China Telecom Corporation Limited

中国电信股份有限公司

(A joint stock limited company incorporated in the People's Republic of China with limited liability)

Announcement of Annual Results for the Year Ended 31 December 2002

HIGHLIGHTS

- Total operating revenue was RMB75,496 million, up by 10.1%
- Total number of access lines in service reached 56.86 million, up by 17.3%
- Broadband subscribers up to 1.38 million, an increase of 247.4%
- Profit attributable to shareholders was RMB16,864 million, up by 145.0%
- Earnings per share reached RMB0.24
- EBITDA reached RMB42,260 million, EBITDA margin reached 56.0%

CHAIRMAN'S STATEMENT

In 2002 China Telecom Corporation Limited successfully completed its corporate restructuring and went on to complete its global initial public offering. The Company has seized this opportunity to advance closer to its goal of being a world-class telecommunications company and has turned in a strong performance for the year, surpassing its goals for 2002 and realising its promises to shareholders.

Review of 2002

Revenue for the year grew by 10.1% to RMB75,496 million and net income increased to RMB16,864 million with a net profit margin of 22.3%, while operating expenses of RMB54,118 million, 7.3% up from 2001, increased at a rate lower than that of revenue. We have expanded our wireline subscriber base by 17.3%, adding 8.38 million access lines in service, bringing our total to 56.86 million. We more than doubled the size of our broadband business, signing up approximately 0.98 million new customers to reach a year-end subscriber base of 1.38 million. Profitability was enhanced with basic earnings per share of RMB0.24.

Our strong performance is largely the result of the effective execution of our business strategies, continued improvement of our internal management systems, encouragement of innovation, and steadfast work ethic. This has led the Company into a new era of development along with a new corporate image.

- We firmly believe in the maximisation of shareholder value as our operating principle. We seek to develop a business model that is market-oriented, customer-centered, and return-driven. We strive to take advantage of organic and external growth opportunities to leverage our strength and continuously create value for our shareholders.
- We fine-tune our marketing strategy according to market conditions. We adopt different marketing strategies based on specific customer segments. This has enabled us to achieve stable growth in wireline voice services and high growth in broadband and Internet services. We have enhanced revenue driven by traffic volume growth and also actively developed new value-added services. As a result, we have successfully maintained a commanding market position.
- We continue to take measures to improve cost control and profitability. We have upgraded our overall budget planning and control capabilities through centralised cash, investment, and equipment procurement management. We have consistently implemented operating expense controls, especially in network operations and maintenance, and have reduced capital expenditures, thereby improving profitability.
- We are continuing management reform initiatives. We have re-positioned our local branches as Basic Business Units and carried out a critical overhaul of their business operations. We have established an internal Service Level Agreement mechanism between front-end marketing units and back-end network support units. A Key Performance Indicator system has been established to improve performance evaluation. We have upgraded our information technology infrastructure (CTG — MBOSS). All of these efforts are designed to improve our operating efficiency, market responsiveness and service quality, so as to strengthen our core competitiveness.
- We continue to capitalise on our network advantages. Our network is characterised by reliability, extensive coverage and high capacity. While further optimising its structure, we have upgraded network intelligence. As a result, we are able to create new value-added products and services for our customers and are well-positioned to migrate seamlessly to the next generation of technology.
- We have taken innovative measures in the management of human resources. We have established a compensation system linked with value creation and growth in profitability. We have also set up a dual-track promotion system for employee career development. Together these new approaches have greatly stimulated the enthusiasm and creativeness of our employees, creating a strong basis for our new corporate culture.
- We have adopted OECD corporate governance standards. In accordance with relevant laws and regulations, we have adopted OECD corporate governance norms. We have established a corporate governance structure consisting of shareholders' meetings, board of directors, supervisory committee, and corporate management with clear-cut responsibilities. Under the board of directors, we have established audit and remuneration committees in which independent directors play key roles. Further, we are continuing our efforts to improve information disclosure to ensure transparent, efficient and smooth communications between management and investors.

In 2002, we successfully completed our initial public offering, the world's largest telecom IPO for the year. Our shares have been listed on the Stock Exchange of Hong Kong and the New York Stock Exchange since November 2002. We take pride in the fact that *Fortune* magazine named us as one of the "most admired companies" for the year 2002.

Outlook for 2003

We believe China's economy will continue to record strong and healthy growth in 2003 with the goal of further improving the people's living standards. The government's strategic focus is on the development of information technology. Under the slogan of "let technology drive industrial development, let industrial development drive technology", a nationwide promotional campaign will help stimulate demand for telecommunications services. With low penetration rates across most of China for wireline services, we see a huge potential for growth. Data communications and information technology solutions have shown strong demand among all customer segments. With the popularisation of the Internet, the communication of knowledge and information will drive the fast growth of our broadband services. Various information applications will stimulate high-capacity, value-added services of all kinds. We intend to take full advantage of the unique opportunity presented by China's large and growing market to create as much value as possible for our shareholders.

Over time, we believe the regulatory environment will become more transparent and mature. Tariff policy for wireline telecommunication services is basically stable. Regulations benefit us in the provision of new services that will enjoy strong demand and high margins. We are actively seeking to become a full service telecommunications operator.

The reform and restructuring of China's telecommunications sector continues to provide us with both opportunities and challenges. We welcome orderly competition as well as cooperation with others in the years to come in the best interest of our shareholders. As a responsible carrier, we seek to provide as many telecom services as possible when they are commercially viable, so as to better serve our communities.

We have the unique right, but not the obligation, to grow through acquisitions of high-quality assets from our parent company and see this type of opportunity as an important means of expanding our operations. If we seek to carry out such an acquisition, however, it will be based on market conditions and commercial considerations and will be subject to minority shareholders' approval.

We are excited by our future prospects. We will continue to improve capital expenditures and operating expense control so as to enhance our profitability. We are building China Telecom on the values of innovation, integrity, cooperation, value creation based on a carefully executed strategy. We have a commitment to you, our shareholders and customers, to share the very best of this Information Age.

Dividend Policy

At the forthcoming annual general meeting, the board of directors will propose a dividend of HK$0.065 per share on an annual basis. Actual dividend payment for the year 2002 will be pro-rated based on the period from the date of listing to 31 December 2002.

Finally, I would like to take this opportunity to express my sincere thanks to all of our constituents — our board members, supervisors, shareholders, employees and customers, for your great support this year.

Zhou Deqiang
Chairman and Chief Executive Officer

Beijing, PRC
24 April 2003

GROUP RESULTS

China Telecom Corporation Limited (the "Company") is pleased to announce the consolidated results of the Company and its subsidiaries (the "Group") for the year ended 31 December 2002 extracted from the audited financial statements of the Group as set out in its 2002 annual report.

CONSOLIDATED STATEMENT OF INCOME AND CONSOLIDATED BALANCE SHEET (AUDITED)

CONSOLIDATED STATEMENT OF INCOME

for the year ended 31 December 2002
(Amounts in millions, except per share data)

	Note	**2002** *RMB*	2001 *RMB*
Operating revenue		**75,496**	68,546
Operating expenses			
Depreciation and amortisation		**(20,882)**	(19,451)
Network operations and support		**(20,131)**	(20,269)
Selling, general and administrative		**(10,468)**	(9,401)
Other operating expenses		**(2,637)**	(1,327)
Total operating expenses		**(54,118)**	(50,448)
Operating profit		**21,378**	18,098
Deficit on revaluation of property, plant and equipment		**—**	(11,930)
Net finance (costs)/income		**(632)**	293
Investment income		**4**	310
Share of profit from associates		**35**	22
Profit before taxation and minority interests		**20,785**	6,793
Taxation		**(3,855)**	69
Profit before minority interests		**16,930**	6,862
Minority interests		**(66)**	21
Profit attributable to shareholders		**16,864**	6,883
Basic earnings per share	2	**0.24**	0.10
Weighted average number of shares	2	**69,242**	68,317

CONSOLIDATED BALANCE SHEET

at 31 December 2002
(Amounts in millions)

	2002	2001
	RMB	*RMB*
ASSETS		
Non-current assets		
Property, plant and equipment, net	**149,165**	138,623
Construction in progress	**20,319**	23,274
Lease prepayments	**2,644**	2,638
Interests in associates	**429**	417
Investments	**270**	446
Deferred tax assets	**5,118**	4,059
Other assets	**6,405**	5,749
Total non-current assets	**184,350**	175,206
Current assets		
Inventories	**1,066**	1,413
Accounts receivable, net	**5,961**	5,608
Prepayments and other current assets	**1,736**	2,752
Time deposits with maturity over three months	**1,316**	473
Cash and cash equivalents	**16,423**	3,882
Total current assets	**26,502**	14,128
Total assets	**210,852**	189,334
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Short-term debt	**19,175**	18,827
Current portion of long-term debt	**2,219**	3,621
Accounts payable	**14,399**	14,919
Accrued expenses and other payables	**10,266**	11,672
Income tax payable	**3,842**	212
Current portion of finance lease obligations	**—**	38
Current portion of deferred revenues	**7,726**	8,155
Total current liabilities	**57,627**	57,444
Net current liabilities	**(31,125)**	(43,316)
Non-current liabilities		
Long-term debt	**4,853**	7,101
Finance lease obligations	**—**	11

Deferred revenues	**21,612**	26,353
Deferred tax liabilities	**618**	—
Total non-current liabilities	**27,083**	33,465
Total liabilities	**84,710**	90,909
Minority interests	**1,134**	940
Shareholders' equity		
Share capital	**75,614**	—
Reserves	**49,394**	97,485
Total shareholders' equity	**125,008**	97,485
Total liabilities and shareholders' equity	**210,852**	189,334

Note:

1. Basis of presentation

Since China Telecommunications Corporation controlled the Predecessor Operations transferred to the Company before the Restructuring and continues to control the Company after the Restructuring, the financial statements have been prepared as a reorganisation of businesses under common control in a manner similar to a pooling-of-interests. Accordingly, the assets and liabilities transferred to the Company have been recognised at historical amounts. For periods prior to the legal formation of the Company and its subsidiaries ("the Group"), the assets, liabilities, revenue and expenses of the entities comprising the Predecessor Operations were combined in preparing the financial statements.

The consolidated financial statements present the results of the Group as if the Group had been in existence throughout the years presented and as if the Predecessor Operations were transferred to the Company from China Telecommunications Corporation as at 1 January 2001. In addition, the consolidated financial statements for the year ended 31 December 2001 include the results related to certain assets historically associated with the Predecessor Operations that were not transferred to the Company and were retained by China Telecommunications Corporation in connection with the Restructuring.

2. Basic earnings per share

The calculation of basic earnings per share is based on the net profit of RMB16,864 million (2001: RMB6,883 million) and the weighted average number of shares in issue during the year of 69,241,674,942 (2001: 68,317,270,803), as if the 68,317,270,803 shares issued and outstanding upon the legal formation of the Company on 10 September 2002 had been outstanding for all periods presented. The weighted average number of shares for the year ended 31 December 2002 also reflects the issuance of 7,296,915,700 shares in 2002 in connection with the Company's global initial public offering.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

Operating Revenue

Our total operating revenue grew by RMB6,950 million, or 10.1%, from RMB68,546 million in 2001 to RMB75,496 million in 2002. Driven by the continued expansion of our wireline telephone subscriber base and a higher proportion of high-end subscribers, revenue from our local telephone services grew 12.1% to RMB35,847 million. Although revenue from our long distance telephone services decreased by 2.3% to RMB17,650 million as a result of increased proportion of VoIP calls and intense competition, the rate of decline decelerated from that of 2001. Fuelled by the surge in broadband subscribers and continued growth in managed data services, our total revenue from Internet and managed data services increased by 53.4% from that of 2001 to reach RMB5,564 million and to account for 7.4% of our total operating revenue in 2002. Total revenue from leased line services, interconnection and other services was RMB10,417 million in 2002, representing an increase of 21.3% from that of 2001. The amortised amount of upfront connection fees decreased by 4.3% to RMB6,018 million.

Operating Expenses

In 2002, we took the initiative to centralise our financial and budget management, equipment procurement, billing, network resource allocation and network maintenance to improve the efficiency of our resource utilisation, to rationalise our cost structure and to keep operating expenses under control.

Our total operating expenses increased by 7.3%, from RMB50,448 million in 2001 to RMB54,118 million in 2002. In 2002, depreciation and amortisation expenses, personnel expenses and interconnection and other expenses increased by 7.4%, 43.6% and 98.7% respectively from those of 2001. Excluding personnel expenses, selling, general and administrative expenses and network operations and support expenses decreased by 0.4% and 10.6% respectively.

Net Finance Costs/(Income)

Caused primarily by a change in net foreign exchange differences, we had net finance costs of RMB632 million in 2002 as opposed to net finance income of RMB293 million in 2001. We experienced a net foreign exchange loss of RMB221 million in 2002, as compared to a net foreign exchange gain of RMB430 million in 2001. In addition, while our gross interest expense in 2002 decreased by RMB94 million from 2001 as a result of repayment of bank loans, net interest expense increased from RMB383 million in 2001 to RMB551 million in 2002. This increase was primarily due to a reduction in the amount of capitalised interest of RMB262 million following a decrease in our capital expenditures.

Income Tax

In 2002, our income tax expense was RMB3,855 million, representing an effective tax rate of 18.5%.

Net Income

In 2002, we surpassed the profit forecast set out in our initial public offering prospectus. Driven by steady revenue growth, coupled with effective control over our operating expenses, we attained net income of RMB16,864 million for 2002 and our basic earning per share was RMB0.24.

EBITDA

Our EBITDA[1] was RMB42,260 million, representing an EBITDA margin (defined as EBITDA divided by total operating revenue) of 56.0%.

(1) Our EBITDA represents profit before net finance (costs)/income, investment income, share of profit from associates, taxation, depreciation and amortisation and minority interests. As the telecommunications business is a capital-intensive industry, capital expenditures, the level of gearing and finance costs may have a significant impact on the net profit of companies with similar operating results. Therefore, we believe EBITDA may be helpful in analysing the operating results of a telecommunications service provider like us. Although EBITDA is widely used in the global telecommunications industry as a benchmark to reflect operating performance, financing capability and liquidity, it is not regarded as a measure of operating performance and liquidity under generally accepted accounting principles. It also does not represent cash flows from operating activities. In addition, our EBITDA may not be comparable to similar indicators provided by other companies.

Capital expenditures

Our capital expenditures decreased by 27.8%, from RMB40,028 million in 2001 to RMB28,919 million in 2002. The advanced and expansive network infrastructure we built in recent years, together with the improved utilisation of these resources, afforded us the flexibility to substantially decrease our capital expenditure in 2002.

We further rationalised the allocation of our capital expenditures in 2002. We continued to allocate a majority of our capital expenditures to the development of access infrastructure in order to meet subscriber growth needs and to strengthen our position as the owner of the "last mile." Internet and data networks were another major area of capital expenditure as we capitalised on the surging demand for broadband, managed data and Internet services. In addition, we increased expenditures for our Business Support System (BSS), Operation Support System (OSS) and Management Support System (MSS) as part of our effort to improve customer service quality, operating efficiency and information disclosure. Our planned capital expenditures for 2003 and 2004 are RMB25,000 million and RMB23,500 million respectively.

Cash Flows

We experienced a net cash inflow of RMB12,541 million in 2002 as opposed to a net cash outflow of RMB9,979 million in 2001. In 2002, our cash flows from operating activities was RMB37,102 million, representing an increase of RMB4,341 million from that of 2001. Stemming from a substantial decrease in capital expenditures, net cash used in investing activities fell by RMB6,304 million to RMB29,095 million in 2002. Net cash from financing activities was RMB4,534 million in 2002, while net cash used in financing activities was RMB7,341 million in 2001. This change was primarily due to the net proceeds of RMB10,659 million we raised from the initial public offering of our shares in the fourth quarter of 2002. This cash inflow was offset by the substantial amount of bank loans we were able to repay, given the significant increase in cash flows from operating activities and the substantial decrease in our capital expenditures.

Our cash and cash equivalents were RMB16,423 million as at 31 December 2002, of which 70.2%, 23.4% and 6.4% were denominated in Renminbi, US dollars and Hong Kong dollars, respectively.

Indebtedness

With the benefits of increased cash flows from operating activities and decreased amount of cash used in investing activities, we paid off significant amount of bank loans. This, together with the proceeds from the initial public offering of our shares, have strengthened our capital structure. Our debt-to-asset ratio (defined as total debt divided by total assets) declined from 15.6% as at 31 December 2001 to 12.4% as at 31 December 2002. This has provided us with a solid foundation for continuing organic and external growth.

In 2002, we further centralised cash management to boost efficiency. Our total debt was reduced by RMB3,302 million to RMB26,247 million as at 31 December 2002, of which 84.0%, 10.0% and 6.0% were denominated in Renminbi, Japanese Yen and US dollar, respectively.

Having established and maintained high credit ratings at major commercial banks in the PRC, we have been able to obtain adequate debt financing on preferable terms. In 2002, we fine-tuned our debt financing strategy to achieve the dual objectives of reducing financing cost and managing financial risks. The weighted average interest rate of our short-term debt was 4.7% as at 31 December 2002, representing an 80 basis points decrease from that as at 31 December 2001.

SUPPLEMENTARY INFORMATION FOR ADS HOLDERS

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 year ended 31 December 2002 is as follows:

	Note	**2002 US$ millions** *(Note c)*	**2002 RMB millions**	2001 RMB millions
Net profit under IFRS		**2,037**	**16,864**	6,883
US GAAP adjustments:				
Reversal of deficit on revaluation of property, plant and equipment, net of minority interests	(a)	**—**	**—**	11,838
Depreciation on revalued property, plant and equipment	(a)	**(186)**	**(1,542)**	—
Disposal of revalued property, plant and equipment	(b)	**(7)**	**(55)**	—
Deferred tax effect of US GAAP adjustments	(a)	**64**	**527**	(3,936)
Net profit under US GAAP		**1,908**	**15,794**	14,785
Basic earnings per share under US GAAP		**0.03**	**0.23**	0.22
Basic earnings per ADS* under US GAAP		**2.76**	**22.81**	21.64

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

The effect on shareholders' equity of significant differences between IFRS and US GAAP as at 31 December 2002 is as follows:

	Note	**2002 US$ millions** *(Note c)*	**2002 RMB millions**	2001 RMB millions
Shareholders' equity under IFRS		**15,098**	**125,008**	97,485
US GAAP adjustments:				
Revaluation of property, plant and equipment, net of minority interests	(a)	**735**	**6,087**	7,684
Deferred tax effect of US GAAP adjustment	(a)	**(246)**	**(2,039)**	(2,566)
Shareholders' equity under US GAAP		**15,587**	**129,056**	102,603

Note:

(a) Revaluation of property, plant and equipment

In connection with the Restructuring, the property, plant and equipment of the Group were revalued as at 31 December 2001 (see note 3 on the financial statements for further details). The net revaluation deficit has been reflected in the consolidated financial statements as at 31 December 2001. Such revaluation resulted in an increase directly to shareholders' equity of RMB4,154 million with respect to the increase in carrying amount of certain property, plant and equipment above their historical cost bases, and a charge to income of RMB11,930 million with respect to the reduction in carrying amount of certain property, plant and equipment below their historical cost bases.

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

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

(b) Disposal of revalued property, plant and equipment

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

(c) Solely for the convenience of the reader, the amounts for 2002 have been translated into United States dollars at the noon buying rate in New York City on 31 December 2002 for cable transfers in RMB as certified for custom purposes by the Federal Reserve Bank of New York of US$1.00=RMB8.2800. 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 31 December 2002, or at any other date.

PURCHASE, SALE OR REDEMPTION OF SHARES

For the year ended 31 December 2002, neither the Company nor its subsidiaries has purchased, sold or redeemed any of the Company's listed shares.

COMPLIANCE WITH CODE OF BEST PRACTICE

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

CLOSURE OF SHARE REGISTRAR

The Company's share registrar will be closed from Tuesday, 20 May 2003 until Friday, 20 June 2003 (inclusive of both days), during which period all transfers of shares in the Company will be suspended. In order to qualify for the proposed dividend, all transfers, accompanied by the relevant share certificates, must be lodged with the Company's registrar, Computershare Hong Kong Investor Services Limited at 1712–1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong, before 4:00 pm on Monday, 19 May 2003.

ANNUAL REPORT

The Annual Report for the year ended 31 December 2002 containing all information required by Appendix 16 of the Listing Rules has been published on the website of The Stock Exchange of Hong Kong Limited (www.hkex.com.hk) as well as the website of the Company (www.chinatelecom-h.com)

FORWARD-LOOKING STATEMENTS

The Company would also like to caution readers about the forward-looking nature of certain of the above statements. These forward-looking statements are subject to risks and uncertainties, some of which are beyond our control. Potential risks and uncertainties include those concerning the continued growth of the telecommunications industry in China, the development of the regulatory environment and our ability to successfully execute our business strategies.