
Adjusted for the Second Acquisition	1	—	—	—	—	—	—	34,177	—	34,177
Balance as at 1 January 2003, as adjusted		75,614	20,955	3,362	4,904	8,121	1,624	65,241	7,204	187,025
Net profit for the six-month period ended 30 June 2003		—	—	—	—	—	—	—	13,058	13,058
Contributions from China Telecom		—	—	—	—	—	—	—	215	215
Distributions to China Telecom		—	—	—	—	—	—	—	(214)	(214)
Transfer from retained earnings to other reserves		—	—	—	—	—	—	3,823	(3,823)	—
Dividends	15	—	—	—	—	—	—	—	(673)	(673)
Revaluation surplus realised		—	—	—	(4)	—	—	—	4	—
Deferred tax on land use rights realised		—	—	—	—	—	—	(76)	76	—
Balance as at 30 June 2003		75,614	20,955	3,362	4,900	8,121	1,624	68,988	15,847	199,411
Net profit for the six-month period ended 31 December 2003		—	—	—	—	—	—	—	824	824
Contributions from China Telecom		—	—	—	—	—	—	—	4,094	4,094
Distributions to China Telecom		—	—	—	—	—	—	—	(1,020)	(1,020)
Assets distributed to China Telecom in connection with the Second Acquisition	1	—	—	—	—	—	—	—	(10,762)	(10,762)
Recognition of deferred tax assets		—	—	—	—	—	—	2,209	—	2,209
Transfer from retained earnings to other reserves		—	—	—	—	—	—	(15,635)	15,635	—
Consideration for the acquisition of the First Acquired Group	1	—	—	—	—	—	—	(45,649)	—	(45,649)
Appropriations		—	—	—	—	7,340	1,748	—	(9,088)	—
Transfer from other reserves to capital reserve		—	(14,388)	—	—	—	—	14,388	—	—
Revaluation surplus		—	—	—	1,537	—	—	—	—	1,537
Eliminations of deferred tax liabilities		—	—	—	—	—	—	—	150	150
Revaluation surplus realised		—	—	—	(13)	—	—	—	13	—
Deferred tax on land use rights realised		—	—	—	—	—	—	(55)	55	—
Balance as at 31 December 2003		75,614	6,567	3,362	6,424	15,461	3,372	24,246	15,748	150,794
Issue of shares, net of issuing expenses of RMB294 million		5,318	—	7,384	—	—	—	—	—	12,702
Net profit for the six-month period ended 30 June 2004		—	—	—	—	—	—	—	14,708	14,708
Contributions from China Telecom		—	—	—	—	—	—	—	100	100
Transfer from retained earnings to other reserves		—	—	—	—	—	—	2,653	(2,653)	—
Consideration for the acquisition of the Second Acquired Group	1	—	—	—	—	—	—	(27,800)	—	(27,800)
Transfer from other reserves to capital reserve		—	(9,371)	—	—	—	—	9,371	—	—
Dividends	15	—	—	—	—	—	—	—	(5,224)	(5,224)
Revaluation surplus realised		—	—	—	(8)	—	—	—	8	—
Effect of change in tax rate	9	—	—	—	—	—	—	(166)	—	(166)
Deferred tax on land use rights realised		—	—	—	—	—	—	(74)	74	—
Balance as at 30 June 2004		80,932	(2,804)	10,746	6,416	15,461	3,372	8,230	22,761	145,114

The notes on pages 15 to 30 form part of these interim financial statements.

## CONSOLIDATED STATEMENT OF CASH FLOW (UNAUDITED)

*for the six-month period ended 30 June 2004  
(Amounts in millions)*

	<i>Note</i>	<b>Six-month periods</b>	
		<b>ended 30 June</b>	
		<b>2004</b>	2003
		<b>RMB</b>	RMB
<b>Net cash from operating activities</b>	<i>(a)</i>	<b>35,517</b>	29,558
<b>Cash flows from investing activities</b>			
Capital expenditure		<b>(26,023)</b>	(24,161)
Purchase of investments		<b>(42)</b>	(73)
Lease prepayments		<b>(125)</b>	(28)
Proceeds from disposal of property, plant and equipment		<b>136</b>	49
Increase in time deposits with maturity over three months		<b>(45)</b>	(294)
Maturity of time deposits with maturity over three months		<b>168</b>	1,262
<b>Net cash used in investing activities</b>		<b>(25,931)</b>	(23,245)
<b>Cash flows from financing activities</b>			
Capital element of finance lease payments		<b>(30)</b>	(35)
Proceeds from issue of shares, net of issuing expenses		<b>12,702</b>	—
Proceeds from bank and other loans		<b>41,129</b>	48,119
Repayments of bank and other loans		<b>(42,083)</b>	(52,424)
Payment of dividends		<b>(4,833)</b>	—
Cash contributions from minority interests		<b>68</b>	18
Cash payment for the acquisition of the Second Acquired Group		<b>(12,650)</b>	—
Cash contributions from China Telecom		<b>100</b>	292
Cash distributions to China Telecom		<b>—</b>	(224)
<b>Net cash used in financing activities</b>		<b>(5,597)</b>	(4,254)
<b>Net increase in cash and cash equivalents</b>		<b>3,989</b>	2,059
<b>Cash and cash equivalents at 1 January</b>		<b>12,721</b>	22,743
<b>Cash and cash equivalents at 30 June</b>		<b>16,710</b>	24,802

The notes on pages 15 to 30 form part of these interim financial statements.

CONSOLIDATED STATEMENT OF CASH FLOW (UNAUDITED) – (CONTINUED)

for the six-month period ended 30 June 2004  
(Amounts in millions)

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

	Six-month periods	
	ended 30 June	
	2004	2003
	RMB	RMB
<b>Profit before taxation and minority interests</b>	<b>18,401</b>	16,415
Adjustments for:		
Depreciation and amortisation	<b>23,255</b>	22,666
Provision for doubtful accounts	<b>679</b>	733
Investment loss	<b>—</b>	85
Share of profit from associates	<b>(6)</b>	—
Interest income	<b>(109)</b>	(151)
Interest expense	<b>2,522</b>	1,820
Unrealised foreign exchange (gains)/losses	<b>(56)</b>	41
Loss on retirement and disposal of property, plant and equipment	<b>65</b>	967
Increase in accounts receivable	<b>(2,914)</b>	(3,702)
Decrease/(increase) in inventories	<b>26</b>	(271)
Decrease/(increase) in prepayments and other current assets	<b>16</b>	(108)
Decrease/(increase) in other non-current assets	<b>169</b>	(2)
Increase/(decrease) in accounts payable	<b>878</b>	(456)
Increase in accrued expenses and other payables	<b>3,770</b>	3,311
Decrease in deferred revenues	<b>(4,726)</b>	(4,862)
<b>Cash generated from operations</b>	<b>41,970</b>	36,486
Interest received	<b>109</b>	151
Interest paid	<b>(3,125)</b>	(2,572)
Investment income received	<b>30</b>	13
Income tax paid	<b>(3,467)</b>	(4,520)
<b>Net cash from operating activities</b>	<b>35,517</b>	29,558

The notes on pages 15 to 30 form part of these interim financial statements.

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

### Principal activities

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, Zhejiang Province, Anhui Province, Fujian Province, Jiangxi Province, Guangxi Zhuang Autonomous Region, Chongqing Municipality, Sichuan Province, Hubei Province, Hunan Province, Hainan Province, Guizhou Province, Yunnan Province, Shaanxi Province, Gansu Province, Qinghai Province, Ningxia Hui Autonomous Region and Xinjiang Uygur Autonomous Region 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 operations of the Group are subject to the supervision and regulation by the PRC government. The Ministry of Information Industry, pursuant to the authority delegated to it by the PRC’s State Council, is responsible for formulating the telecommunications industry policies and regulations, including the regulation and setting of tariff levels for basic telecommunications services, such as local and long distance telephone services, managed data services, leased line and interconnection arrangements.

### Organisation

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. In November 2001, pursuant to a further industry restructuring plan approved by the State Council, China Telecom’s wireline telecommunications networks and related operations in 10 northern provinces, municipalities and autonomous regions of the PRC were transferred to China Netcom Group. China Telecom retained the wireline telecommunications networks and related operations of 21 provinces, municipalities and autonomous regions of the PRC, including those of the Company’s subsidiaries. In accordance with this industry restructuring plan, China Telecom and China Netcom Group own 70% and 30%, respectively, of the nationwide inter-provincial optic fibres.

for the six-month period ended 30 June 2004

## 1. PRINCIPAL ACTIVITIES, ORGANISATION AND BASIS OF PRESENTATION (Continued)

### Organisation (Continued)

Pursuant to the resolution passed by the Company's independent shareholders at an Extraordinary General Meeting held on 15 December 2003, the Company acquired the entire equity interests in Anhui Telecom Company Limited, Fujian Telecom Company Limited, Jiangxi Telecom Company Limited, Guangxi Telecom Company Limited, Chongqing Telecom Company Limited and Sichuan Telecom Company Limited (collectively the "First Acquired Group") and certain network management and research and development facilities from China Telecom for a total purchase price of RMB46,000 million on 31 December 2003 (hereinafter, referred to as the "First Acquisition"). The purchase price consisted of a cash payment of RMB11,000 million and a long-term payable of RMB35,000 million. In connection with the First Acquisition and effective 31 December 2002, China Telecom transferred the wireline telecommunications business and related operations in Anhui Province, Fujian Province, Jiangxi Province, Guangxi Zhuang Autonomous Region, Chongqing Municipality and Sichuan Province together with the related assets and liabilities in consideration for the entire equity interests in each of the entities of the First Acquired Group. Certain assets historically associated with these operations were retained by China Telecom, and as at 31 December 2002, these assets amounted to RMB5,189 million and consisted primarily of investments in non-telecommunications industries and properties.

Pursuant to the resolution passed by the Company's independent shareholders at an Extraordinary General Meeting held on 9 June 2004, the Company acquired the entire equity interests in Hubei Telecom Company Limited, Hunan Telecom Company Limited, Hainan Telecom Company Limited, Guizhou Telecom Company Limited, Yunnan Telecom Company Limited, Shaanxi Telecom Company Limited, Gansu Telecom Company Limited, Qinghai Telecom Company Limited, Ningxia Telecom Company Limited and Xinjiang Telecom Company Limited (collectively the "Second Acquired Group") from China Telecom for a total purchase price of RMB27,800 million on 30 June 2004 (hereinafter, referred to as the "Second Acquisition"). The purchase price consisted of a cash payment of RMB8,340 million and a long-term payable of RMB19,460 million. On 30 June 2004, the Company repaid RMB4,310 million of this payable amount using the net proceeds from issue of new H shares in May 2004 (see Note 10). In connection with the Second Acquisition and effective 31 December 2003, China Telecom transferred the wireline telecommunications business and related operations in Hubei Province, Hunan Province, Hainan Province, Guizhou Province, Yunnan Province, Shaanxi Province, Gansu Province, Qinghai Province, Ningxia Hui Autonomous Region and Xinjiang Uygur Autonomous Region together with the related assets and liabilities in consideration for the entire equity interests in each of the entities of the Second Acquired Group. Certain assets historically associated with these operations were retained by China Telecom, and as at 31 December 2003, these assets amounted to RMB10,762 million and consisted primarily of investments in non-telecommunications industries and properties.



**1. PRINCIPAL ACTIVITIES, ORGANISATION AND BASIS OF PRESENTATION (Continued)****Basis of presentation**

As the First Acquired Group and the Second Acquired Group (“the Acquired Groups”) were under the common control of China Telecom, the acquisitions have been reflected in the accompanying consolidated interim financial statements as a combination of entities under common control in a manner similar to a pooling-of-interests. Accordingly, the assets and liabilities of the Acquired Groups have been accounted for at historical amounts and the consolidated financial statements of the Company prior to the acquisitions have been restated to include the results of operations and assets and liabilities of the Acquired Groups on a combined basis. The assets retained by China Telecom in respect of the First Acquisition and the Second Acquisition have been reflected as distributions to China Telecom in the consolidated statement of shareholders’ equity as at 31 December 2002 and 31 December 2003 respectively. The considerations paid by the Company for the Acquired Groups have been accounted for as equity transactions in the consolidated statement of shareholders’ equity.

The results of operations previously reported by the Group for the six-month period ended 30 June 2003 have been restated to include the results of the First Acquired Group and the Second Acquired Group as set out below:

	<b>The Group (as previously reported)</b>	<b>The First Acquired Group</b>	<b>The Second Acquired Group</b>	<b>The Group (combined)</b>
	RMB millions	RMB millions	RMB millions	RMB millions
<b>Result of operations:</b>				
Operating revenues	39,536	18,247	16,285	74,068
Operating profit	12,198	4,863	1,167	18,228
Net profit	9,260	3,371	427	13,058
Basic earnings per share (RMB)	0.12	0.04	0.01	0.17

for the six-month period ended 30 June 2004

## 1. PRINCIPAL ACTIVITIES, ORGANISATION AND BASIS OF PRESENTATION (Continued)

### Basis of presentation (Continued)

The financial condition as at 31 December 2003 and shareholders' equity as at 31 December 2003 and 1 January 2003 previously reported by the Group have been restated to include the assets and liabilities of the Second Acquired Group as set out below:

	<b>The Group (as previously reported)</b>	<b>The Second Acquired Group</b>	<b>The Group (combined)</b>
	RMB millions	RMB millions	RMB millions
<b>Financial condition:</b>			
Current assets	25,504	7,589	33,093
Total assets	305,605	98,337	403,942
Current liabilities	96,666	52,469	149,135
Total liabilities	173,064	78,815	251,879
Shareholders' equity as at 31 December 2003	131,272	19,522	150,794
Shareholders' equity as at 1 January 2003	152,848	34,177	187,025

For the periods presented, all significant balances and transactions between the Group and the Acquired Groups have been eliminated.

## 2. BASIS OF PREPARATION

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 2004 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 2004.

The interim financial statements set out on pages 9 to 30 have been authorised for issue by the Board of Directors on 1 September 2004. These interim financial statements are unaudited, but have been reviewed by the Audit Committee of the Company. These interim financial statements have also been reviewed 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.

**2. BASIS OF PREPARATION (Continued)**

The accounting policies adopted in the 2003 annual financial statements have been consistently applied by the Group in preparing these interim financial statements. The consolidated interim financial statements presented herein should be read in conjunction with the consolidated financial statements and notes thereto included in the 2003 annual report of the Company.

**3. 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.

**4. ACCOUNTS RECEIVABLE, NET**

Accounts receivable, net, are analysed as follows:

	<b>30 June 2004 RMB millions</b>	31 December 2003 RMB millions
Accounts receivable	<b>17,369</b>	14,769
Less: Allowance for doubtful accounts	<b>(2,183)</b>	(1,818)
	<b>15,186</b>	12,951

Amounts arising 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 2004 RMB millions</b>	31 December 2003 RMB millions
Current, within 1 month	<b>11,051</b>	9,650
1 to 3 months	<b>1,684</b>	1,425
4 to 12 months	<b>1,320</b>	1,169
More than 12 months	<b>826</b>	611
	<b>14,881</b>	12,855
Less: Allowance for doubtful accounts	<b>(2,146)</b>	(1,780)
	<b>12,735</b>	11,075

for the six-month period ended 30 June 2004

**4. ACCOUNTS RECEIVABLE, NET (Continued)**

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

	<b>30 June 2004</b>	31 December 2003
	<b>RMB millions</b>	RMB millions
Current, within 1 month	<b>1,048</b>	1,147
1 to 3 months	<b>695</b>	355
4 to 12 months	<b>537</b>	285
More than 12 months	<b>208</b>	127
	<b>2,488</b>	1,914
Less: Allowance for doubtful accounts	<b>(37)</b>	(38)
	<b>2,451</b>	1,876

**5. CASH AND CASH EQUIVALENTS**

	<b>30 June 2004</b>	31 December 2003
	<b>RMB millions</b>	RMB millions
Cash at bank and in hand	<b>12,464</b>	12,451
Time deposits with maturity within three months	<b>4,246</b>	270
	<b>16,710</b>	12,721

**6. SHORT-TERM DEBT**

Short-term debt is analysed as follows:

	<b>30 June 2004</b>	31 December 2003
<i>Note</i>	<b>RMB millions</b>	RMB millions
Bank loans	<b>56,042</b>	56,243
Loans from China Telecom	<b>9,469</b>	—
	<b>65,511</b>	56,243

*Note:*

- (i) The loans from China Telecom bear interest at fixed rates ranging from 2% to 3.45% per annum, are unsecured and are repayable within 1 year.

**7. LONG-TERM DEBT**

Long-term debt is analysed as follows:

	<i>Note</i>	<b>30 June 2004 RMB millions</b>	31 December 2003 RMB millions
Bank loans	<i>(i)</i>	<b>37,300</b>	47,553
Other loans		<b>11</b>	36
Amount due to China Telecom in connection with the First Acquisition	<i>(ii)</i>	<b>35,000</b>	35,000
Amount due to China Telecom in connection with the Second Acquisition	<i>(iii)</i>	<b>15,150</b>	—
<b>Total long-term debt</b>		<b>87,461</b>	82,589
<b>Less: current portion</b>		<b>(14,970)</b>	(13,957)
<b>Non-current portion</b>		<b>72,491</b>	68,632

*Note:*

- (i) As at 30 June 2004, bank loans of RMB6 million (2003: RMB22 million) were secured by certain of the Group's property, plant and equipment. The net book value of the property, plant and equipment pledged as security amounted to RMB1 million as at 30 June 2004 (2003: RMB27 million).
- (ii) This represents the deferred consideration payable to China Telecom in respect of the First Acquisition (Note 1). The amount is unsecured, and for the first five years after the date of the First Acquisition, the Company pays interest on the outstanding balance at the rate of 5.184% per annum. Thereafter the interest rate is adjusted based on the prevailing market interest rate. This amount is repayable on 31 December 2013 and the Company may, from time to time, repay all or part of the amount at any time until 31 December 2013 without penalty.
- (iii) This represents the remaining balance of the deferred consideration payable to China Telecom in respect of the Second Acquisition (Note 1). The amount is unsecured, and for the first five years after the date of the Second Acquisition, the Company pays interest on the outstanding balance at the rate of 5.184% per annum. Thereafter the interest rate is adjusted based on the prevailing market interest rate. This amount is repayable on 30 June 2014 and the Company may, from time to time, repay all or part of the amount at any time until 30 June 2014 without penalty.

for the six-month period ended 30 June 2004

## 8. ACCOUNTS PAYABLE

Accounts payable are analysed as follows:

	<b>30 June</b>	31 December
	<b>2004</b>	2003
	<b>RMB millions</b>	RMB millions
Third parties	<b>26,923</b>	28,367
China Telecom Group	<b>7,668</b>	7,262
	<b>34,591</b>	35,629

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</b>	31 December
	<b>2004</b>	2003
	<b>RMB millions</b>	RMB millions
Due within 1 month or on demand	<b>4,560</b>	6,658
Due after 1 month but within 3 months	<b>7,688</b>	5,661
Due after 3 months but within 6 months	<b>7,698</b>	8,099
Due after 6 months	<b>14,645</b>	15,211
	<b>34,591</b>	35,629

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## 9. DEFERRED TAX ASSETS AND LIABILITIES

Deferred tax assets and deferred tax liabilities are attributable to the items set out below:

	Assets		Liabilities		Net balance	
	30 June	31 December	30 June	31 December	30 June	31 December
	2004	2003	2004	2003	2004	2003
	RMB millions					
<i>Current</i>						
Provisions, primarily for receivables	326	198	—	—	326	198
<i>Non-current</i>						
Property, plant and equipment	74	67	(734)	(579)	(660)	(512)
Deferred revenues and installation costs	2,032	1,788	(841)	(746)	1,191	1,042
Land use rights	8,230	8,470	—	—	8,230	8,470
Deferred tax assets/(liabilities)	10,662	10,523	(1,575)	(1,325)	9,087	9,198

Movements in temporary differences are as follows:

	Note	Balance at 1 January 2004 RMB millions	Recognised in statement of income RMB millions	Recognised in shareholders' equity RMB millions	Balance at 30 June 2004 RMB millions
<i>Current</i>					
Provisions, primarily for receivables		198	128	—	326
<i>Non-current</i>					
Property, plant and equipment		(512)	(148)	—	(660)
Deferred revenues and installation costs		1,042	149	—	1,191
Land use rights	(i)	8,470	(74)	(166)	8,230
Net deferred tax assets		9,198	55	(166)	9,087

(Note 14)

Note:

- (i) In connection with the Restructuring, the First Acquisition and the Second Acquisition, the land use rights of the Group were revalued as required by the relevant PRC rules and regulations. The tax bases of the land use rights have been adjusted to conform to such revalued amounts. The land use rights were not revalued for financial reporting purposes and accordingly, deferred tax assets were created with corresponding increases in shareholders' equity.

In the second quarter of 2004, certain subsidiaries with operations in the western region of the PRC obtained approval from tax authority to reduce the income tax rate from 33% to 15% for the period from 1 January 2004 to 31 December 2010. Accordingly, the effect of the change in tax rate on the amount of the deferred tax asset expected to be realised during 2004 to 2010 amounting to RMB166 million was charged to shareholders' equity.

for the six-month period ended 30 June 2004

**10. SHARE CAPITAL**

	<b>30 June 2004</b>	31 December 2003
	<b>RMB millions</b>	RMB millions
<b>Registered, issued and fully paid</b>		
67,054,958,321 (2003: 67,586,776,503) ordinary domestic shares of RMB1.00 each	<b>67,055</b>	67,587
13,877,410,000 (2003: 8,027,410,000) overseas listed H shares of RMB1.00 each	<b>13,877</b>	8,027
	<b>80,932</b>	75,614

In May 2004, the Company issued and allotted 5,318,181,818 new H shares with a par value of RMB1.00 each, representing 4,466,693,018 H shares and 8,514,888 American Depositary Shares ("ADSs", each representing 100 H shares), at prices of HK\$2.30 per H share and US\$29.49 per ADS, respectively, by way of a global offering to Hong Kong and overseas investors. As part of the global offering, 531,818,182 existing domestic shares of RMB1.00 each owned by China Telecom and the other domestic shareholders were converted into H shares and sold to Hong Kong and overseas investors. The Company raised net proceeds of RMB12,702 million from issue of new H shares.

**11. OPERATING REVENUES**

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

		<b>Six-month periods ended 30 June</b>	
		<b>2004</b>	2003
	<i>Note</i>	<b>RMB millions</b>	RMB millions
Upfront connection fees	<i>(i)</i>	<b>4,236</b>	4,886
Upfront installation fees	<i>(ii)</i>	<b>1,432</b>	1,301
Monthly fees	<i>(iii)</i>	<b>15,023</b>	13,829
Local usage fees	<i>(iv)</i>	<b>24,072</b>	22,486
DLD	<i>(iv)</i>	<b>13,145</b>	12,693
ILD	<i>(iv)</i>	<b>1,906</b>	1,951
Internet	<i>(v)</i>	<b>6,602</b>	4,355
Managed data	<i>(vi)</i>	<b>1,524</b>	1,628
Interconnections	<i>(vii)</i>	<b>5,013</b>	4,095
Leased line	<i>(viii)</i>	<b>2,112</b>	2,608
Others	<i>(ix)</i>	<b>5,152</b>	4,236
		<b>80,217</b>	74,068

## 11. 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, and lease of telecommunications network facilities.

## 12. NET FINANCE COSTS

Net finance costs comprise:

	Six-month periods ended 30 June	
	2004	2003
	RMB millions	RMB millions
Interest expense incurred	3,260	2,576
Less: Interest expense capitalised*	(738)	(756)
Net interest expense	2,522	1,820
Interest income	(109)	(151)
Foreign exchange losses	4	100
Foreign exchange gains	(76)	(41)
	<b>2,341</b>	<b>1,728</b>
* Interest expense was capitalised in construction in progress at the following rates per annum	<b>4.1%–5.2%</b>	<b>4.3%–5.5%</b>

for the six-month period ended 30 June 2004

**13. PROFIT BEFORE TAXATION AND MINORITY INTERESTS**

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

	Six-month periods ended 30 June	
	2004	2003
	RMB millions	RMB millions
Personnel expenses	11,689	10,342
Interconnection charges	1,773	1,504

**14. TAXATION**

Taxation in the consolidated statement of income comprises:

	Six-month periods ended 30 June	
	2004	2003
	RMB millions	RMB millions
Provision for PRC income tax	3,736	3,782
Deferred taxation ( <i>Note 9</i> )	(55)	(449)
	3,681	3,333

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

	Note	Six-month periods ended 30 June	
		2004	2003
		RMB millions	RMB millions
Profit before taxation and minority interests		18,401	16,415
Expected PRC income tax expense at statutory tax rate of			
33%	(i)	6,072	5,417
Differential tax rate on subsidiaries income	(i)	(954)	(398)
Non-deductible expenses	(ii)	435	199
Non-taxable income	(iii)	(1,872)	(1,885)
Income tax		3,681	3,333

#### 14. TAXATION (Continued)

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

#### 15. DIVIDENDS

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

Pursuant to the shareholders' approval at the Annual General Meeting held on 20 June 2003, a final dividend of RMB0.008897 per share totaling 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 2004.

#### 16. BASIC EARNINGS PER SHARE

The calculation of basic earnings per share for the six-month period ended 30 June 2004 is based on the net profit of RMB14,708 million and the weighted average number of shares in issue during the period of 76,724,576,113 shares. The weighted average number of shares in issue during the six-month period ended 30 June 2004 reflects the issuance of 5,318,181,818 new H shares in May 2004 (see Note 10). The calculation of basic earnings per share for the six-month period ended 30 June 2003 is based on the net profit of RMB13,058 million divided by 75,614,186,503 shares.

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

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## 17. CAPITAL COMMITMENTS

As at 30 June 2004, the Group had capital commitments as follows:

	<b>30 June 2004 RMB millions</b>	31 December 2003 RMB millions
Authorised and contracted for		
Properties	<b>2,268</b>	1,857
Telecommunications network plant and equipment	<b>5,124</b>	9,257
	<b>7,392</b>	11,114
Authorised but not contracted for		
Properties	<b>2,105</b>	2,458
Telecommunications network plant and equipment	<b>10,629</b>	12,725
	<b>12,734</b>	15,183

## 18. RELATED PARTY TRANSACTIONS

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

		<b>Six-month periods ended 30 June</b>	
		<b>2004</b>	2003
	<i>Note</i>	<b>RMB millions</b>	RMB millions
Purchases of telecommunications equipment and materials	<i>(i)</i>	<b>152</b>	222
Construction, engineering and information technology services	<i>(ii)</i>	<b>2,597</b>	2,851
Provision of community services	<i>(iii)</i>	<b>1,101</b>	1,064
Provision of ancillary services	<i>(iv)</i>	<b>796</b>	683
Provision of comprehensive services	<i>(v)</i>	<b>120</b>	—
Operating lease expenses	<i>(vi)</i>	<b>203</b>	235
Centralised service expenses	<i>(vii)</i>	<b>108</b>	144
Interconnection revenues	<i>(viii)</i>	<b>98</b>	99
Interconnection charges	<i>(viii)</i>	<b>201</b>	280
Interest on amounts due to and loans from China Telecom	<i>(ix)</i>	<b>993</b>	—

**18. RELATED PARTY TRANSACTIONS (Continued)**

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 by the Group to China Telecom Group in respect of comprehensive services provided (see scope of comprehensive service defined below).
- (vi) Represent amounts paid and payable to China Telecom Group for operating leases in respect of business premises and inter-provincial transmission optic fibres.
- (vii) Represent net amount charged by China Telecom to the Group for costs associated with common corporate services and international telecommunications facilities.
- (viii) Represent amounts charged from/to China Telecom for interconnection of domestic long distance telephone calls.
- (ix) Represent interest paid and payable to China Telecom with respect to the deferred consideration payable to China Telecom in connection with the First Acquisition and interest with respect to loans from China Telecom (Note 7).

In connection with the Second Acquisition, the Group and China Telecom Group entered into a number of agreements on 13 April 2004. The principal terms of these agreements are similar to those disclosed in Note 32 to the Group's 2003 consolidated financial statements, other than an increase in the maximum commission rate for domestic equipment procurement from 1.8% to 3% to reflect the latest market price.

In addition, the Company entered into a comprehensive services framework agreement with China Telecom on 13 April 2004 to govern the terms and conditions of transactions between the Group and entities within China Telecom Group which were not within the scope of the agreements entered into previously. Such transactions include procurement of telecommunications equipment, network design, software upgrade, system integration, manufacture of calling cards and other services. Pursuant to this agreement, China Telecom Group charges the Group for these services in accordance with the following terms:

- government prescribed price;
- where there is no government prescribed price but where there is a government guided price, the government guided price will apply;

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## 18. RELATED PARTY TRANSACTIONS (Continued)

- where there is neither a government prescribed price nor a government guided price, the market price will apply;
- where none of the above is available, the price is to be agreed between the relevant parties, which shall be based on the cost incurred in providing the services plus a reasonable profit margin.

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.

## 19. PRINCIPAL SUBSIDIARIES

Following the completion of the Second Acquisition on 30 June 2004, the Company has the following wholly-owned subsidiaries which principally affect the results of operations and the financial position of the Group:

Name of Company	Type of legal entity	Date of incorporation	Registered capital (RMB millions)
Shanghai Telecom Company Limited	Limited company	11 October 2002	15,984
Guangdong Telecom Company Limited	Limited company	10 October 2002	47,513
Jiangsu Telecom Company Limited	Limited company	19 October 2002	19,208
Zhejiang Telecom Company Limited	Limited company	10 October 2002	22,400
Anhui Telecom Company Limited	Limited company	26 August 2003	3,871
Fujian Telecom Company Limited	Limited company	28 August 2003	10,364
Jiangxi Telecom Company Limited	Limited company	18 September 2003	1,153
Guangxi Telecom Company Limited	Limited company	28 August 2003	4,992
Chongqing Telecom Company Limited	Limited company	22 August 2003	4,276
Sichuan Telecom Company Limited	Limited company	28 August 2003	8,123
Hubei Telecom Company Limited	Limited company	9 March 2004	5,412
Hunan Telecom Company Limited	Limited company	12 March 2004	661
Hainan Telecom Company Limited	Limited company	9 March 2004	580
Guizhou Telecom Company Limited	Limited company	12 March 2004	2,401
Yunnan Telecom Company Limited	Limited company	9 March 2004	3,747
Shaanxi Telecom Company Limited	Limited company	8 March 2004	2,482
Gansu Telecom Company Limited	Limited company	10 March 2004	3,413
Qinghai Telecom Company Limited	Limited company	10 March 2004	965
Ningxia Telecom Company Limited	Limited company	10 March 2004	795
Xinjiang Telecom Company Limited	Limited company	11 March 2004	4,660

All of the above subsidiaries are incorporated in the PRC.

**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"). The nature of differences which have a significant effect on the Group's 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 Company's predecessor operations 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.

In connection with the First Acquisition, the property, plant and equipment of the First Acquired Group were revalued as at 31 December 2002. The net revaluation deficit has been reflected in the consolidated financial statements as at 31 December 2002. Such revaluation resulted in an increase directly to shareholders' equity of RMB760 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 RMB14,690 million with respect to the reduction in carrying amount of certain property, plant and equipment below their historical cost bases.

In connection with the Second Acquisition, the property, plant and equipment of the Second Acquired Group were revalued as at 31 December 2003. The net revaluation deficit has been reflected in the consolidated financial statements as at 31 December 2003. Such revaluation resulted in an increase directly to shareholders' equity of RMB1,537 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 RMB14,832 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, the First Acquisition and the Second Acquisition, 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, the First Acquisition and the Second Acquisition, 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 gain and loss on disposal of the asset is determined with reference to the asset's revalued amount less subsequent depreciation, and any 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 cost carrying amount and included in current earnings.

**(c) EFFECT OF CHANGE IN TAX RATE**

Under IFRS, the effect of a change in tax rate that results in a change in the carrying amounts of deferred tax assets and liabilities is charged or credited directly to equity, to the extent that such deferred tax assets and liabilities are previously charged or credited to equity. Under US GAAP, the effect of a change in tax rate for all items of deferred tax assets and liabilities is recorded in the income statement.

**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 2004 and 2003 is as follows:

	Six-month periods ended 30 June		
	2004 US\$ millions (Note)	2004 RMB millions	2003 RMB millions
Net profit under IFRS	1,777	14,708	13,058
US GAAP adjustments:			
Depreciation on revalued property, plant and equipment	(426)	(3,530)	(2,037)
Disposal of revalued property, plant and equipment	(3)	(24)	(23)
Effect of change in tax rate on deferred tax assets arising from revaluation of land use rights	(20)	(166)	—
Effect of change in tax rate on deferred tax liabilities arising from revaluation of property, plant and equipment	251	2,079	—
Deferred tax effect of US GAAP adjustments	113	934	679
Net profit under US GAAP	1,692	14,001	11,677
Basic earnings per share under US GAAP	US\$0.02	RMB0.18	RMB0.15
Basic earnings per ADS* under US GAAP	US\$2.20	RMB18.25	RMB15.44

\* 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 2004 and 31 December 2003 is as follows:

	<b>30 June 2004 US\$ millions (Note)</b>	<b>30 June 2004 RMB millions</b>	31 December 2003 RMB millions
Shareholders' equity under IFRS	<b>17,533</b>	<b>145,114</b>	150,794
US GAAP adjustments:			
Revaluation of property, plant and equipment, net of minority interests	<b>3,112</b>	<b>25,758</b>	29,312
Deferred tax effect of US GAAP adjustment	<b>(779)</b>	<b>(6,452)</b>	(9,465)
Shareholders' equity under US GAAP	<b>19,866</b>	<b>164,420</b>	170,641

*Note:*

Solely for the convenience of the reader, the amounts as at and for the six-month period ended 30 June 2004 have been translated into United States dollars at the noon buying rate in New York City on 30 June 2004 for cable transfers in RMB as certified for custom purposes by the Federal Reserve Bank of New York of US\$1.00=RMB8.2766. 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 2004, or at any other date.

## OTHER INFORMATION

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### **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 2003 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 2004.

### **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.

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

As at 30 June 2004, 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 (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 30 June 2004, 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.

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

As at 30 June 2004, 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	58,346,370,499 domestic shares	87.01%	Principal
Guangdong Rising Assets Management Co., Ltd.	5,614,082,653 domestic shares	8.37%	Principal
J.P. Morgan Chase & Co.	1,401,997,276 H shares	10.10%	Beneficial owner; investment manager; custodian (shares available for lending)
Huawei Tech. Investment Co., Limited	959,154,000 H shares	6.91%	Beneficial owner
The Capital Group Companies, Inc.	883,744,400 H shares	6.37%	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 positions 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 1.46% 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 30 June 2004, 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.

**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.

By Order of the Board

**Zhou Deqiang**

*Chairman and CEO*

Beijing, PRC

1 September 2004