



NOTES TO THE UNAUDITED INTERIM FINANCIAL STATEMENTS

for the six-month period ended 30 June 2006

1. 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.

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 (“IASB”) and the applicable disclosure requirements of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. These interim financial statements, which were authorised for issuance by the Board of Directors on 30 August 2006, reflect the unaudited financial position of the Group as at 30 June 2006 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 2006.

The interim financial statements have been prepared in accordance with the same accounting policies adopted in the 2005 annual financial statements.

The preparation of interim financial statements in conformity with IAS 34 “Interim Financial Reporting” requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses on a year to date basis. Actual results may differ from these estimates.

These interim financial statements contain condensed consolidated financial statements and selected explanatory notes. The notes include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the Group since the 2005 annual financial statements. The condensed consolidated interim financial statements and notes thereon do not include all of the information required for full set of financial statements prepared in accordance with International Financial Reporting Standards (“IFRSs”).

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 Institute of Certified Public Accountants.

The financial information relating to the financial year ended 31 December 2005 that is included in these interim financial statements as being previously reported information 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 2005 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 22 March 2006.



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:

	30 June 2006	31 December 2005
	RMB millions	RMB millions
Third parties	16,508	15,636
China Telecom Group	115	224
Other state-controlled telecommunications operators in the PRC	2,201	1,786
	18,824	17,646
Less: Impairment losses for bad and doubtful debts	(2,143)	(1,504)
	16,681	16,142

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:

	30 June 2006	31 December 2005
	RMB millions	RMB millions
Current, within 1 month	11,163	12,104
1 to 3 months	2,214	1,563
4 to 12 months	1,280	1,037
More than 12 months	743	340
	15,400	15,044
Less: Impairment losses for bad and doubtful debts	(2,023)	(1,377)
	13,377	13,667

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

	30 June 2006	31 December 2005
	RMB millions	RMB millions
Current, within 1 month	1,035	1,244
1 to 3 months	1,366	686
4 to 12 months	696	371
More than 12 months	327	301
	3,424	2,602
Less: Impairment losses for bad and doubtful debts	(120)	(127)
	3,304	2,475



NOTES TO THE UNAUDITED INTERIM FINANCIAL STATEMENTS *(Continued)*

for the six-month period ended 30 June 2006

5. CASH AND CASH EQUIVALENTS

	30 June 2006	31 December 2005
	RMB millions	RMB millions
Cash at bank and in hand	13,947	11,583
Time deposits with maturity within three months	7,505	3,538
	21,452	15,121

6. SHORT-TERM AND LONG-TERM DEBT

Short-term debt comprises:

	30 June 2006	31 December 2005
	RMB millions	RMB millions
Loans from state-controlled banks – unsecured	34,176	45,704
Commercial paper – unsecured	20,000	9,917
Loans from China Telecom Group – unsecured	30,474	20,384
Total short-term debt	84,650	76,005

Weighted average interest rate of the Group's total short-term debt as at 30 June 2006 was 3.5% (31 December 2005: 4.2%). The loans from state-controlled banks bear interest at rates ranging from 3.0 to 7.7% per annum and are repayable within one year. The commercial paper as at 31 December 2005 bore interest at a fixed rate of 2.54% per annum and was repaid in April 2006. The commercial paper as at 30 June 2006 bears interest at a fixed rate of 3.05% per annum and is repayable by April 2007. The loans from China Telecom Group bear interest at fixed rates ranging from 2.3% to 5.0% per annum and are repayable within one year.

Long-term debt comprises:

	30 June 2006	31 December 2005
<i>Note</i>	RMB millions	RMB millions
Loans from state-controlled banks – unsecured	19,302	24,584
Other loans	6	6
Amount due to China Telecom in connection with the First Acquisition – unsecured	15,000	25,000
Amount due to China Telecom in connection with the Second Acquisition – unsecured	15,150	15,150
Total long-term debt	49,458	64,740
Less: current portion	(5,895)	(8,963)
Non-current portion	43,563	55,777



6. SHORT-TERM AND LONG-TERM DEBT (Continued)

Note:

- (i) The loans from state-controlled banks bear interest at rates ranging from 0.5% to 8.3% per annum with maturity through 2040.
- (ii) The amount bears interest on the outstanding balance at 5.184% per annum until 31 December 2008. 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. In April 2006, the Company repaid RMB10,000 million to China Telecom.
- (iii) The amount bears interest on the outstanding balance at 5.184% per annum until 30 June 2009. 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.

7. ACCOUNTS PAYABLE

Accounts payable are analysed as follows:

	30 June 2006 RMB millions	31 December 2005 RMB millions
Third parties	25,855	26,996
China Telecom Group	7,382	6,886
Other state-controlled telecommunications operators in the PRC	184	67
	33,421	33,949

Ageing analysis of accounts payable is as follows:

	30 June 2006 RMB millions	31 December 2005 RMB millions
Due within 1 month or on demand	6,361	5,379
Due after 1 month but within 3 months	6,861	8,797
Due after 3 months but within 6 months	8,424	9,283
Due after 6 months	11,775	10,490
	33,421	33,949



NOTES TO THE UNAUDITED INTERIM FINANCIAL STATEMENTS *(Continued)*

for the six-month period ended 30 June 2006

8. OPERATING REVENUES

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

	Note	Six-month periods ended 30 June	
		2006 RMB millions	2005 RMB millions
Upfront connection fees	(i)	2,494	3,403
Upfront installation fees	(ii)	1,458	1,479
Monthly fees	(iii)	14,936	15,326
Local usage fees	(iv)	23,378	24,005
DLD	(iv)	12,889	12,918
ILD	(iv)	1,562	1,705
Internet	(v)	11,154	8,538
Managed data	(vi)	1,492	1,481
Interconnections	(vii)	6,975	6,141
Leased line	(viii)	2,098	2,265
Value-added services	(ix)	6,580	4,601
Others	(x)	1,920	2,161
		86,936	84,023



8. 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 voice and data traffic connecting to the Group's wireline telecommunications networks.
- (viii) Represent primarily 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.
- (ix) Represent amounts charged to customers for the provision of wireline value-added services, which comprise primarily caller ID services, short messaging services, ring tone services, integrated information services and telephone information services.
- (x) Represent primarily revenues from sale and repairs and maintenance of customer-end equipment.

9. PERSONNEL EXPENSES

Personnel expenses are attributable to the following functions:

	Six-month periods ended 30 June	
	2006 RMB millions	2005 RMB millions
Network operations and support	9,083	8,974
Selling, general and administrative	4,232	4,280
	13,315	13,254

10. OTHER OPERATING EXPENSES

Other operating expenses comprise primarily interconnection charges of RMB2,972 million for the period ended 30 June 2006 (six-month period ended 30 June 2005: RMB2,506 million).



NOTES TO THE UNAUDITED INTERIM FINANCIAL STATEMENTS *(Continued)*

for the six-month period ended 30 June 2006

11. NET FINANCE COSTS

Net finance costs comprise:

	Six-month periods ended 30 June	
	2006 RMB millions	2005 RMB millions
Interest expense incurred	3,060	3,446
Less: Interest expense capitalised*	(397)	(630)
Net interest expense	2,663	2,816
Interest income	(133)	(112)
Foreign exchange losses	70	12
Foreign exchange gains	(8)	(248)
	2,592	2,468
* Interest expense was capitalised in construction in progress at the following rates per annum	2.0% – 5.3%	3.5% – 5.2%

12. INCOME TAX

Income tax in the consolidated income statement comprises:

	Six-month periods ended 30 June	
	2006 RMB millions	2005 RMB millions
Provision for PRC income tax	4,566	4,543
Deferred taxation	(56)	13
	4,510	4,556

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

	Note	Six-month periods ended 30 June	
		2006 RMB millions	2005 RMB millions
Profit before taxation		18,627	19,269
Expected PRC income tax expense			
at statutory tax rate of 33%	(i)	6,147	6,359
Differential tax rate on subsidiaries' income	(i)	(960)	(900)
Non-deductible expenses	(ii)	476	449
Non-taxable income	(iii)	(993)	(1,352)
Tax credit for domestic equipment purchases		(160)	–
Income tax		4,510	4,556

(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 Company which are taxed at a preferential rate of 7.5% to 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.



13. DIVIDENDS

Pursuant to the shareholders' approval at the Annual General Meeting held on 23 May 2006, a final dividend of RMB0.077637 (equivalent to HK\$0.075) per share totalling RMB6,283 million in respect of the year ended 31 December 2005 was declared and was paid on 15 June 2006.

Pursuant to the shareholders' approval at the Annual General Meeting held on 25 May 2005, a final dividend of RMB0.069139 (equivalent to HK\$0.065) per share totalling RMB5,596 million in respect of the year ended 31 December 2004 was declared and was paid on 23 June 2005.

The Board of Directors has resolved not to pay an interim dividend for the year ending 31 December 2006.

14. BASIC EARNINGS PER SHARE

The calculation of basic earnings per share for the six-month periods ended 30 June 2006 and 2005 is based on the profit attributable to equity holders of the Company of RMB14,084 million and RMB14,696 million, respectively, divided by 80,932,368,321 shares in issue.

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

15. CAPITAL COMMITMENTS

As at 30 June 2006, the Group had capital commitments as follows:

	30 June 2006	31 December 2005
	RMB millions	RMB millions
Authorised and contracted for		
Properties	544	513
Telecommunications network plant and equipment	4,537	2,278
	5,081	2,791
Authorised but not contracted for		
Properties	1,365	1,896
Telecommunications network plant and equipment	9,576	3,047
	10,941	4,943



NOTES TO THE UNAUDITED INTERIM FINANCIAL STATEMENTS *(Continued)*

for the six-month period ended 30 June 2006

16. RELATED PARTY TRANSACTIONS

Companies are considered to be related if one company has the ability, directly or indirectly, to control or jointly control the other company or exercise significant influence over the other company in making financial and operating decisions. Companies are also considered to be related if they are subject to common control.

(a) Transactions with China Telecom Group

The Group is part of a large group of companies under China Telecommunications Corporation ("China Telecom", a company owned by the PRC government), and has significant transactions and relationships with members of China Telecom. Because of these relationships, it is possible that the terms of these transactions are not the same as those that would result from transactions among unrelated parties.

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

	Note	Six-month periods ended 30 June	
		2006 RMB millions	2005 RMB millions
Purchases of telecommunications equipment and materials	(i)	95	103
Construction, engineering and information technology services	(ii)	3,420	2,592
Provision of community services	(iii)	1,199	1,166
Provision of ancillary services	(iv)	1,115	1,195
Provision of comprehensive services	(v)	335	107
Operating lease expenses	(vi)	195	238
Centralised service expenses	(vii)	120	98
Interconnection revenues	(viii)	91	68
Interconnection charges	(viii)	350	296
Interest on amounts due to and loans from China Telecom Group	(ix)	1,218	1,422



16. RELATED PARTY TRANSACTIONS (Continued)

(a) Transactions with China Telecom Group (Continued)

Note:

- (i) Represent commission paid and payable for procurement services provided by China Telecom Group.
- (ii) Represent provision of network construction, engineering and information technology services provided by China Telecom Group.
- (iii) Represent amounts paid and payable to China Telecom Group in respect of cultural, educational, hygiene and other community services.
- (iv) Represent amounts paid and payable 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 entities of China Telecom Group which were not within the scope of other related party service agreements in respect of services for procurement of telecommunications equipment, network design, software upgrade, system integration and manufacturing of calling cards.
- (vi) Represent amounts paid and payable to China Telecom Group for leases of business premises and inter-provincial transmission optic fibres.
- (vii) Represent net amount charged by China Telecom 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 Group with respect to the amounts due to China Telecom and loans from China Telecom Group (Note 6).

Amounts due from/to China Telecom Group included in the following balances are summarised as follows:

	30 June 2006 RMB millions	31 December 2005 RMB millions
Accounts receivable	115	224
Prepayments and other current assets	723	606
Total amounts due from China Telecom Group	838	830
Accounts payable	7,382	6,886
Accrued expenses and other payables	4,585	4,534
Short-term debt	30,474	20,384
Long-term debt	30,150	40,150
Total amounts due to China Telecom Group	72,591	71,954



NOTES TO THE UNAUDITED INTERIM FINANCIAL STATEMENTS *(Continued)*

for the six-month period ended 30 June 2006

16. RELATED PARTY TRANSACTIONS *(Continued)*

(a) Transactions with China Telecom Group *(Continued)*

Amounts due from/to China Telecom Group, other than short-term debt and long-term debt, bear no interest, are unsecured and are repayable in accordance with normal commercial terms. The term and conditions associated with short-term debt and long-term debt payable to China Telecom Group are set out in Note 6.

As at 30 June 2006 and 31 December 2005, no material impairment losses for bad and doubtful debts was recorded in respect of amounts due from China Telecom Group.

(b) Key management personnel compensation

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including directors and supervisors of the Group.

Key management personnel compensation of the Group is summarised as follows:

	Six-month periods ended 30 June	
	2006	2005
	RMB thousands	RMB thousands
Short-term employee benefits	3,833	2,678
Post-employment benefits	331	242
	4,164	2,920

The above remuneration is included in personnel expenses.

(c) Contributions to post-employment benefit plans

As stipulated by the regulations of the PRC, the Group participates in various defined contribution post-employment benefit plans organised by municipal and provincial governments for its employees. The Group is required to make contributions to the post-employment benefit plans at rates ranging from 18% to 20% of the salaries, bonuses and certain allowances of the employees. A member of the plan is entitled to a pension equal to a fixed proportion of the salary prevailing at the member's retirement date. The Group has no other material obligation for the payment of pension benefits associated with these plans beyond the contributions described above.

The Group's contributions to post-employment benefit plans for the six-month period ended 30 June 2006 were RMB1,201 million (six-month period ended 30 June 2005: RMB1,094 million).

The amount of contributions to post-employment benefit plans payable as at 30 June 2006 was RMB885 million (31 December 2005: RMB648 million).



16. RELATED PARTY TRANSACTIONS (Continued)

(d) Transactions with other state-controlled entities in the PRC

The Group is a state-controlled public utilities enterprise and operates in an economic regime currently dominated by entities directly or indirectly controlled by the State through government authorities, agencies, affiliations and other organisations (collectively referred to as “state-controlled entities”).

Apart from transactions with parent company and its affiliates, the Group have transactions with other state-controlled entities which include but not limited to the following:

- sales and purchases of goods, properties and other assets
- rendering and receiving services
- lease of assets
- depositing and borrowing money
- use of public utilities

These transactions are conducted in the ordinary course of the Group’s business on terms comparable to those with other entities that are not state-controlled. The Group prices its telecommunication services and products based on government-regulated tariff rates, where applicable, or based on commercial negotiations. The Group has also established its procurement policies and approval processes for purchases of products and services, which do not depend on whether the counterparties are state-controlled entities or not.

Having considered the transactions potentially affected by related party relationships, the entity’s pricing strategy, procurement policies and approval processes, and the information that would be necessary for an understanding of the potential effect of the related party relationships on the financial statements, the directors are of the opinion that the following related party transactions require disclosure of numeric details:

(i) Transactions with other state-controlled telecommunications operators in the PRC

The Group’s wireline telecommunications networks interconnect with the networks of other state-controlled telecommunications operators. The Group also leases wireline telecommunications networks to these operators in the normal course of business. The interconnection and leased line charges are regulated by the Ministry of Information Industry. The extent of the Group’s interconnection and leased line transactions with other state-controlled telecommunications operators in the PRC is as follows:

	Six-month periods ended 30 June	
	2006	2005
	RMB millions	RMB millions
Interconnection revenues	5,926	5,044
Interconnection charges	1,564	1,221
Leased line revenues	744	1,114



NOTES TO THE UNAUDITED INTERIM FINANCIAL STATEMENTS *(Continued)*

for the six-month period ended 30 June 2006

16. RELATED PARTY TRANSACTIONS *(Continued)*

(d) Transactions with other state-controlled entities in the PRC *(Continued)*

(i) Transactions with other state-controlled telecommunications operators in the PRC *(Continued)*

Amounts due from/to other state-controlled telecommunications operators in the PRC included in the following balances are summarised as follows:

	30 June 2006 RMB millions	31 December 2005 RMB millions
Accounts receivable	2,201	1,786
Prepayments and other current assets	371	397
Total amounts due from other state-controlled telecommunications operators in the PRC	2,572	2,183
Accounts payable	184	67
Accrued expenses and other payables	217	243
Total amounts due to other state-controlled telecommunications operators in the PRC	401	310

Amounts due from/to other state-controlled telecommunications operators in the PRC bear no interest, are unsecured and are repayable in accordance with normal commercial terms.

As at 30 June 2006 and 31 December 2005, there were no material impairment losses for bad and doubtful debts in respect of amounts due from other state-controlled telecommunications operators in the PRC.

(ii) Transactions with state-controlled banks

The Group deposits its cash balances with several state-controlled banks in the PRC and obtains short-term and long-term loans from these banks in the ordinary course of business. The interest rates of the bank deposits and loans are regulated by the People's Bank of China. The Group's interest income earned from deposits with and interest expense incurred on loans from state-controlled banks in the PRC are as follows:

	Six-month periods ended 30 June	
	2006 RMB millions	2005 RMB millions
Interest income	133	112
Interest expense	1,842	2,024



16. RELATED PARTY TRANSACTIONS (Continued)

(d) Transactions with other state-controlled entities in the PRC (Continued)

(ii) Transactions with state-controlled banks (Continued)

The amounts of cash deposited with and loans from state-controlled banks in the PRC are summarised as follows:

	30 June 2006 RMB millions	31 December 2005 RMB millions
Cash at bank and in hand	13,933	11,572
Time deposits	7,650	3,830
Total deposits with state-controlled banks in the PRC	21,583	15,402
Short-term loans	34,176	45,704
Long-term loans	19,302	24,584
Total loans from state-controlled banks in the PRC	53,478	70,288

Further details of the interest rates and repayment terms of loans from state-controlled banks are set out in Note 6.

The directors believe the above information has provided meaningful disclosure of related party transactions.

17. TRANSFER FROM STATUTORY COMMON WELFARE FUND TO SURPLUS RESERVES

Pursuant to the revision of the PRC Company Law, companies with limited liabilities and companies limited by shares are no longer required to make annual profit appropriation to the statutory common welfare fund commencing on 1 January 2006. The opening balance of the Group's statutory common welfare fund as at 1 January 2006 was transferred to the surplus reserves in accordance with "Notice on accounting issue relating to the implementation of the Company Law of the PRC" issued by the Ministry of Finance.

18. CHANGE IN PRESENTATION OF PERSONNEL EXPENSES

In the prior year financial statements, the amount of personnel expenses was not separately presented on the face of the consolidated income statement but was included as part of network operations and support expenses and selling, general and administrative expenses with the total amount of personnel expenses disclosed in the notes to the financial statements.

With effect from 1 January 2006, the Group has presented the amount of personnel expenses on the face of the consolidated income statement as a separate caption and disclosed the respective amounts attributable to the network operations and support, and selling, general and administrative functions in the notes to the financial statements. The related comparative figures have been reclassified to conform with the current period's presentation.