中国电信
CHINA TELECOM

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)

DISCLOSEABLE AND CONNECTED TRANSACTIONS

SUMMARY

The Acquisition

The Company entered into the Acquisition Agreement on October 26, 2003, pursuant to which the Company agreed to acquire, and China Telecommunications Corporation, the Company's controlling shareholder and promoter, agreed to sell the Target Assets, subject to certain conditions.

The Target Companies are the leading providers of wireline telecommunications services including wireline telephone, data and Internet and leased line services in the Target Service Areas, comprising Anhui province, Fujian province, Jiangxi province, Guangxi Zhuang autonomous region, Chongqing municipality and Sichuan province in the PRC. As of June 30, 2003, the Target Group had a total of approximately 45.1 million access lines in service for its local telephone service. The Target Group had a 98.3% market share in the Target Service Areas in terms of the number of access lines in service as of June 30, 2003.

Consideration for the Acquisition

The Acquisition was negotiated and entered into on an arm's length basis and on normal commercial terms. The purchase price of the Acquisition amounts to RMB46,000 million (equivalent to approximately US$5,558 million), and will consist of the payment of an initial cash consideration of RMB11,000 million (equivalent to approximately US$1,329 million) on completion of the Acquisition and the payment of a deferred consideration of RMB35,000 million (equivalent to approximately US$4,229 million). From the date of the completion of the Acquisition, the Company will pay interest to China Telecommunications Corporation at half-yearly intervals on the actual amount of deferred consideration remaining outstanding. Interest will accrue daily and, for the first five years after completion of the Acquisition, will be payable at the rate of 5.184% per year, being the RMB lending rate of commercial banks in the PRC in respect of loans with tenure of more than five years of 5.76% per year as set by the People's Bank of China and prevailing on the date of the Acquisition Agreement, less a discount of 10%. Thereafter, the interest rate will be adjusted accordingly on the fifth anniversary of completion of the Acquisition. The Company intends to fund the interest payments with its internal cash resources.

The deferred consideration is payable ten years after the date of completion of the Acquisition. The Company may from time to time, prepay all or part of the deferred consideration, at any time after completion until the tenth anniversary of the completion of the Acquisition, without penalty.

China Telecommunications Corporation currently owns 77.78% of the issued share capital of the Company. Based on the audited financial statements of the Company prepared under IFRS, the book value of the net assets of the Listed Group as of December 31, 2002 was approximately RMB125,008 million (equivalent to approximately US$15,103 million). Based on the unaudited interim financial statements of the Company prepared under IFRS, the book value of the net assets of the Listed Group as of June 30, 2003 was approximately RMB133,595 million (equivalent to approximately US$16,141 million). Accordingly, under the Hong Kong Listing Rules, the Acquisition constitutes both a discloseable transaction and a connected transaction for the Company.

Reasons for and benefits of the Acquisition

The Company believes that the Acquisition represents a new and important opportunity for the Listed Group to strengthen its market position, improve its growth prospects, realize operating synergies, increase its earnings and improve its capital efficiency.

Independent Shareholders' Approval and Independent Financial Adviser

An Independent Board Committee has been established to advise the Independent Shareholders in respect of the terms of the Acquisition, the terms of certain Prospective Connected Transactions and the terms of certain supplemental agreements relating to the Existing Connected Transactions. JPMorgan has been retained as the Independent Financial Adviser to the Independent Board Committee.

The Acquisition, certain Prospective Connected Transactions and certain supplemental agreements relating to the Existing Connected Transactions require the approval of the Independent Shareholders at the Extraordinary General Meeting at which China Telecommunications Corporation and its Associates will abstain from voting.

Financial Advisers

CICC and Morgan Stanley are the financial advisers to the Company in respect of the Acquisition, the Prospective Connected Transactions and the supplemental agreements relating to the Existing Connected Transactions.

Connected Transactions

After the Reorganization, the Combined Group entered into various agreements with China Telecommunications Corporation and a number of its subsidiaries relating to the mutual provision of ongoing telecommunications and other services. The mutual provision of ongoing telecommunications and other services between the Parent Group and the Combined Group will constitute connected transactions within the meaning of the Hong Kong Listing Rules upon completion of the Acquisition.

As these connected transactions are expected to occur on a regular and continuous basis in the ordinary and usual course of business, the Company has made an application to the Hong Kong Stock Exchange for a waiver from compliance with the normal approval and disclosure requirements relating to certain connected transactions under the Hong Kong Listing Rules. In its application, the Company has sought a new waiver for the Combined Group from the Stock Exchange to combine certain categories of the Existing Connected Transactions, waiver of which were granted by the Stock Exchange in its letter dated October 28, 2002, with the corresponding categories of the Prospective Connected Transactions so that the waiver in respect of annual monetary limits of certain Existing Connected Transactions be aggregated. The new waiver will be effective for two years from January 1, 2004 until December 31, 2005.

Dispatch of shareholders circular

A circular containing, amongst other things, details of the terms of the Acquisition, the Prospective Connected Transactions and supplemental agreements relating to Existing Connected Transactions, letters from the Independent Board Committee and from JPMorgan, further financial and other information of the Target Assets and a notice to shareholders of the Company convening an Extraordinary General Meeting to approve, amongst other things, the terms of the Acquisition, the terms of certain Prospective Connected Transactions and the terms of certain supplemental agreements relating to the Existing Connected Transactions will be dispatched to the shareholders of the Company as soon as practicable.

1. ACQUISITION OF THE TARGET ASSETS

(a) The Acquisition

The Company entered into the Acquisition Agreement on October 26, 2003, pursuant to which the Company agreed to acquire and China Telecommunications Corporation, the Company's controlling shareholder and promoter, agreed to sell the Target Assets, subject to certain conditions.

The Company has agreed, subject to certain conditions, to acquire from the Parent the Target Assets for a purchase price of RMB46,000 million (equivalent to approximately US$5,558 million). The net indebtedness of the Target Group as of June 30, 2003 amounted to approximately RMB33,988 million (equivalent to approximately US$4,106 million). Upon completion of the Acquisition, each of the Target Companies will become a wholly-owned subsidiary of the Company.

The Target Assets

The Target Companies are the leading providers of wireline telecommunications services including wireline telephone, data and Internet and leased line services in the Target Service Areas, comprising Anhui province, Fujian province, Jiangxi province, Guangxi Zhuang autonomous region, Chongqing municipality and Sichuan province in the PRC. As of June 30, 2003, the Target Group had a total of approximately 45.1 million access lines in service for its local telephone service. The Target Group had a 98.3% market share in the Target Service Areas in terms of the number of access lines in service as of June 30, 2003.

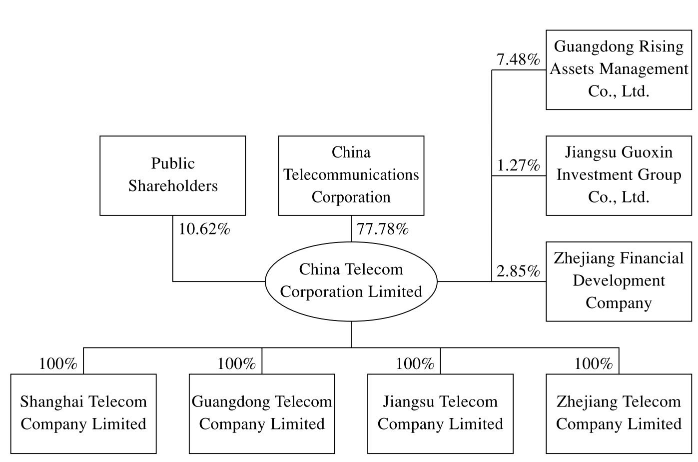
The Company will also acquire from the Parent certain assets which are used for network management, research and development purposes.

The Reorganization

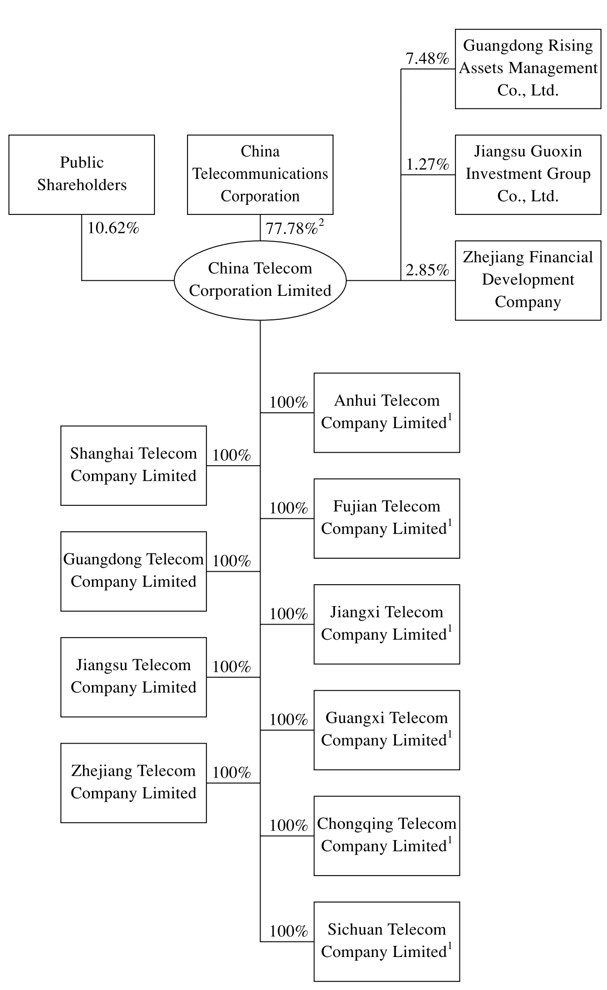
In preparation for the Acquisition, Anhui Telecom was incorporated on August 26, 2003, Fujian Telecom, Guangxi Telecom and Sichuan Telecom were incorporated on August 28, 2003, Jiangxi Telecom was incorporated on September 18, 2003 and Chongqing Telecom was incorporated on August 22, 2003, each as a wholly-owned subsidiary of China Telecommunications Corporation. China Telecommunications Corporation's telecommunications operations in Anhui province, Fujian province, Jiangxi province, Guangxi Zhuang autonomous region, Chongqing municipality and Sichuan province, together with related assets and liabilities were transferred to these Target Companies. The assets, liabilities and operations of the Target Group have been segregated and separately managed since December 31, 2002. As part of the Reorganization, the Parent has undertaken to indemnify the Target Companies for any loss or damages suffered by the Target Companies as a result of, or related to, the Reorganization and/or in connection with events preceding the Reorganization.

Set out below are the corporate structures of the Company and its principal subsidiaries immediately prior to and after the Acquisition.

Corporate Structure immediately before Acquisition



Corporate Structure immediately after Completion of the Acquisition



Notes:

1. Denotes the Target Companies to be acquired pursuant to the Acquisition.

2. As part of the reform plan of rural telecommunications services, China Telecommunications Corporation has agreed to transfer 977,004,913 shares of the Company (representing 1.29% of the Company's issued share capital as at the Latest Practicable Date) to Fujian Electronic Information (Group) Co., Ltd. upon satisfaction of a number of conditions precedent. Such transfer will not be made prior to September 10, 2005.

(b) The Consideration

The Acquisition was negotiated and entered into on an arm's length basis and on normal commercial terms. The purchase price of the Acquisition is RMB46,000 million (equivalent to approximately US$5,558 million), and will consist of payment of an initial consideration and a deferred consideration.

The purchase price of the Acquisition was determined based on various factors, including the quality of the assets being acquired, their growth prospects, earnings potential, competitive advantages in their respective markets, the prospective profit contributions of the Target Group to the Combined Group and other relevant valuation benchmarks. The purchase price of the Acquisition will represent a multiple of 7.2 times the Target Group's forecast combined 2003 profit after taxation and minority interests but before extraordinary items (the "net profits") of approximately RMB6,352 million (equivalent to approximately US$767 million).

The initial consideration of RMB11,000 million (equivalent to approximately US$1,329 million) will be satisfied on completion of the Acquisition by payment in cash in RMB. The Company intends to finance all of the initial consideration using internal cash resources, including proceeds raised from the Global Offering. Details of the amount of proceeds used to fund the initial consideration will be disclosed in the announcement following the EGM to be held on December 15, 2003.

The deferred consideration represents the difference between the purchase price and the initial consideration and amounts to RMB35,000 million (equivalent to approximately US$4,229 million). From the date of the completion of the Acquisition, the Company will pay interest to the Parent at half-yearly intervals on the actual amount of deferred consideration remaining outstanding. Interest will accrue daily and, for the first five years after completion of the Acquisition, will be payable at the rate of 5.184% per year, being the RMB lending rate of commercial banks in the PRC in respect of loans with tenure of more than five years of 5.76% per year as set by the People's Bank of China and prevailing on the date of the Acquisition Agreement, less a discount of 10%. Thereafter, the interest rate will be adjusted accordingly on the fifth anniversary of completion of the Acquisition. The Company intends to fund the interest payments with its internal cash resources.

The deferred consideration is payable ten years after the date of completion of the Acquisition. The Company may, from time to time, prepay all or part of the deferred consideration, at any time after completion until the tenth anniversary of the completion of the Acquisition, without penalty.

The payment of the deferred consideration and the interest payments can be made in RMB, or any other currencies which may in the future be agreed between China Telecommunications Corporation and the Company, subject to the approvals of the relevant PRC governmental authorities. Any payment made in currencies other than RMB will be based on the exchange rates between RMB and such currencies prevailing at 12:00 noon (Beijing time) on October 24, 2003, being the Business Day immediately preceding the day of the execution of the Acquisition Agreement.

(c) Conditions to Completion of the Acquisition

Completion of the Acquisition is conditional upon the fulfilment (to the reasonable satisfaction of the Company) of the following conditions, among others, on or before December 31, 2003 or such later date as the Company and China Telecommunications Corporation may agree:

(i) the passing of resolutions by the Board approving the terms of the Acquisition, the terms of the Prospective Connected Transactions and the terms of certain supplemental agreements relating to the Existing Connected Transactions;

(ii) the passing of ordinary resolutions by Independent Shareholders approving the terms of the Acquisition, the terms of certain Prospective Connected Transactions and the terms of certain supplemental agreements relating to the Existing Connected Transactions;

(iii) there having been no material adverse change to the financial conditions, business operations or prospects of the Target Assets; and

(iv) the obtaining of various approvals from relevant PRC regulatory authorities.

If any of the above-mentioned conditions is or are not satisfied (or in the case of (iii) above, not waived by the Company) by December 31, 2003, or such other date as the Company and China Telecommunications Corporation may agree, the Acquisition Agreement will lapse.

2. REASONS FOR AND BENEFITS OF THE ACQUISITION

The Acquisition represents a new and important opportunity for the Listed Group to strengthen its market position, enhance its competitiveness, promote business development and improve financial performance, so as to benefit further from the sustained growth of the telecommunications industry in the PRC.

(a) Enhancement of market position

The Acquisition will expand the geographic coverage of the Company's telecommunications operations. This expansion will further enhance the market position and competitiveness of the Company by improving its ability to provide long distance, managed data and other telecommunications services that require extensive geographic coverage. The Acquisition is also expected to significantly increase the Company's subscriber base, revenue and net profit. The Company believes that the enhanced financial strength resulting from such increases will enable it to better deal with competitive pressure and capture growth opportunities.

The table below sets out selected operating and financial data of the Target Group, the Listed Group and the pro forma data of the Combined Group as of or for the six-month period ended June 30, 2003:

	Listed Group	Target Group	Pro Forma Combined
Access lines in service (in thousands)	62,199	45,073	107,272
Operating revenues (in RMB millions)	39,536	18,247	57,770(1)
Net profit (in RMB millions)	9,260	3,371	12,054(1)
Earnings per share (in RMB)	0.12	N/A	0.16(1)

Notes:

(1) For further details of the Combined Group's pro forma financial information, please refer to Appendix VI to the shareholders' circular "Pro Forma Financial Information of the combined Group".

(2) As a result of both the Target Group and the Company being under common control prior to the Acquisition, the acquisition of the Target Group will be considered as a "combination of entities under common control". Under a combination of entities under common control, the assets and liabilities of the Target Group to be acquired by the Company will be accounted for at historical amounts in a manner similar to a pooling-of-interests ("as-if pooling-of-interests accounting"). In as-if pooling-of-interests accounting, the consolidated financial statements of the Company for periods prior to the combination will be restated to include the assets and liabilities and results of operations of the Target Group for those periods on a combined basis. The purchase price in respect of the acquisition of the Target Group will be treated as an equity transaction at the date of the acquisition.

(b) Improvement of growth prospects

The Company believes that the Acquisition will improve the growth potential for its telecommunications business. The total population in the Company's Listed Service Areas was 221 million at the end of 2002 (representing 17.2% of the total population in China at the end of 2002), while the total population in the service areas of the Combined Group, on a pro forma basis, would be 524 million at the end of 2002 (representing 40.8% of the total population in China at the end of 2002). In addition, the Target Service Areas, with sustained GDP growth and a lower-than-national-average telephone penetration rate, present significant growth potential for telecommunications services. For example, access lines in service and broadband subscriber growth rates of the Target Group were stronger than those of the Listed Group in the first six months of 2003.

	Listed Group	Target Group	Combined Group
Total population(1)(2) (in millions)	221	303	524
Penetration rate(3)	25.7%	13.4%	18.6%
Access lines in service growth(4)	9.4%	12.9%	10.8%
Broadband subscriber growth(4)	85.8%	108.3%	91.7%

Notes:

(1) As of end of 2002.

(2) *Source:* Data in respect of the total population in the Company's Listed Service Areas is estimated by the Company assuming that the growth rate of the population in the Company's Listed Service Areas in 2002 was the same as that in 2001.

(3) Determined by dividing the number of wireline access lines in service by the total population in the relative service areas.

(4) In the first six months of 2003.

(c) Realization of operating synergy

The Company believes that the Acquisition will enable it to achieve significant cost savings through reduction of interconnection traffic between the Listed Group and the Parent Group. Cost savings can also be achieved through centralized investment planning, procurement and financial management. The Company intends to implement within the Combined Group the business process re-engineering initiatives it has successfully implemented in the Listed Group. Establishment of a more effective corporate governance system is another focus of the post-Acquisition management reform efforts. These measures are expected to achieve improved operating efficiency and financial performance.

The network management, research and development facilities of the Parent to be acquired by the Company are an important part of the infrastructure necessary for the operation and development of the Company's business. The Company currently utilizes these facilities on a cost sharing basis with the Parent. Acquisition of these facilities will give the Company full operational control and is expected to strengthen the Company's ability to manage its network operations on a centralized basis and enable the Company to better coordinate its research and development efforts.

(d) Significant earnings accretion

As set out above, assuming that the Acquisition had been completed on January 1, 2003, the pro forma net profit of the Combined Group for the six-month period ended June 30, 2003 would have been RMB12,054 million (equivalent to approximately US$1,456 million), representing an increase of 30.2% of the net profit of the Company for the same period. Taking into account the interest payment in connection with the deferred consideration for the Acquisition and the other pro forma adjustments and on the basis that there is no intention to issue additional shares of the Company, the pro forma earnings per share of the Combined Group for the six-month period ended June 30, 2003 would have been RMB0.16 (equivalent to approximately US$0.02), representing an increase of 30.2% of the earnings per share of the Company for the same period.

(e) Improvement of capital efficiency

The Company believes that the Acquisition will significantly improve its return on equity. Based on the Company's audited financial statements for 2002 and unaudited interim financial statements for the six-month period ended June 30, 2003 prepared under IFRS, the Company had a return on equity (calculated by dividing the net profit by the average shareholders' equity) of 7.2% for the six-month period ended June 30, 2003. Assuming that the Acquisition had been completed on January 1, 2003, the return on equity, on a pro forma basis, would have been 10.7% for the Combined Group for the same period, representing an increase of 3.5 percentage points.

In addition, the Acquisition will enable the Company to optimize and enhance its capital structure. Taking into account the deferred consideration outstanding from the Company to the Parent and the indebtedness of the Target Group, the Combined Group would have a higher proportion of debt in its capital structure post the Acquisition and the Board believes this is appropriate and desirable.

FINANCIAL INFORMATION

The following is a summary of the combined results of the Target Group for the years ended December 31, 2001 and 2002 and the six-month period ended June 30, 2003, as extracted from the audited combined financial statements of the Target Group prepared in accordance with IFRS included in the shareholders' circular to be issued by the Company.

(Amounts in millions)

	Years ended December 31,		Six-month period ended June 30,
	2001	2002	2003
	RMB	*RMB*	*RMB*
Operating revenues	31,951	34,068	18,247
Operating expenses			
Depreciation and amortisation	(10,724)	(12,123)	(5,136)
Network operations and support	(11,621)	(12,097)	(5,534)
Selling, general and administrative	(4,550)	(4,993)	(2,602)
Other operating expenses	(538)	(236)	(112)
Total operating expenses	(27,433)	(29,449)	(13,384)
Operating profit	4,518	4,619	4,863
Deficit on revaluation of property, plant and equipment	—	(14,690)	—
Net finance costs	(1,169)	(1,512)	(726)
Investment (loss)/income	(9)	59	—
Share of profit from associates	—	2	—
Profit/(loss) before taxation and minority interests	3,340	(11,522)	4,137
Taxation	(230)	4,437	(763)
Profit/(loss) before minority interests	3,110	(7,085)	3,374
Minority interests	(7)	(6)	(3)
Net profit/(loss)	3,103	(7,091)	3,371

The following is a summary of the combined balance sheets of the Target Group as at December 31, 2001 and 2002 and June 30, 2003, as extracted from the audited combined financial statements of the Target Group prepared in accordance with IFRS included in the shareholders' circular to be issued by the Company.

(Amounts in millions)

	December 31,		June 30,
	2001	2002	2003
	RMB	*RMB*	*RMB*
ASSETS			
Non-current assets			
Property, plant and equipment, net	82,710	71,596	72,503
Construction in progress	9,490	7,650	8,259
Lease prepayments	518	617	620
Interests in associates	50	35	39
Investments	2,563	1	1
Deferred tax assets	1,816	2,408	2,819
Other assets	2,939	3,254	3,367
Total non-current assets	100,086	85,561	87,608
Current assets			
Inventories	824	687	769
Accounts receivable, net	2,928	3,097	3,727
Prepayments and other current assets	2,024	1,116	1,007
Time deposits with maturity over three months	77	36	33
Cash and cash equivalents	3,815	2,262	2,323
Total current assets	9,668	7,198	7,859
Total assets	109,754	92,759	95,467

	December 31, 2001	December 31, 2002	June 30, 2003
	RMB	*RMB*	*RMB*
LIABILITIES AND OWNER'S EQUITY			
Current liabilities			
Short-term debt	15,087	21,161	21,011
Current portion of long-term debt	5,095	3,455	4,837
Accounts payable	9,152	7,329	7,109
Accrued expenses and other payables	5,258	6,031	6,642
Income tax payable	—	—	1,068
Current portion of finance lease obligations	203	67	66
Current portion of deferred revenues	3,970	3,878	3,640
Total current liabilities	38,765	41,921	44,373
Net current liabilities	(29,097)	(34,723)	(36,514)
Total assets less current liabilities	70,989	50,838	51,094
Non-current liabilities			
Long-term debt	14,681	12,741	10,379
Finance lease obligations	367	82	51
Deferred revenues	12,112	10,123	9,319
Deferred tax liabilities	6,110	—	106
Total non-current liabilities	33,270	22,946	19,855
Total liabilities	72,035	64,867	64,228
Minority interests	48	52	53
Owner's equity	37,671	27,840	31,186
Total liabilities and owner's equity	109,754	92,759	95,467

Further detailed information in respect of the Target Group's historical results of operations and financial position is set out in the shareholders' circular to be issued by the Company.

3. PROSPECTIVE FINANCIAL INFORMATION

The Target Group has prepared certain prospective financial information in respect of themselves for the year ending December 31, 2003. There is no present intention to update this information during the year or to publish such information in future years, although the Directors are aware of the requirements of paragraphs 2.10 and 2.11 of the Listing Agreement entered into between the Company and the Stock Exchange. This information is necessarily based upon a number of assumptions that, while presented with numerical specificity and considered reasonable by the Company and the Target Group, are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond the control of the Company or the Target Group, and upon assumptions with respect to future business decisions which are subject to change. Accordingly, there can be no assurance that these results will be realized. The prospective financial information presented below may vary from actual results, and these variations may be material.

The Company and the Target Group believe that, on the bases and the assumptions to be disclosed in the shareholders' circular to be issued by the Company, and in the absence of unforeseen circumstances, the Target Group's forecast combined profit after taxation and minority interests but before extraordinary items for the year ending December 31, 2003 under IFRS is unlikely to be less than RMB6,352 million (equivalent to approximately US$767 million). The texts of the letters from KPMG, CICC and Morgan Stanley in respect of the profit forecast are set out in the shareholders' circular to be issued by the Company.

4. UNAUDITED PRO FORMA COMBINED FINANCIAL INFORMATION OF THE TARGET GROUP

Certain pro forma financial information of the Target Group for the year ended December 31, 2002 has been prepared based on the historical combined statement of operations of the Target Group, after giving effect to the pro forma adjustments described below, as if the transactions and arrangements described had taken effect on January 1, 2002.

A pro forma combined balance sheet is not prepared as the effect of revaluation of the Target Group's property, plant and equipment has been fully reflected in its historical combined balance sheet as at December 31, 2002.

The unaudited pro forma combined financial information of the Target Group is based on a number of assumptions, estimates, uncertainties and currently available information. As a result of these assumptions, estimates and uncertainties, the accompanying unaudited pro forma combined statement of operations of the Target Group for the year ended December 31, 2002 does not purport to describe the results of the Target Group's operations that would have been achieved had the Reorganization and the effects of the related service agreements taken effect on January 1, 2002, nor does it purport to predict the Target Group's future financial position or results of operations.

The unaudited pro forma combined financial information of the Target Group should be read in conjunction with the audited combined financial statements of the Target Group, including notes thereto, and other financial information included in the shareholders' circular.

Unaudited pro forma combined statement of operations for the year ended December 31, 2002

	Target Group Historical	Pro Forma Adjustments	Target Group Pro Forma
	RMB millions	*RMB millions*	*RMB millions*
Operating revenues	34,068		34,068
Operating expenses			
Depreciation and amortisation	(12,123)	2,643(1) 59(2)	(9,421)
Network operations and support	(12,097)		(12,097)
Selling, general and administrative	(4,993)	(33)(2)	(5,026)
Other operating expenses	(236)		(236)
Total operating expenses	(29,449)		(26,780)
Operating profit	4,619		7,288
Deficit on revaluation of property, plant and equipment	(14,690)		(14,690)
Net finance costs	(1,512)		(1,512)
Investment income	59	(59)(3)	—
Share of profit from associates	2		2
Loss before taxation and minority interests	(11,522)		(8,912)
Taxation	4,437	(861)(4)	3,576
Loss before minority interests	(7,085)		(5,336)
Minority interests	(6)		(6)
Net loss	(7,091)		(5,342)

Notes:

(1) In connection with the Reorganization, the property, plant and equipment of the Target Group were revalued as at December 31, 2002 which resulted in a net revaluation deficit of RMB13,930 million. The pro forma adjustment reflects the reduction in depreciation charge resulting from the revaluation of the Target Group's property, plant and equipment as if the results of the revaluation had been recorded on January 1, 2002.

(2) In connection with the Reorganization, certain properties and buildings associated with the wireline telecommunications business and related operations of the Target Group were not transferred to the Target Group but were retained by China Telecommunications Corporation. Pursuant to property leasing agreements between the Target Group and the Parent Group, the Target Group leases the properties and buildings from the Parent Group. The amount to be paid by the Target Group to the Parent Group is based on market rates, with reference to amounts stipulated by local price bureaus. The pro forma adjustment reflects the effects of a reduction in depreciation charge relating to these properties and buildings and an increase in rental expense as if the Reorganization occurred and the property leasing agreements took effect on January 1, 2002.

(3) In connection with the Reorganization, certain long-term investments and interests in associates that are unrelated to the telecommunications industries were not transferred to a Target Group but were retained by China Telecommunications Corporation. The pro forma adjustment reflects a reduction in investment income generated from these investments as if the Reorganization occurred on January 1, 2002.

(4) The pro forma adjustment reflects the tax effect of the above pro forma adjustments using the statutory tax rate of 33%.

5. INFORMATION ON THE TARGET ASSETS

INDUSTRY BACKGROUND

The telecommunication industry in China has experienced rapid growth in recent years. According to the MII, the total number of wireline access lines in service increased from 144.8 million as of the end of 2000 to 214.4 million as of the end of 2002, representing a compound annual growth rate of 21.7%. Wireline telephone penetration rate increased from 11.4% to 16.7% during the same period. As a result of the increasing demand for information services and technology development, the market for data communications and Internet services in China also experienced rapid growth during that period. The number of Internet users in China increased from 22.5 million as of the end of 2000 to 49.7 million as of the end of 2002, representing a compound annual growth rate of 48.6%.

The following table sets forth certain information relating to the telecommunications and information industry in China as of the dates indicated.

	As of December 31, 2000	2001	2002	Compound Annual Growth Rate (2000–2002)
China's population *(in millions)*	1,267	1,276	1,285	0.7%
China's GDP per capita *(RMB)*	7,081	7,543	8,184	7.5%
Wireline telephone				
Access lines in service *(in millions)*	144.8	180.4	214.4	21.7%
Penetration rate(1)	11.4%	14.1%	16.7%	—
Internet				
Users *(in millions)*	22.5	33.7	49.7	48.6%
Penetration rate(1)	1.8%	2.6%	3.9%	—

Note:

(1) Determined by dividing the number of access lines in service or users by the total population of China.

Sources: Data in respect of China's population and GDP per capita, which is calculated at current prices, are derived from information published by the National Statistical Bureau; data in respect of wireline access lines in service are derived from information published by the MII; data in respect of Internet users of 2000 and 2001 are derived from information published by China Internet Network Information Centre, or CNNIC, and that of 2002 are derived from information published by the MII.

The Parent and the Company face competition from other telecommunications service providers, such as China Netcom Group, China Mobile, China Unicom and China Railcom in their wireline telephone, data, Internet, and leased line services. All of the principal competitors are wholly or majority owned by the Chinese government. The government encourages orderly and fair competition in the telecommunications industry in China. Currently, providers of basic telecommunications services must apply for a license from the MII. Only a limited number of providers have obtained licenses to provide basic telecommunications services in China.

MARKET ENVIRONMENT OF THE TARGET GROUP

The Target Service Areas accounted for 18.9% of the total GDP of China in 2002, with a compound annual growth rate of GDP of 9.3% from 2000 to 2002. The wireline penetration rate in the Target Service Areas reached 13.4% as of December 31, 2002. The penetration rate in these service regions is relatively low compared to that in the Listed Service Areas. The Board believes this will enhance growth potential for the Company.

The table below sets out selected demographic and market information related to these service areas and the whole country as of or for the year ended December 31, 2002, unless otherwise indicated.

	Target Service Areas	China
Population *(in millions)*	303	1,285
GDP per capita *(RMB)*(1)	6,538	8,184
2000–2002 compound annual growth rate of GDP(1)	9.3%	8.2%
Wireline telephone penetration rate(2)	13.4%	16.7%
Number of Internet subscribers *(in thousands)*	7,569(3)	49,700(4)
Internet penetration rate(5)	2.5%	3.9%

Notes:

(1) GDP is calculated at current prices.

(2) Calculated by dividing the number of wireline access lines in service by the relevant population.

(3) Excludes inactive subscribers, who have registered accounts with the Target Group but have not used the Target Group's Internet access services.

(4) Includes inactive subscribers.

(5) Calculated by dividing the number of Internet subscribers by the relevant population.

Sources: Data in respect of China's population, 2002 GDP per capita, 2000 to 2002 compound annual growth rate of GDP and wireline telephone penetration rate of China are derived from information published by the National Statistical Bureau and MII; data in respect of wireline access lines in service are derived from information provided by Provincial Telecommunications Administrations in the Target Service Areas; and data in respect of Internet users are derived from information published by the MII.

OVERVIEW OF THE BUSINESS OF THE TARGET GROUP

The Target Group is the leading provider of wireline telephone, data, Internet and leased lines services in its service regions. The following table sets forth the percentages of contribution by the Target Group's different services to its total operating revenues for the periods indicated:

	Year ended December 31, 2001	2002	Six months ended June 30, 2003
Wireline telephone services:			
Local			
Installation fees	1.5%	1.7%	1.8%
Monthly fees	16.0%	19.2%	20.2%
Local usage fees	36.0%	35.3%	34.3%
Domestic long distance(1)	18.6%	16.9%	16.1%
International long distance(1) (2)	1.2%	1.2%	1.1%
Interconnection	4.7%	4.6%	5.1%
Upfront connection fees	8.2%	7.5%	6.4%
Sub-total	86.2%	86.4%	85.0%
Data and Internet services:			
Internet(3)	2.0%	3.3%	4.6%
Managed data(4)	1.8%	1.9%	1.7%
Sub-total	3.8%	5.2%	6.3%
Leased line services	3.7%	3.3%	3.1%
Other services(5)	6.3%	5.1%	5.6%
Total operating revenue of the Target Group	100.0%	100.0%	100.0%

Notes:

(1) Includes revenue from VoIP long distance services.

(2) Includes revenue from calls to Hong Kong, Macau and Taiwan.

(3) Includes revenue from dial-up, dedicated and broadband Internet access services as well as value-added data services.

(4) Includes revenue from DDN, frame relay and ATM services.

(5) Include revenue from value-added voice services and sales and maintenance of customer-end equipment, and lease of telecommunications network facilities.

WIRELINE TELEPHONE SERVICES

The wireline telephone services of the Target Group consist of local telephone, domestic and international long distance and interconnection services.

Wireline telephone services are the Target Group's main services, generating 86.4% of its total operating revenue in 2002. Revenue generated by these services in the Target Service Areas increased from RMB27,546 million in 2001 to RMB29,420 million in 2002 and reached RMB15,519 million in the six months ended June 30, 2003. The demand for value-added voice and information services has also increased in recent years. The Target Group's wireline telephone services will continue to provide steady revenue stream and drive the overall earnings growth of the Combined Group.

Local Telephone Services

The local telephone services in the Target Service Areas have grown significantly in terms of number of access lines in service in recent years, representing the largest revenue source for the wireline telephone services of the Target Group and contributing 56.2% of its total operating revenue in 2002 and 56.3% in the six months ended June 30, 2003, as compared to 53.5% in 2001.

Access lines. The following table sets out selected information regarding the local telephone services of the Target Group as of the dates indicated:

	As of December 31, 2000	2001	2002	As of June 30, 2003
	(in thousands, except percentages)			
Number of access lines in service(1):				
Residential	20,800	26,166	30,165	32,663
Enterprise	3,350	3,664	3,931	3,849(2)
Public telephones	1,006	1,265	1,783	2,029
Wireless local access	283	1,260	4,049	6,532
Total(3)	25,440	32,356	39,929	45,073
Wireline telephone penetration rate	8.5%	10.8%	13.4%	15.1%(4)
Market share measured by number of access lines in service(5)	99.7%	99.3%	98.6%	98.3%

Notes:

(1) Includes ISDN lines as measured by the number of bearer channels.

(2) The decline in the number of access lines in service for enterprise subscribers from 3.9 million ended December 31, 2002 to 3.8 million ended June 30, 2003 is due to an elimination of inactive enterprise subscribers.

(3) The total number of access lines in service is different with the sum of all kinds of access lines because of rounding discrepancies.

(4) Population used for calculating the penetration rate is estimated based on the population as of the end of 2002, and assuming that the growth rate in the first half of 2003 is the same as the growth rate in 2002.

(5) *Sources:* Data in respect of the number of the Target Group's access lines in service are provided by the Target Group. Data in respect of the total number of access lines in the Target Service Areas are derived from the Provincial Telecommunications Administrations in the Target Service Areas.

The number of the Target Group's access lines in service has increased rapidly from 25.4 million as of the end of 2000 to 39.9 million as of the end of 2002 and 45.1 million as of June 30, 2003. The Target Group had a 98.3% market share in the Target Service Areas in terms of the number of access lines in service as of June 30, 2003. The wireline penetration rate in the Target Service Areas increased from 8.5% as of the end of 2000 to 15.1% as of June 30, 2003.

Being an extension and supplement to local wireline telephone services, wireless local access provides personal communications at an attractive price and enjoys strong demand in niche markets. The continued decline in the price of wireless access equipment has made it a more profitable business. The Target Group's wireless local access customers grew by 2.5 million in the first half of 2003.

The Target Group also operates an extensive network of public telephones in the Target Service Areas, and the number of public telephones reached approximately 2.0 million as of the end of June 30, 2003. Public telephone services are targeted at the large and fast growing mobile population in the Target Service Areas. The Company believes demand for the Target Group's public telephone services in these areas will continue to expand.

Service usage. The following table sets out certain usage information regarding the Target Group's local telephone services for the periods indicated:

	Year ended December 31, 2000	2001	2002	Six months ended June 30, 2003
Total usage *(pulses in billions)*(1) (2)	79.9	111.4	119.8	59.6
Total usage *(minutes in billions)*(3)	88.1	118.7	121.6	57.3

Notes:

(1) Pulses are the billing units for calculating local telephone usage fees. The definition of a pulse for intra-district calls changed in connection with the 2001 tariff adjustments. The pulse data for 2000 were converted into pulses under the new definition through a statistical sampling of calling patterns, and may be subject to certain statistical error.

(2) Include 8.1 billion pulses in 2000, 20.1 billion pulses in 2001, 19.3 billion pulses in 2002 and 6.9 billion pulses in the six months ended June 30, 2003, in respect of Internet dial-up usage generated by our Internet subscribers and subscribers of other Internet access providers.

(3) Minutes reported were calculated from pulses through a statistical sampling of calling patterns.

The total usage of the Target Group's local telephone services, including those associated with voice and VoIP long distance calls, increased from 111.4 billion pulses in 2001 to 119.8 billion pulses in 2002 and reached 59.6 billion pulses in the six months ended June 30, 2003. Dial-up Internet usage as a percentage of total local usage in terms of pulses, decreased from 18.0% in 2001 to 16.1% in 2002 and 11.5% in the six months ended June 30, 2003. Tariffs for the communications fees of dial-up Internet access were much lower than the usage fees for voice services.

Tariffs. For its local telephone services, the Target Group charges an upfront installation fee, a fixed monthly fee and local call usage fees based on call duration. The tariffs are regulated by the Chinese government. The local call usage fees are either intra-district or inter-district, depending upon whether a call is within a single service district or between service districts. In December 2000, the Chinese government issued a notice of tariff adjustments, which the Target Group implemented in the first half of 2001. The tariff adjustments changed the tariff levels for many telecommunications services, including local and long distance telephone, data and leased line services.

The following table sets out the changes in the Target Group's tariffs before and after the tariff adjustments implemented in 2001 for local telephone services:

	Before Tariff Adjustments	After Tariff Adjustments
	(RMB)	
Monthly fee(1):		
Residential customers	7.6–21.6	10.0–25.0
Enterprise customers	12.0–33.0	25.0–35.0
Usage fee:		
Intra-district	0.18–0.20 per pulse (three minute intervals)	0.20–0.22 for the first two pulses (first three minutes or less) and 0.10–0.11 for each additional pulse (one minute intervals)
Inter-district	0.20–0.50 per pulse (one minute intervals)	0.20–0.50 per pulse (one minute intervals)
Communications fee:		
Internet dial-up	0.09–0.10 per pulse (three minute intervals)	0.02 per pulse (one minute intervals)

Note:

(1) Monthly fees for customers vary depending on whether a subscriber is located in the provincial capital, a city, a county or rural areas.

Prior to July 2001, the Target Group charged an upfront connection fee for basic access services. State guidance rates for connection fees for basic access services varied from time to time and ranged from RMB100 to RMB1,000. The connection fees were eliminated entirely in July 2001. The decrease in and ultimate elimination of the connection fees have stimulated customer growth, especially for residential customers. In addition, all previous surcharges on telephone services, which were mostly levied by provincial and local governments, were eliminated in July 2001.

Domestic Long Distance Services

The Target Group offers long distance services through its public switched telephone network as well as VoIP long distance services. Total revenue from the Target Group's domestic long distance services represented 16.9% of its total operating revenue in 2002 and 16.1% in the six months ended June 30, 2003, compared to 18.6% in 2001. The Target Group is the largest provider of domestic long distance services in the Target Service Areas, with a 55.7% market share, as measured by total minutes carried through, of all wireline and mobile operators in Target Service Areas in 2002. The market share of the Target Group decreased to 51.8% in the six months ended June 30, 2003. In addition, the Target Group commenced offering VoIP domestic long distance services in 1999. From 2000 to 2002, the proportion of VoIP services in total long distance usage increased from 2.1% to 42.1%.

Service usage. The following table shows the total minutes of domestic long distance calls carried through the Target Group's long distance network and the market share of its domestic long distance services for the periods indicated:

	Year ended December 31, 2000	2001	2002	Six months ended June 30, 2003
Total minutes of usage *(in millions)*(1)	10,657	12,070	13,168	6,790
Market share(2)	80.0%	68.2%	55.7%	51.8%
Percentage of usage via VoIP	2.1%	28.1%	42.1%	45.1%

Notes:

(1) Includes calls originated by mobile subscribers that are carried over the Target Group's long distance networks.

(2) *Sources:* Data in respect of the number of domestic long distance call minutes of the Target Group are provided by the Target Group. Data in respect of the total number of domestic long distance call minutes in the Target Service Areas are derived from the Provincial Telecommunications Administrations in the Target Service Areas.

The decrease in the market share of the Target Group's domestic long distance services from 2000 to June 30, 2003 was mainly attributable to the expansion of mobile operators' long distance networks and their increased routing of long distance calls placed by their mobile subscribers through their own long distance networks as well as increased competition from other wireline long distance service providers. Despite such competition, the total minutes of usage of domestic long distance services of the Target Group have maintained a steady growth through marketing and further development of distribution channels.

Tariffs. The tariff adjustments in 2001 abolished the distance-based tariff structure, reduced the unit of billing from one minute to six seconds and eliminated long distance call surcharges.

The following table sets out the tariffs for the Target Group's domestic long distance telephone services before and after the tariff adjustments in 2001, which are based on state tariff rates:

	Before Tariff Adjustments	After Tariff Adjustments
	(RMB)	
Public switched telephone network services		All at the unified rate of 0.07 per six seconds(1)
Intra-provincial less than 300 km	0.50–0.60 per minute(2)	
Intra-provincial more than 300 km	0.60 per minute(2)	
Inter-provincial less than 800 km	0.80 per minute(2)	
Inter-provincial more than 800 km	1.00 per minute(2)	
VoIP services(3)	0.30 per minute	Not regulated

Notes:

(1) A discount rate of up to 40% applies to calls made during off-peak hours, which are from 12:00 a.m. to 7:00 a.m. every day.

(2) A discount rate of 50% applies to calls made during off-peak hours, which are from 9:00 p.m. to 12:00 a.m. for weekdays and from 7:00 a.m. to 12:00 a.m. on public holidays and weekends; a discount rate of 70% applies to calls made during 12:00 a.m. to 7:00 a.m. everyday.

(3) Does not include separate usage fees for local services when a VoIP call is placed. The local usage fee of a VoIP call is the same as the local usage fee of an intra-district local voice call.

The tariff adjustments in 2001 also deregulated the tariffs for VoIP services. VoIP long distance services have lower tariff rates than those for long distance services using public switched telephone networks. However, the Target Group also charges local usage fees on VoIP long distance calls.

International Long Distance Services

The Target Group is the largest provider of international long distance services in its service regions, with a 65.1% market share in 2002 and a 59.0% market share in the six months ended June 30, 2003 as measured by the total number of outgoing call minutes generated in the Target Service Areas and carried through international gateways of all wireline and mobile operators. The Target Group's international long distance telephone services contributed 1.2% to its total operating revenue in 2001 and 2002 and 1.1% in the six months ended June 30, 2003. The Target Group began offering VoIP international long distance services in 1999, similar to its VoIP domestic long distance services in the Target Service Areas.

Service usage. The following table sets out certain information related to the usage and market share of the Target Group's international long distance services, including usage of international long distance services by mobile subscribers, for the periods indicated:

	Year ended December 31, 2000	2001	2002	Six months ended June 30, 2003
Outgoing call minutes *(in millions)*(1)	122.6	155.3	168.7	77.4
Market share by outgoing call minutes(2)	78.0%	68.2%	65.1%	59.0%
Percentage of usage via VoIP	5.1%	43.2%	64.6%	68.5%

Notes:

(1) Includes calls originated by mobile subscribers that are carried through the international gateways of China Telecommunications Corporation.

(2) *Sources:* Data in respect of the number of outgoing call minutes of the Target Group are provided by the Target Group. Data in respect of the total number of outgoing call minutes in the Target Service Areas are derived from the Provincial Telecommunications Administrations in the Target Service Areas.

The market share in terms of outgoing call minutes of the Target Group's international long distance services declined from 78.0% in 2000 to 65.1% in 2002, mainly because mobile operators established their own international gateways and diverted international calls previously placed by their mobile subscribers through the Parent's international gateways.

Tariffs. The tariff adjustments in 2001 reduced the basic unit of billing from one minute to six seconds and simplified the rate schedule by abolishing the distance-based tariff structure.

The following table sets out the international long distance tariffs of the Target Group before and after the tariff adjustments in 2001, which are based on state tariff rates:

	Before Tariff Adjustments	After Tariff Adjustments
	(RMB)	
Public switched telephone network services:		
To Hong Kong, Macau and Taiwan	5.00 per minute(1)	0.20 per 6 seconds
To all international destinations	5.30–15.00 per minute(2)	0.80 per 6 seconds(3)
VoIP services(4):		
To Hong Kong, Macau and Taiwan	2.50 per minute	Not regulated
To all international destinations	4.80 per minute	Not regulated

Notes:

(1) A discount rate of 40% applied to calls made during off-peak hours.

(2) Rates of RMB5.30–12.00 per minute applied to calls made to Asian countries and regions and a rate of RMB15.00 per minute applied to calls to all other international destinations. A discount rate of 40% applied to calls made during off-peak hours.

(3) A discount rate of up to 40% applies to calls made during off-peak hours.

(4) Does not include separate usage fees for local services when a VoIP call is placed. The local usage fee of a VoIP call is the same as the local usage fee of an intra-district local voice call.

Since the tariff adjustments, the Target Group charges RMB1.50 per minute for VoIP long distance calls to Hong Kong, Macau and Taiwan and RMB2.40–4.60 per minute for VoIP long distance calls to international destinations, but offers various incentive programs and discounts from time to time.

The Target Group offers international long distance services through the international gateways of China Telecommunications Corporation. China Telecommunications Corporation negotiates bilateral settlement arrangements and rates based on the international settlement standards in the telecommunications industry, and those settlement arrangements and rates also apply to the Target Group.

Interconnection

All interconnection and settlement arrangements among public wireline telephone, mobile, and Internet networks in China are governed by the Telecommunications Regulations and the rules on interconnection arrangements and settlement promulgated by the MII in 2001.

Subsidiaries of China Telecommunications Corporation, including the provincial subsisting companies in the Target Service Areas, have entered into interconnection agreements with other telecommunications service providers in the Target Service Areas. These agreements provide for interconnection settlement with respect to local calls and domestic and international long distance calls involving the Target Group's networks. In connection with the Reorganization in preparation for the Acquisition, China Telecommunications Corporation has assigned to the Target Companies, and the Target Companies have assumed, its rights and obligations under these agreements. The economic terms and the settlement procedures under those agreements are in accordance with the standards set forth in the interconnection rules and regulations.

Based on the existing interconnection arrangement between the Company and China Telecommunications Corporation, the proposed acquisition of the Target Group would reduce the Combined Group's interconnection revenue and expense with respect to the traffic between the Target Group and the Listed Group, and would increase the Combined Group's interconnection revenue and expense with respect to the traffic between the Target Group and the Parent Group.

Value-added Voice and Information Services

Value-added voice service. In addition to basic local and long distance services, the Target Group offers a number of value-added voice services. The Target Group continues to leverage its extensive network resources, customer base and distribution channels and cooperate with other service providers to develop new revenue sources, including caller ID display, telephone information services, telephone directory services, conference calling and toll-free services. Caller ID display service has approximately 20.7 million users with a penetration rate of 46.0% as of June 30, 2003 amongst the Target Group's wireline access lines in service. The Target Group has strengthened the promotion of value-added services, gradually introduced new products such as call-center out-sourcing, video conferencing, 17901 direct dial VoIP, "Telephone QQ" (電話聊天業務), wireline short messaging services (家加e), and "Walk with Me" (伴我行). Subscribers are becoming familiar with these branded services through active marketing by the Target Group. The Company believes that these services allow the Company to enhance customer satisfaction and increase its revenue after the Acquisition. As subscribers in China become more accustomed to these value-added voice services, the Company expects significant growth potential in this area.

Telephone information services. The Target Group has significantly expanded the scope of its automated and operator-assisted telephone information and applications services in recent years. The Target Group's general information services allow users to access information at its standard telephone usage rates plus information usage fees. The Target Group also provides other specialized telephone information and applications services, such as telephone banking and telephone advertising. Total usage of the telephone information services provided by the Target Group reached 281.2 million minutes in the six months ended June 30, 2003. The Target Group intends to further expand the scope and usage of these services and develop flexible revenue sharing arrangements with content and application service providers.

Telephone directory services. The Target Group publishes telephone directories, known as Yellow Pages, in the Target Service Areas. In addition, the Target Group has introduced online telephone directory and other related information services. The Target Group derives advertising revenue from its printed and on-line directories.

DATA AND INTERNET SERVICES

The Target Group is the leading provider of data and Internet services in the Target Service Areas. The data and Internet services of the Target Group is supported by extensive local access networks in the Target Service Areas and the largest nationwide fiber optic backbone transmission network jointly operated by the Combined Group and the Parent. Revenue from the Target Group's Internet services was RMB1,139 million in 2002, representing 3.3% of its total operating revenue for that year, and reached RMB841 million in the six months ended June 30, 2003, representing 4.6% of its total operating revenue for that period. Revenue from the Target Group's managed data services was RMB642 million in 2002, representing 1.9% of its total operating revenue for that year, and was RMB308 million in the six months ended June 30, 2003, representing 1.7% of its total operating revenue for that period.

The following table sets forth selected information regarding the data, Internet and related services of the Target Group as of the dates or for the periods indicated:

	As of or for the year ended December 31,			As of or for the six months ended June 30,
	2000	2001	2002	2003
Managed data services:				
Number of ports *(in thousands):*				
DDN services	51.7	64.5	72.1	73.3
Frame relay services	2.8	5.5	9.4	10.8
ATM services	0.0	0.1	0.5	0.7
Bandwidth leased *(in thousands):*				
DDN services *(x64Kbps)*	46.6	63.8	70.6	79.8
Frame relay services *(x128Kbps)*	2.7	7.3	15.5	18.2
ATM services *(x2Mbps)*	0.0	0.2	5.1	3.7
Dial-up and dedicated Internet access services:				
Dial-up subscribers *(in thousands)*	1,844.6	4,366.3	5,978.5	6,303.0
Dial-up on-line usage *(minutes in billions)*	7.8	19.1	16.9	6.0
Dedicated Internet access lines *(in thousands)*	1.8	1.8	1.5	1.2
Broadband access services *(in thousands):*				
DSL subscribers	1.3	36.1	303.2	688.9
FTTx + LAN subscribers	—	50.6	187.0	337.9
Others	—	—	4.5	3.8

Managed Data Services

The Target Group's managed data services include DDN, frame relay and ATM services. The Target Group is the market leader in the managed data services in the Target Service Areas.

DDN services. The Target Group's DDN services provide high-quality and reliable transmission at speeds ranging from 64Kbps to 2Mbps and continue to meet the increasing demand for low-to medium-speed transmission capacity from enterprise customers. DDN systems are composed of optic fibers, digital transmission paths and digital cross multiplexing nodes. DDN systems are capable of providing high-quality private circuits and other services at various data rates to satisfy users' multimedia communications needs.

Frame relay/ATM services. The Target Group offers advanced high-speed data communications services based on frame relay and ATM technologies. These services enable flexible and cost-effective use of bandwidth resources. Frame relay is a type of connection-oriented packet switching technology that employs statistical multiplexing over a shared network. Frame relay offers both access to a network and transmission of data across a network and is used by customers with significant amounts of data traffic. ATM is a high bandwidth and multiplexing technology. ATM is developed for high data rates with a high quality of service, and can offer integrated voice, data and video services at various data rates.

Tariffs. The Target Group determines most of the tariffs for its data services within a price range set by the Chinese government. The Target Group generally charges an upfront fee for installation and testing for its data services and a fixed monthly fee. The Target Group offers various incentive programs and discounts for the customers who wish to upgrade to higher brandwidth services. These incentive programs and discounts have stimulated demand for data services.

The following table sets forth the monthly fees in 2002 for DDN services at the bandwidth of 64Kbps and 2Mbps:

	Monthly Fee
	(RMB)
64Kbps	
Intra-district	1,500
Inter-district	2,000
Intra-provincial	3,500
Inter-provincial *(less than 800 km)*	3,500
Inter-provincial *(more than 800 km)*	3,500
2Mbps	
Intra-district	6,000
Inter-district	8,000
Intra-provincial	12,000
Inter-provincial *(less than 800 km)*	12,000
Inter-provincial *(more than 800 km)*	12,000

The following tables set forth the monthly fees in 2002 for frame relay and ATM services, which include monthly fees for port access and permanent virtual circuits, or PVCs:

	Bandwidth			
	2Mbps	10Mbps	100Mbps	155Mbps
		(RMB)		
Monthly Fees for port access	1,000	5,000	9,000	10,000

PVC monthly fees (RMB)(1):

	PVC Monthly Fees		
Bandwidth	Intra-District	Inter-District	Domestic Long Distance
		(RMB)	
256Kbps	800	1,150	2,200
2Mbps	1,500	2,200	4,000
10Mbps	5,000	11,500	15,500
155Mbps	14,500	39,000	130,000

Note:

(1) One-way tariff for PVC circuits of ATM services.

Dial-up and Dedicated Internet Access Services

The Target Group is the largest provider of dial-up and dedicated Internet access services in the Target Service Areas in terms of the number of subscribers. The Target Group classifies its dial-up Internet access users into registered users, non-registered users and prepaid users. The Target Group provides a variety of dedicated Internet access services to its business and government customers.

The dial-up Internet access subscribers of the Target Group increased from 4.4 million as of the end of 2001 to 6.0 million as of the end of 2002 and 6.3 million as of June 30, 2003. Total dial-up usage generated from the Target Group's subscribers declined from 19.1 billion minutes in 2001 to 16.9 billion minutes in 2002, and reached 6.0 billion minutes in the first six months in 2003. The decrease of the dial-up usage was mainly caused by the upgrade made by some of the dial-up subscribers to broadband services.

To further develop dial-up Internet access services, the Target Group has strengthened its content application services by introducing a new Internet dial-up value-added business known as "D-net". Relying on the extensive dial-up network resources, access number resources and billing channels of the Target Group, the Target Group cooperates with Internet content providers to provide dial-up Internet subscribers with a dedicated platform for value-added services, thereby achieving the integration of dial-up Internet access services with the provision of value-added services by Internet content providers. Upon its introduction, this form of cooperation received immediate positive responses from Internet content providers, increasing the attractiveness of service content to dial-up subscribers and aiding the enhancement of the Target Group's reputation with subscribers.

Dial-up Internet access services and application services have created more subscriber interest in the Internet. Furthermore, the convenience of dial-up Internet access also satisfies the need of certain customer groups. Due to the interactive relationship between dial-up Internet access services and broadband access services, the Target Group aims to balance the development between dial-up Internet access and broadband access.

Tariffs. Registered dial-up Internet access users pay an Internet access fee as well as a local communications fee. Dedicated Internet access users pay usage fees for the leased dedicated lines or fiber optic access. The tariff adjustment in 2001 reduced tariffs for dial-up Internet access service.

The following table sets forth the tariffs for the Target Group's dial-up Internet access services before and after the tariff adjustment in 2001:

	Before Tariff Adjustments	After Tariff Adjustments
Dial-up Internet access fees	RMB4.00 per hour	RMB3.00 per hour

The following table sets forth the tariffs for the dedicated Internet access services in 2002:

Bandwidth	*RMB per month*
64Kbps–128Kbps	4,000
1Mbps–2Mbps	20,000

Broadband Internet Access

DSL services. The Target Group promotes DSL services as the primary broadband Internet access means for residential customers and small- and medium-sized enterprise customers. DSL services can be offered over copper wires and are suitable for high-speed Internet access. The Target Group's DSL service charges are based on bandwidth and whether the customer is a residential customer or enterprise customer. The Target Group's service fees include an upfront installation fee, monthly fees and overtime charges. The Target Group had 303,220 DSL subscribers as of the end of 2002 and 688,929 DSL subscribers as of June 30, 2003.

Fiber-Ethernet access services. The Target Group offers broadband access services through fiber optic cables that directly link Ethernet technology-based LANs in office buildings or high value residential complexes to the Internet. Fiber-Ethernet access uses optic fiber technology and Ethernet protocol to connect residential users and business users to a telecommunications network and greatly expands capacity of the access network. As of the end of 2002 and June 30, 2003, the Target Group had 186,988 customers and 337,902 customers, respectively, using Fiber-Ethernet access services.

Wireless LAN services. The Target Group provides fast and convenient wireless LAN services through its wireless local area networks in public places, such as airports, hotels, conference centers and office buildings.

Broadband application services. The Target Group continues to leverage its broadband access networks and distribution channels to develop various broadband application services, such as distance education, distance medical services, video conferencing, on-line games, entertainment and video-on-demand.

Cooperating with certain service providers and relying on the large subscriber base, network resources, application platforms and the reliable supporting system, customers management and billing channels, the Target Group has introduced ChinaVnet to provide the content/application service providers with billing platforms and channels and to promote to subscribers the modified and consolidated network services provided by the content/application service providers. ChinaVnet actively promotes the continual developments of Internet industrial chain and creates a new business model. Through the integration of content and application from providers and the creation of a rich and varied Internet service for Internet subscribers, ChinaVnet will effectively promote the rapid proliferation of broadband applications and stimulate growth in subscriber base and revenue.

Tariffs. The following table sets forth the tariffs for DSL services in 2002:

Type of Service	Connection Fee	Network Fee
	(RMB per Port)	*(RMB per Port)*
Residential	400	200 per month if less than 120 hours and 4.00 per hour for every hour exceeding the 120-hour limit
Enterprise	1,000	800 per month if less than 180 hours, and 6.00 per hour for every hour exceeding the 180-hour limit

Note:

(1) Some companies would provide some packaged DSL promotion to meet the needs of customers.

For customers connected through LANs, the Target Group charges either a monthly network fee plus a fiber optic access fee determined by bandwidth, or a monthly network fee plus an upfront connection fee. The following table sets forth the guidance tariffs for its Fiber-Ethernet access services:

Type of Customer	Port Bandwidth	Connection Fee(1)	Network Fee
		(RMB per Port)	*(RMB per Port per month)*
Residential	10Mbps	400	200
	100Mbps	—	300
Enterprise	10Mbps	1,000	1,000
	100Mbps	—	2,000

Note:

(1) Includes registration fee, installation fee and labor expenses, but does not include equipment fees incurred by customers

System Integration and Other Value-Added Services

The Target Group offers system integration and solution services to its customers. Its system integration services encompass initial consulting, network planning, network implementation, application development and maintenance. The current development of the Target Group focuses on system integration and information management such as network management and data mining and analysis services.

The Target Group's Internet data centers primarily offer co-location and web hosting services. It operates many large Internet data centers that together provide more than 6,300 square meters of rack space. As part of those services, the Target Group also leases to its customers various resources at these Internet data centers, such as servers and database storage capacity. In addition, the Target Group is developing a range of Internet-based services to meet increasing corporate outsourcing requirements for website development and maintenance as well as Internet-based applications.

LEASED LINE SERVICES

The Target Group also provides leased line services in the Target Service Areas. In addition to leased lines, the Target Group also leases other network elements to business and government customers and other telecommunications service providers. It mainly leases digital circuits, digital trunk lines and optic fibers. The revenue from the Target Group's leased line services is mainly derived from the lease of digital circuits. Revenue from the Target Group's leased line services was RMB1,119 million in 2002, representing 3.3% of its total operating revenue for that year, and reached RMB566 million in the six months ended June 30, 2003.

The Target Group offers these services as part of its total telecommunications solutions and markets these services to large enterprise customers and other operators through its large enterprise customer service teams. The decline in total digital circuits leased in 2002 and the six months ended June 30, 2003 was primarily due to the reduction of circuits leased by mobile operators in the Target Service Areas, as these operators develop their own network infrastructure. Increasing demand from business and government subscribers has partially offset the impact of such reduction.

The following table sets forth the total amounts of bandwidth of leased line service of the Target Group as of the dates indicated:

	As of December 31,			As of June 30,
Leased Digital Circuits	2000	2001	2002	2003
Total bandwidth *(in 2Mbps equivalents)*	25,625	29,343	28,326	27,767

Tariffs. The Target Group charges monthly fees for leased lines based on tariff rates set by the Chinese government, which vary based on bandwidth and whether the leased line is local or long distance. Leased line tariffs have generally decreased in recent years. The tariff adjustments in 2001 substantially reduced tariffs for leased line services.

The following table sets forth the tariffs for 2Mbps and 155Mbps digital circuits in 2002:

	Monthly Fee
	(RMB)
2Mbps	
Intra-district	2,000
Inter-district	4,000
Intra-provincial(1)	6,000
Inter-provincial(1) *(less than 800km)*	6,000
Inter-provincial(1) *(more than 800km)*	6,000
155Mbps	
Intra-district	44,000
Inter-district	88,000
Intra-provincial(1)	132,000
Inter-provincial(1) *(less than 800km)*	132,000
Inter-provincial(1) *(more than 800km)*	132,000

Note:

(1) Does not include the tariffs for local digital circuits and access lines.

MARKETING, DISTRIBUTION AND CUSTOMER SERVICES

Marketing Initiatives

The Target Group markets all of its telecommunications services under the "China Telecom" brand name, which is one of the best-known brand names in China. The Target Group offers a full range of differentiated services to its customers to address their telecommunications needs. The Target Group offers individually tailored services to its large enterprise customers, specialized services to its small- and medium-sized enterprise customers and standardized services to its residential customers. In addition, the Target Group plans to increase its advertising activities to enhance customer awareness of its available services and promote brand loyalty.

Sales, Distribution and Customer Services

Dedicated customer manager system for large enterprise customers. The Target Group has implemented a large enterprise customer manager system. Under this system, dedicated customer managers of the Target Group directly markets their services to large enterprise customers. These customer managers form dedicated management teams based on the industry background or geographical locations of the customers. The Target Group conducts periodic performance reviews and evaluations of the performance of the customer managers based on several factors, including revenue growth, market share, customer satisfaction and customer retention. To strengthen its marketing efforts, the Target Group has increased the total number of its customer managers from 1,979 as of the end of 2002 to 2,422 as of the end of June 2003.

Community manager system. The Target Group offers integrated sales and maintenance services to small- and medium-sized enterprise customers through its community manager system and divides its community coverage responsibilities by geographical area. The Target Group's community managers are responsible for customer development and customer care. The Target Group links its compensation mainly to the voice traffic in its coverage areas. In addition, community managers of the Target Group are also responsible for gathering market and demand information.

Contract system in rural areas. Under this system, the Target Group selects certain local residents to be responsible for service promotion, customer development, equipment maintenance and fee collection. This system enables the Target Group to lower operational costs effectively while at the same time satisfying the needs of its rural customers.

Customer service hotlines. The Target Group provides customer services through its customer service hotlines with the uniform access number of "10000." These customer service hotlines offer unified electronic-based services to the residential and enterprise customers in the Target Service Areas. These customer service hotlines handle service inquiries and service applications, collect bill payments and handle customer complaints.

Billing services. The Target Group bills its residential customers on a monthly basis and provide a range of payment choices for the convenience of its customers, including direct-debit service, which automatically deducts the monthly payment from the subscriber's designated bank or postal account. The Target Group also provides specially tailored billing and collection services to their large enterprise customers to help them more effectively plan and monitor their telecommunications needs.

Marketing and sales agencies and other wholesale channels. The Target Group markets its services through its own retail outlets as well as agents and distributors. The Target Group's cooperation with third party agencies and distributors helps it reach a broader customer base and reduce its operating expenses. As of December 31, 2002, the Target Group had a total of 6,149 authorized third-party agencies and distributors in addition to 3,886 retail outlets that the Target Group owned and operated directly.

The Target Group provides a range of wireline telecommunications services, including, among others, local and long distance telephone and data services, to government agencies and regulatory authorities at all levels as well as to many state-owned enterprises in the Target Service Areas. A number of these government entities and state-owned enterprises are among the largest customers of the Target Group. The Target Group provides these services in the normal course of business and do not offer them any special tariff discounts.

NETWORK SYSTEM

The Target Group was able to realize significant economies of scale as a result of the extensive coverage and scale of its network. It employs a variety of advanced technologies and suitable architecture and can be efficiently migrated to the next generation of network technology. The Target Group's network system is managed and operated by its experienced network management and maintenance teams and offers flexible functionality and reliable operation. It supports a comprehensive range of end-to-end wireline telecommunications services and enables customized products to be delivered for a variety of telecommunications needs.

Network Architecture

The Target Group's network system consists of transport networks, service networks, an application layer and support networks.

- *Transport networks:* Transport networks provide the transport functions of voice and data signals for all of the Target Group's services.
- *Service networks:* Service networks include wireline telephone network, data networks, Internet network and other service networks such as intelligent networks, and support the Target Group's basic and value-added telecommunications services.
- *Application layer:* The application layer provides the platform for a variety of applications and services such as e-commerce, video-on-demand, and on-line games.
- *Support networks:* Support networks include signaling networks, digital synchronous networks and network management systems and support the reliable and effective operation of the Target Group's networks at all levels.

Network Capacity and Technology

Local access networks. The Target Group owns extensive local access networks in the Target Service Areas. As of December 31, 2002, the Target Group's local access networks covered all cities, counties and rural villages in the Target Service Areas. As part of its strategic focus on the data and Internet market, the Target Group continues to expand its broadband local access networks utilizing its existing copper line resources. In addition, the Target Group continues to upgrade its existing local access lines using DSL technology. At the same time, the Target Group is selectively connecting additional large office buildings and business centers with fiber optic access. As of December 31, 2002, the total capacity of DSL access ports of the Target Group reached 686,306 lines. The Target Group has also selectively developed PHS networks for wireless local telephone service to supplement its wireline access systems. Moreover, the Target Group is developing wireless LANs in airports and other commercial centers to provide business travellers with broadband access services.

Transport network. The Target Group's transport system is based on an advanced, high-speed, large-capacity, secure and reliable fiber optic network throughout its service regions. The Target Group's fiber optic transport network is also supplemented by satellite transmissions and digital microwave links. Its fiber optic network had a total cable length of 263,844 kilometers in its service regions as of the end of 2002. The Target Group's transport network is integrated with the fiber optic network of the Parent Group outside the Target Service Areas, which, together with the Company's current networks, forms the largest nationwide fiber optic transport network in China, and is connected with networks worldwide.

The Target Group's fiber optic transport network employs SDH architecture and DWDM technology extensively, both of which allow for simpler and more easily managed networks with enhanced reliability. The Target Group uses DWDM technology on most of its long distance transmission routes to expand transmission capacity. The main routes of the Target Group's backbone fiber optic networks in its service regions have been upgraded to 10Gbps-based DWDM systems and provide transmission bandwidth of up to 32 x 10Gbps or 160 x 10Gbps. In addition, the Target Group has deployed self-healing, DXC, 1+1 protection and other protection technologies and provides customers with network services of various levels of reliability based on their requirements.

Wireline telephone networks. The Target Group's wireline telephone network has been substantially built in the last decade utilizing digital technology. It consists of long distance switching facilities and 69 local switching networks. As of the end of 2002, the total capacity of local switches reached 49.8 million lines, and the capacity of long distance toll switches reached 1.8 million ports. In developing its wireline telephone networks, the Target Group has adopted technologies that enable high capacity and fewer exchanges to reduce its construction and operating costs. The Target Group has installed advanced intelligent networks over its telephone networks. Intelligent networks combine advanced computer technologies with traditional switching techniques to provide flexible value-added services such as prepaid services, virtual private network services and toll free call services.

Data and Internet networks. The Target Group has developed a large-capacity, high-quality, reliable and extensive data and Internet network system in the Target Service Areas. The Target Group's data and Internet networks allow it to provide services both at the network layer, such as Internet access, managed data and virtual private network services, and at the application layer, such as Internet data center, e-commerce and video-on-demand services. These networks cover all cities and counties in the Target Service Areas. The Target Group's ATM network allows multi-service access and flexible bandwidth management and provides high-quality, integrated end-to-end services.

The Target Group's Internet network is part of ChinaNET, the largest public Internet network in China, operated by the Parent Group. ChinaNET deploys mainstream Gigabyte routers as the main network technology. Most of its backbone routes allow high-speed transmission with the use of several 2.5Gbps circuits.

Support networks. The operation of the Target Group's wireline telephone, data and Internet networks depends on various support networks, including a signaling network based on a signaling technology known as Signaling System 7 protocol, a digital synchronous network and network management systems for various networks and services such as Internet data center, e-commerce and video-on-demand services.

Equipment procurement. The Target Group purchases most of its network equipment from leading international suppliers or their joint ventures in China. The Target Group also purchases from local suppliers a variety of network equipment, such as transport equipment and local switches. The Target Group makes most of its purchases through competitive tenders primarily based on product and service quality, system compatibility and price.

Research and Development

The Target Group's emphasis on research and development has enhanced a clear vision in market direction, the development of advanced network system and the rollout of new applications and services. The Target Group's research and development is carried out by specialised research centers or small teams of experts. Researchers are primarily responsible for conducting researches on business strategies, network planning and support, new product trials and investment decisions.

IT Systems

As a consistent corporate focus, the Target Group sought to improve operational and management efficiency through establishing strong IT systems. IT systems (CTG-MBOSS) include the Business Support System (BSS), Operation Support System (OSS) and Management Support System (MSS). Implementation of IT design heralds the technological and organizational restructuring of the IT systems. Adoption of the Enterprise Application Integration (EAI) technology has allowed for smooth interconnection between all major systems, enabling full information sharing within the Company. The planned future development of the IT system is expected to further enhance market responsiveness and improve customer service, significantly raise operation and management levels and strengthen competitiveness.

ORGANIZATIONAL REORGANIZATION AND BUSINESS PROCESS RE-ENGINEERING

Determined to maintain market leadership and improve the Target Group's competitiveness, the Target Group continues to implement internal restructuring and business process re-engineering measures aimed at further gearing toward a "market-oriented, customer-centered and return-driven" business model.

The Target Group has implemented various initiatives to reorganize its organisation and has undertaken a business process re-engineering, or BPR, project. These BPR project aims to effect organizational and operational changes in a number of areas, including organizational structure, network investment process, allocation of network resources, large customer management, billing and collection and employee evaluation and incentive scheme.

In addition, the Target Group has taken various steps to centralize and streamline the management of its business. For example, the Target Group has improved its capital budgeting process and centralized equipment procurement in order to reduce the cost of network expansion and maximize return on investment. The Target Group has also centralized network maintenance of local networks to optimize the network maintenance system and reduce maintenance costs.

The Target Group has launched an organizational restructuring that involved all levels of operations. A new "front-end-back-end" structure has been established at each level to enhance market responsiveness. The front-end is composed of "customer interface units" with related marketing functions, while at the back-end, all network resources have been consolidated to provide the front-end with service provisioning, quality control, billing and operation support services. An internal Service Level Agreement (SLA) system has been set up between the front-end and the back-end to ensure more concerted and high quality end-to-end service delivery.

CAPITAL EXPENDITURE

The table below sets forth the Target Group's historical capital expenditures for the years indicated.

	Year ended December 31,	
	2001	2002
	(RMB in millions)	
Total capital expenditures	18,787	16,095

The Target Group has further rationalized the allocation of its capital expenditures in 2002. It has continued to allocate a majority of its capital expenditures to the development of access infrastructure in order to meet the demands of the subscriber growth and to strengthen its position as owners of the "last mile" in the Target Service Areas. Internet and data networks are another major area of capital expenditures as the Target Group capitalized on the surging demand for broadband, managed data and Internet services. In addition, the Target Group has increased expenditures for the Business Support System (BSS), Operation Support System (OSS) and Management Support System (MSS) as part of its effort to improve customer service quality, operating efficiency and information disclosure.

The Board expects to fund the capital expenditure needs of the Target Group through a combination of cash generated from operating activities, short-term and long-term bank loans and other debt and equity financing. The Board believes the Target Group will have sufficient resources to meet capital expenditure requirements for the foreseeable future.

NETWORK MANAGEMENT AND RESEARCH FACILITIES

Apart from the Target Group, the Company will also acquire from the Parent certain assets which are used for network management, research and development purposes. The network management assets to be acquired from the Parent are essential for the smooth operation of the entire China Telecom network systems. Capabilities of the network management assets include function management, resource allocation, performance monitoring, network security and billing. The network management assets also provide certain value-added services, such as SLA reporting and VPN. The research and development assets, including a research institute located in Beijing, are used for developing new telecommunications products and technologies. Based on an asset appraisal report prepared by an independent appraiser appointed by the Company, the value of such assets as of December 31, 2002 amounted to RMB432 million. There has been no material change to the value of such assets after December 31, 2002.

6. RELATIONSHIP WITH CHINA TELECOMMUNICATIONS CORPORATION

As of the Latest Practicable Date, China Telecommunications Corporation directly owned 77.78% of the Company's issued share capital. In connection with the Global Offering of the Company, China Telecommunications Corporation has, by a letter of undertakings that is legally binding indefinitely, undertaken that it will support the Company's existing operations and future development, including that the Company will be treated equally with any other operators of wireline telephone, data and Internet, leased line or other related telecommunications services that are controlled by China Telecommunications Corporation and the Company will have the option to provide additional telecommunications services in the service regions that fall within China Telecommunication Corporation's scope of business.

ARRANGEMENT RELATING TO THE REORGANIZATION AND THE ACQUISITION

The following arrangement has been entered into between the Parent Group and the Company, the performance of which will technically be considered as a connected transaction after the Acquisition.

Amounts due to the Parent

In 1994, the Ministry of Finance obtained a loan from the World Bank (the ***World Bank Loan***) which was subsequently novated to the former Ministry of Posts and Telecommunications. After a series of further novations made in conjunction with the restructuring of the telecommunications industry by the Chinese government, China Telecommunications Corporation became the borrower of record of the World Bank Loan. A portion of the World Bank Loan was advanced by China Telecommunications Corporation to, and utilized by, the provincial subsisting companies of Jiangxi province, Guangxi Zhuang autonomous region and Sichuan province, which also bore the costs of servicing that portion of the World Bank Loan. In connection with the Reorganization, the parties agreed with effect from December 31, 2002 that the Parent would assume the above-mentioned World Bank Loan advanced to the provincial subsisting companies of Jiangxi province, Guangxi Zhuang autonomous region and Sichuan province, in exchange for an unsecured interest-free indebtedness of US$47.4 million due from Jiangxi Telecom, Guangxi Telecom and Sichuan Telecom. Subsequent to December 31, 2002, the Parent would bear the costs of servicing that portion of the World Bank Loan.

The Company has agreed to cause the entire amount of that account payable outstanding from Jiangxi Telecom, Guangxi Telecom and Sichuan Telecom to be repaid to the Parent using their internal cash resources on the next business day following the completion of the Acquisition.

CONNECTED TRANSACTIONS

As a result of the Reorganization, certain transactions entered into between the Target Companies and the Parent Group will constitute Prospective Connected Transactions. Specific agreements to be entered into in respect of each of the Prospective Connected Transactions are described in this section.

The Prospective Connected Transactions set out in this section which relate to the operations of the Target Group are identical in nature and substance to the corresponding Existing Connected Transactions. The pricing standards and principal terms of the Prospective Connected Transactions are also identical to those of the Existing Connected Transactions.

The Company and the Target Group have included certain historical amounts in respect of the Prospective Connected Transactions that occurred prior to the Reorganization. These historical amounts are based on the Company's and the Target Group's respective audited and unaudited financial statements. The Target Group's audited financial statements for periods prior to January 1, 2003 were prepared to include the operating results related to certain assets that were retained by the Parent Group in connection with Reorganization and reflect transactions under old pricing mechanisms that were in place before the Reorganization. Accordingly, the historical amounts in respect of the Target Group for the year ended December 31, 2002 should not be read as an indication of future transaction amounts. New arrangements in relation to connected transactions, including new pricing mechanisms as set out in the relevant connected transaction framework agreements took effect from January 1, 2003. Therefore the historical figures for the six months ended June 30, 2003 are comparable to future transaction amounts in terms of pricing mechanism and basis of reporting. However, the expenditures of the connected transactions are incurred unevenly during a financial year, and the transaction amounts for the six months ended June 30, 2003 shall not be used as a basis for prediction of the transaction amounts likely to be incurred for the entire year.

1. Ongoing Connected Transactions Between the Company and China Telecommunications Corporation

After the Reorganization, the Company entered into various agreements with China Telecommunications Corporation and a number of its subsidiaries relating to the mutual provision of ongoing telecommunications and other services.

The mutual provision of ongoing telecommunications and other services between the Parent Group and the Company will constitute connected transactions within the meaning of the Hong Kong Listing Rules. Such agreements include the following:

(a) ***Supplemental Trademark Licence Agreement***

On September 10, 2002, the Company and China Telecommunications Corporation entered into a trademark licence agreement to grant to the Company the right to use certain trademarks owned by the Parent Group on a royalty-free basis.

On October 26, 2003, the Company and China Telecommunications Corporation entered into a supplemental trademark licence agreement (the ***Supplemental Trademark Licence Agreement***) to extend the scope of the licensees to include the Target Companies and to amend the list of trademarks as set out in the trademark licence agreement entered into by the same parties on September 10, 2002. The Supplemental Trademark Licence Agreement further extends the term of the licence from December 31, 2004 to December 31, 2005, after which the licence will be automatically renewed for further periods of three years unless the Company provides three months' written notification to China Telecommunications Corporation of its intention not to renew the agreement at the expiration of its current term.

Pursuant to the Supplemental Trademark Licence Agreement, the Parent has granted to the Combined Group the right to use certain trademarks currently used by the Parent Group in the provision of its telecommunications services on a royalty free basis.

(b) ***Supplemental Agreement Relating to Centralized Services, Interconnection, Optic Fibers Leasing and Non-competition Agreement***

The Company and China Telecommunications Corporation entered into a supplemental agreement in relation to centralized services, interconnection, optic fibers leasing and non-competition agreement on October 26, 2003 (the ***Supplemental Connected Transactions Agreement***) to amend the original centralized services agreement, the interconnection agreement, the optic fibers leasing agreement and the non-competition agreement, all entered into by the same parties on September 10, 2002.

Centralized Services

The Supplemental Connected Transactions Agreement modifies the scope of the centralized services to include sharing the use and costs of headquarters and certain network support premises and related facilities such as air-conditioning, electricity and certain ancillary facilities. Costs of the centralized services such as the management of large enterprise customers, network management center, business support center by the Company and sharing the use of headquarters, international gateways and certain other premises together with costs such as labor costs, depreciation of equipment and premises, daily expenses, costs relating to maintenance and research, are to be apportioned between the Parent and the Company per annum according to their respective proportional income or aggregate volume of inbound and outbound international calls, where appropriate. The Supplemental Connected Transactions Agreement also amends the scope of international telecommunications facilities to include international land cables and related domestic extended portions and extends the term of the centralized services agreement from December 31, 2004 to December 31, 2005. Such agreement will be automatically renewed for further periods of three years unless the Company provide three months' written notification to the Parent of its intention not to renew the agreement. Apart from the amendments described above, the other terms and conditions set out in the original centralized services agreement remain unchanged.

For the year ended December 31, 2002 and the six months ended June 30, 2003, the Target Group's portion of the costs in respect of the centralized services set out above were RMB173 million and RMB71 million, respectively.

For the year ended December 31, 2002 and the six months ended June 30, 2003, the Listed Group's portion of costs in respect of the centralized services set out above were RMB483 million and RMB144 million, respectively.

Interconnection

The Supplemental Connected Transactions Agreement extends the term of the original interconnection agreement from December 31, 2004 to December 31, 2005. The interconnection agreement will be automatically renewed for further periods of three years unless the Company provides three months' written notification to the Parent of its intention not to renew the agreement. The original interconnection agreement does not provide for early termination or non-renewal by the Parent. Furthermore, under Article 17 of the Telecommunications Regulations, a telecommunications operator cannot refuse to enter into interconnection arrangements with another operator if requested. Apart from the amendment described above, the other terms and conditions of the original interconnection agreement remain unchanged.

Prior to the completion of the Acquisition, no such interconnection settlement arrangement was in effect between the Parent Group and the Target Companies, or between the Listed Group and the Target Companies. After the completion of the Acquisition, such interconnection arrangement will be in effect between the Parent Group and the Combined Group.

For the year ended December 31, 2002 and the six months ended June 30, 2003, the net settlement payments made by the Listed Group to the Parent pursuant to the original interconnection agreement were RMB385 million and RMB181 million, respectively.

Optic Fibers Leasing

The Supplemental Connected Transactions Agreement extends the term of the original optic fibers leasing agreement from December 31, 2004 to December 31, 2005. The optic fibers leasing agreement will be automatically renewed for further periods of three years unless the Company provides three months' written notification to the Parent of its intention not to renew the agreement at the expiration of its current term. Apart from the amendment described above, the other terms and conditions of the original optic fibers leasing agreement remain unchanged.

Pursuant to the Reorganization, all optic fibers required for inter-provincial transmission within the Target Service Areas were transferred to the relevant Target Companies. Accordingly, no leasing arrangement for such optic fibers was put in place between the Parent and the Target Companies after the Reorganization.

For the year ended December 31, 2002 and the six months ended June 30, 2003, the total amounts paid by the Listed Group to the Parent with respect to optic fibers leasing were RMB102 million and RMB46 million, respectively.

Non-Competition Agreement

To be in line with an amendment to Directory of Categorization of the Telecommunications Services (the Directory) promulgated by the MII on February 21, 2003, the Supplemental Connected Transactions Agreement amends the definition of "basic telecommunications services" to include 3G businesses. The Supplemental Connected Transactions Agreement also amends the expression of "value-added telecommunications services" in order to be in line with the Directory, which contains domestic multi-parties telecommunications service, Internet access services, Internet data center services, Internet VPN services and VPN services within the scope of such expression. Apart from the amendment described above, the other terms and conditions set out in the original agreement remain unchanged.

2. Ongoing Connected Transactions Between Subsidiaries of the Company and Subsidiaries/Associates of China Telecommunications Corporation

After the Reorganization, certain ancillary, and mostly non-telecommunications related businesses and assets of the Parent Group within the Target Service Areas, continue to be operated or held by certain subsidiaries and/or Associates of the Parent (the Provincial Subsisting Companies). Any transactions between the Provincial Subsisting Companies and subsidiaries of the Company would constitute connected transactions under the Hong Kong Listing Rules.

Since the terms and conditions of the Prospective Connected Transactions are identical to the terms and conditions of the corresponding Existing Connected Transactions, we will not be setting out in this announcement the commercial background, reasons and terms for such transactions which were set out in the Company's Prospectus.

(a) ***Engineering Agreements***

The Target Companies and the Provincial Subsisting Companies have entered into engineering framework agreements (the ***Engineering Framework Agreements***) to govern the arrangements with respect to certain engineering related services. Each Engineering Framework Agreement will expire on December 31, 2005, but will be automatically renewed for further periods of three years unless a Target Company provides three months' written notification to the relevant Provincial Subsisting Company of its intention not to renew its agreement.

The charges payable for engineering related services rendered under the Engineering Framework Agreements shall be determined by reference to market rates as reflected by prices obtained through a tender process. The Target Companies do not accord any priority to any of the Provincial Subsisting Companies to provide such services, and the tender may be awarded to an independent third party. However, if the terms of an offer from a Provincial Subsisting Company are at least as favorable as those offered by another tenderer, the relevant Target Company may award the tender to the relevant Provincial Subsisting Company.

For the year ended December 31, 2002, the Target Group's expenditure for engineering services made available by the Provincial Subsisting Companies to the Target Group was RMB2,172 million. For the six months ended June 30, 2003, the Target Group's expenditure, following the new corporate structure and the pricing mechanism set out in the Engineering Framework Agreements, was RMB873 million.

Currently, the Listed Group and the Provincial Subsisting Companies have on-going arrangements in respect of engineering related services similar to those proposed in the Engineering Framework Agreements which form part of the Existing Connected Transactions. For the year ended December 31, 2002 and the six months ended June 30, 2003, the Listed Group's expenditures for corresponding engineering services pursuant to the Existing Connected Transaction between the relevant Provincial Subsisting Companies and each of Shanghai Telecom, Guangdong Telecom, Jiangsu Telecom and Zhejiang Telecom were RMB3,243 million and RMB982 million, respectively.

(b) ***Property Leasing Agreements***

Mutual leasing of properties

Pursuant to various property leasing framework agreements between the Target Companies and the Provincial Subsisting Companies (the ***Property Leasing Framework Agreements***), the Target Group has leased from the Provincial Subsisting Companies a total of 673 properties covering an aggregate gross floor area of approximately 176,467.7 square metres for use as its business premises, offices, equipment storage facilities and sites for network equipment. These properties are situated in many locations within the Target Service Areas. Pursuant to the Property Leasing Framework Agreements and as part of the Reorganization, the Target Companies have also leased certain properties covering an aggregate gross floor area of approximately 99,182.9 square metres to the Provincial Subsisting Companies.

Each Property Leasing Framework Agreement will expire on December 31, 2005, but will be automatically renewed for further periods of three years unless a Target Company provides three months' written notification to the relevant Provincial Subsisting Company of its intention not to renew its agreement.

The rental charge in respect of each property is based on market rates, with reference to amounts stipulated by local price bureaus, taking into consideration the specific needs of the telecommunications industry when leasing properties. Rental charges are payable monthly in arrears and subject to review every three years.

Pursuant to the Reorganization, the properties occupied by the Target Group with defective titles were retained by the Provincial Subsisting Companies, and such properties are now leased by the Target Group from the Provincial Subsisting Companies. Therefore, the scope of properties leased by the Target Group has been broadened, and no comparable historical figures are available. For the six months ended June 30, 2003, the Target Group's expenditure, following the new corporate structure and the pricing mechanism set out in the Property Leasing Framework Agreement, was RMB22 million. For the same period, the Provincial Subsisting Companies' expenditure for the rental charges in respect of properties leased from the Target Group was RMB8 million.

Chesterton, an independent appraiser appointed by the Company for the purpose of the Acquisition, has reviewed the Property Leasing Framework Agreements and has confirmed that the rental charges payable under the Property Leasing Framework Agreements are fair and reasonable so far as the Target Companies are concerned, and do not exceed market rates in respect of both properties leased to and from the Target Companies.

Currently, the Listed Group and the Provincial Subsisting Companies have on-going arrangements in respect of mutual leasing of properties similar to those proposed in the Property Leasing Framework Agreements which form part of the Existing Connected Transactions. For the year ended December 31, 2002 and the six months ended June 30, 2003, the Listed Group's expenditures for corresponding property leasing pursuant to the Existing Connected Transaction between the relevant Provincial Subsisting Companies and each of Shanghai Telecom, Guangdong Telecom, Jiangsu Telecom and Zhejiang Telecom were RMB266 million and RMB135 million, respectively. For the same period, the Provincial Subsisting Companies' expenditures for corresponding property leasing pursuant to the Existing Connected Transaction between the relevant Provincial Subsisting Companies and each of Shanghai Telecom, Guangdong Telecom, Jiangsu Telecom and Zhejing Telecom were RMB3 million and RMB4 million, respectively.

Sub-Leasing of Third Party Properties

Following the Reorganization, the Provincial Subsisting Companies have sub-let to the Target Group certain properties owned by and leased from independent third parties for use as offices, retail outlets, spare parts storage facilities and sites for network equipment (the Third Party Properties). In order to formalize such arrangement, the Target Companies and the Provincial Subsisting Companies have entered into sub-leasing agreements (the ***Third Party Properties Sub-leasing Agreements***) which will expire on December 31, 2005, but will be automatically renewed for further three-year periods unless a relevant Target Company provides three months' written notification to the relevant Provincial Subsisting Company of its intention not to renew its agreement.

The amounts payable by the Target Group to the Provincial Subsisting Companies under the Third Party Properties Sub-leasing Agreements are the same as the amounts payable by the Provincial Subsisting Companies to the relevant third parties. The rental charges for the Third Party Properties are based on market rates negotiated between the Provincial Subsisting Companies and the relevant third parties on an arm's length basis.

Prior to the Reorganization, no such sub-leasing arrangement was in effect between the Provincial Subsisting Companies and the Target Group. For the six months ended June 30, 2003, the Target Group's expenditure for properties sub-leasing was RMB59 million.

Chesterton, an independent appraiser appointed by the Company for the purpose of the Acquisition, has confirmed that the rental charge payable for each of the Third Party Properties under the Third Party Properties Sub-leasing Agreements is fair and reasonable so far as the Target Group is concerned, and does not exceed market rents.

Currently, the Listed Group and the Provincial Subsisting Companies have on-going arrangements in respect of sub-leasing of third party properties similar to those proposed in the Third Party Properties Sub-leasing Agreements which form part of the Existing Connected Transactions. For the year ended December 31, 2002 and the six months ended June 30, 2003, the Listed Group's expenditures for corresponding properties sub-leasing pursuant to the Existing Connected Transaction between the relevant Provincial Subsisting Companies and each of Shanghai Telecom, Guangdong Telecom, Jiangsu Telecom and Zhejiang Telecom were RMB321 million and RMB160 million, respectively.

(c) ***IT Services Agreements***

The Target Companies have entered into framework agreements with the Provincial Subsisting Companies in each of the Target Service Areas pursuant to which the Provincial Subsisting Companies have agreed to provide the Target Group with certain information technology services such as office automation and software adjustment (the ***IT Services Framework Agreements***). The agreements will expire on December 31, 2005, but will be automatically renewed for further periods of three years unless a Target Company provides three months' written notification to the relevant Provincial Subsisting Company of its intention not to renew its agreement.

The Provincial Subsisting Companies are entitled to tender for the right to provide Target Companies with IT services. The charges payable for such IT services under the IT Services Framework Agreements shall be determined by reference to market rates as reflected by prices obtained through the tender process. The Target Companies do not accord any priority to the Provincial Subsisting Companies to provide such services, and the tender may be awarded to an independent third party. However, if the terms of an offer from a Provincial Subsisting Company are at least as favorable as those offered by another tenderer, the relevant Target Company may award the tender to the relevant Provincial Subsisting Company.

For the year ended December 31, 2002, the Target Group's expenditure for the IT services made available by the Provincial Subsisting Companies to the Target Group was RMB59 million. For the six months ended June 30, 2003, the Target Group's expenditure, following the new corporate structure and the pricing mechanism set out in the IT Services Framework Agreements, was RMB18 million.

Currently, the Listed Group and the Provincial Subsisting Companies have on-going arrangements in respect of IT services similar to those proposed in the IT Services Framework Agreements which form part of the Existing Connected Transactions. For the year ended December 31, 2002 and the six months ended June 30, 2003, the Listed Group's expenditures for corresponding IT services pursuant to the Existing Connected Transaction between the relevant Provincial Subsisting Companies and each of Shanghai Telecom, Guangdong Telecom, Jiangsu Telecom and Zhejiang Telecom were RMB151 million and RMB3 million, respectively.

(d) ***Equipment Procurement Services Agreements***

Pursuant to the equipment procurement framework agreements entered into between the Target Companies and the Provincial Subsisting Companies in each of the Target Service Areas (the ***Equipment Procurement Framework Agreements***), the Provincial Subsisting Companies have agreed to provide comprehensive procurement services, including the management of tenders, verification of technical specifications and installation services.

Pursuant to the Equipment Procurement Framework Agreements between the Target Companies and the Provincial Subsisting Companies, the Target Companies may request that the Provincial Subsisting Companies act as their agents in procuring foreign and domestic telecommunications equipment and other domestic non-telecommunications materials. Each Equipment Procurement Framework Agreement will expire on December 31, 2005, but will be automatically renewed for further periods of three years unless a Target Company provides three months' written notification to the relevant Provincial Subsisting Company of its intention not to renew its agreement. The Target Companies may give priority to the Provincial Subsisting Companies if the terms and conditions of the services provided by them are at least as favorable as those offered by independent third parties.

Commission charges for these services are calculated at the maximum rate of:

(1) 1% of the contract value, in the case of imported telecommunications equipment; or

(2) 1.8% of the contract value, in the case of domestic telecommunications equipment and other domestic non-telecommunications materials.

The Target Group believes that the above charges are the same as market rates or those rates which it would be required to pay had it appointed an independent third party to provide the same procurement services.

Prior to the Reorganization certain of the Target Group's equipment was first purchased from suppliers by the Parent Group and then resold to the Target Group. Under those circumstances, the Parent Group acted primarily as a principal rather than as an agent earning commissions and therefore no historical figures of a comparable nature are available.

For the six months ended June 30, 2003, the Target Group's expenditure for the equipment procurement services provided by the Provincial Subsisting Companies to the Target Group, following the new corporate structure and the pricing mechanism set out in the Equipment Procurement Framework Agreements, was RMB36 million.

Currently, the Listed Group and the Provincial Subsisting Companies have on-going arrangements in respect of equipment procurement services similar to those proposed in the Equipment Procurement Framework Agreements which form part of the Existing Connected Transactions. For the year ended December 31, 2002 and the six months ended June 30, 2003, the Listed Group's expenditures for corresponding equipment procurement pursuant to the Existing Connected Transaction between the relevant Provincial Subsisting Companies and each of Shanghai Telecom, Guangdong Telecom, Jiangsu Telecom and Zhejiang Telecom were RMB78 million and RMB45 million, respectively.

(e) ***Community Services Agreements***

The Parent Group, through the Provincial Subsisting Companies, provides certain cultural, educational, property management, vehicles services, health and medical services, hotel and conference services, community and sanitary services to the Target Group. The arrangements are set out in the community services framework agreements between the Target Companies and the Provincial Subsisting Companies in each of the Target Service Areas (the ***Community Services Framework Agreements***) which will expire on December 31, 2005, but will be automatically renewed for further periods of three years unless terminated by either party with at least three months' written notification to the other party. However, if the Target Companies cannot, without incurring significant cost and expense, obtain these services from a third party after such termination, the Provincial Subsisting Companies cannot terminate the provision of such services.

The Community Services Framework Agreements stipulate that the above community services be provided at:

(1) the government-prescribed price;

(2) where there is no government-prescribed price but where there is a government-guided price, the government-guided price applies;

(3) where there is neither a government-prescribed price nor a government-guided price, the market price applies. The market price is defined as the price at which the same type of services are provided by independent third parties in the ordinary course of business; or

(4) where none of the above is applicable, the price is to be agreed between the relevant parties for the provision of the above services, which shall be the reasonable cost incurred in providing the same plus a reasonable profit margin (For this purpose, "reasonable costs" means such costs as confirmed by both parties after negotiations).

The Target Group believes that the services provided by the Provincial Subsisting Companies under the Community Services Framework Agreements will be on normal commercial terms which are no less favorable than those provided by independent third parties.

For the year ended December 31, 2002, the Target Group's expenditure for community services made available by the Provincial Subsisting Companies to the Target Group was RMB359 million. For the six months ended June 30, 2003, the Target Group's expenditure, following the new corporate structure and the pricing mechanism set out in the Community Services Framework Agreements, was RMB192 million.

Currently, the Listed Group and the Provincial Subsisting Companies have on-going arrangements in respect of community services similar to those proposed in the Community Services Framework Agreements which form part of the Existing Connected Transactions. For the year ended December 31, 2002 and the six months ended June 30, 2003, the Listed Group's expenditures for corresponding community services pursuant to the Existing Connected Transaction between the relevant Provincial Subsisting Companies and each of Shanghai Telecom, Guangdong Telecom, Jiangsu Telecom and Zhejiang Telecom were RMB1,291 million and RMB571 million, respectively.

(f) ***Ancillary Telecommunications Services Agreements***

Following the Reorganization, the Provincial Subsisting Companies have agreed to provide certain repair services to the Target Group, such as the repair of certain telecommunications equipment, the maintenance of fire prevention equipment and telephone booths and other customers' services (the ***Ancillary Telecommunications Services***) on a non-exclusive basis.

Under the framework agreements between the Target Companies and the Provincial Subsisting Companies in each of the Target Service Areas for the provision of Ancillary Telecommunications Services (the ***Ancillary Telecommunications Services Framework Agreements***), the Provincial Subsisting Companies have agreed to provide Ancillary Telecommunications Services to the Target Group. Such agreements will expire on December 31, 2005, but will be automatically renewed for further periods of three years unless either party notifies the other at least three months prior to the expiration of the term in writing of its intention to terminate the relevant agreement. However, if the Target Companies cannot, without incurring significant cost and expense, obtain these services from a third party, the Provincial Subsisting Companies cannot terminate the provision of such services.

The Ancillary Telecommunications Services under the Ancillary Telecommunications Services Framework Agreements are provided in accordance with the same pricing policy as that of the Community Services Framework Agreements.

For the year ended December 31, 2002, the Target Group's expenditure for Ancillary Telecommunications Services made available by the Provincial Subsisting Companies to the Target Group was RMB220 million. For the six months ended June 30, 2003, the Target Group's expenditure, following the new corporate structure and the pricing mechanism set out in the Ancillary Telecommunication Services Framework Agreements, was RMB143 million.

Currently, the Listed Group and the Provincial Subsisting Companies have on-going arrangements in respect of ancillary telecommunications services similar to those proposed in the Ancillary Telecommunications Services Framework Agreements which form part of the Existing Connected Transactions. For the year ended December 31, 2002 and the six months ended June 30, 2003, the Listed Group's expenditure for corresponding Ancillary Telecommunications Services pursuant to the Existing Connected Transaction between the relevant Provincial Subsisting Companies and each of Shanghai Telecom, Guangdong Telecom, Jiangsu Telecom and Zhejiang Telecom were RMB1,219 million and RMB409 million, respectively.

APPLICATION FOR WAIVER

Scope of Waivers

Following the completion of the Acquisition, the Combined Group will continue to enter into the transactions described above. Such transactions will constitute connected transactions for the Company under the Hong Kong Listing Rules for so long as members of the Parent Group remain as connected persons within the meaning of the Hong Kong Listing Rules.

The Independent Board Committee is of the opinion that the Prospective Connected Transactions and the supplemental agreements pursuant to Existing Connected Transactions described above have been entered into, and will be carried out, in the ordinary and usual course of business of the Combined Group and on normal commercial terms which are fair and reasonable so far as the interests of the Independent Shareholders of the Company are concerned.

Pursuant to the Hong Kong Listing Rules, each of the interconnection agreement, engineering agreements, community services agreements and ancillary telecommunications services agreements described above would normally require full disclosure and prior approval by Independent Shareholders in the extraordinary general meeting. It is considered that such disclosure and approval in full compliance with the Hong Kong Listing Rules would be impracticable. The Company has applied to the Stock Exchange, subject to the conditions set out below, for a waiver from strict compliance with the requirements of Chapter 14 of the Hong Kong Listing Rules, in relation to such transactions. In its application, the Company has sought a new waiver for the Combined Group from the Stock Exchange to combine certain Existing Connected Transactions such as interconnection agreement, engineering agreements, community services agreements and ancillary telecommunications services agreements, waiver of which were granted by the Stock Exchange in its letter dated October 28, 2002, with corresponding Prospective Connected Transactions so that the waiver in respect of annual monetary limits of certain Existing Connected Transactions be aggregated. The new waiver will be effective for two years from January 1, 2004 until December 31, 2005.

Conditions of Waiver

The Stock Exchange has indicated that it will grant the waiver applied for in relation to the interconnection agreement, engineering agreements, community services agreements and ancillary telecommunications services agreements for the Combined Group for two years from January 1, 2004 to December 31, 2005 on the following conditions:

(a) Arm's length basis: The transactions as well as the respective agreements governing such transactions shall be:

(1) entered into by the Combined Group in the ordinary and usual course of its business; and

(2) either

(i) on normal commercial terms, or

(ii) where there is no available comparison to judge whether they are on normal commercial terms, on terms no less favorable than those available to or from independent third parties,

(iii) on terms that are fair and reasonable so far as the Independent Shareholders of the Company are concerned, and

(iv) if applicable, with the annual aggregate value of each category of the connected transactions not exceeding the relevant annual limits.

(b) Disclosure: The Company shall disclose in its annual report details of the transactions as required by Rule 14.25(1)(A) to (D) of the Hong Kong Listing Rules, i. e.

(i) the date or period of the transactions;

(ii) the parties thereto and a description of their relationship;

(iii) a brief description of the transactions and the purpose of the transactions;

(iv) the total consideration and the terms; and

(v) the nature and extent of the interest of the connected persons in the transactions.

(c) Independent directors' review: Members of the Independent Board Committee shall review annually the transactions and confirm, in the Company's annual report and accounts for the year in question, that such transactions have been conducted in the manner stated in the conditions above.

(d) Auditors' review: The auditors of the Company shall carry out review procedures annually on the transactions and shall confirm to the Directors of the Company in writing (with a copy to the Stock Exchange at least 10 business days prior to the bulk print of the Company's annual report) whether, based on those procedures, the transactions:

(1) have received the approval of the Company's Directors;

(2) have been entered into in accordance with the pricing policies as stated in the relevant agreements, where applicable;

(3) have been entered into in accordance with the terms of the agreements governing the transactions; and

(4) have not exceeded the annual limits specified in paragraph (f) below.

For the purpose of the above review by the auditors of the Company, the Parent Group has undertaken to the Company to provide the auditors with access to its accounting records, as well as (where possible) those of its subsidiaries and Associates.

(e) Shareholders' approval: Details of the transactions are disclosed to the Independent Shareholders who will be asked to vote in favor of an ordinary resolution to approve the transactions and the annual limits set out in paragraph (f) below at the Company's EGM.

(f) Annual limits:

In determining the proposed annual limits of the following categories of connected transactions for the Combined Group, the Board has considered the relative size of the total assets and operating revenues of the Target Group against the Listed Group, the budget of the Combined Group in terms of capital expenditures, general and administrative expenses and sale and maintenance expenses. The Board (including the independent non-executive directors) is of the view that the monetary limits are set so as to (i) not hinder the ability of the Combined Group to conduct its business in the ordinary and usual course and (ii) allow the Combined Group to benefit from future growth. The aggregate annual value of the following categories of connected transactions for the Combined Group shall not exceed the limits set out below:

	Transactions	**Proposed Annual Limits**
(1)	Engineering agreements	RMB7,020 million
(2)	Community services agreements	RMB3,410 million
(3)	Ancillary telecommunications services agreements	RMB2,640 million

Details of the reasons for increment of the proposed annual limits for the above connected transactions are set out in the shareholders' circular to be dispatched to the Shareholders as soon as practicable. If any of the material terms of the agreements referred to above are altered (unless as provided for under the terms of the relevant agreement or arrangement) or if the Combined Group enters into any new agreements or arrangements with any connected persons (within the meaning of the Hong Kong Listing Rules) in the future under which the aggregate consideration paid or payable by the Combined Group in each year exceeds the limits referred to above, the Company will comply with the provisions of Chapter 14 of the Hong Kong Listing Rules dealing with connected transactions unless it applies for and obtains a separate waiver from the Stock Exchange.

Reasons for no cap for transactions contemplated under the Interconnection Agreement

The Company submits that the value of the settlement of interconnection charges arising from domestic long distance calls under the interconnection agreement, should not be subject to any annual limits for the following reasons:

(a) the Company's revenue depends on growth in call revenue and in its customer base for its various services. Any such growth in the domestic long distance service will necessarily result in increased transaction volumes under the interconnection agreement, which the Company will not be able to control as it depends entirely on customer usage. Any limits on these transactions will therefore potentially limit the Company's ability to conduct or expand its business in the ordinary course; and

(b) the tariffs payable under the interconnection agreement is prescribed by the MII and are subject to change from time to time.

No waivers applied for certain categories of connected transactions

Each of the transactions above other than the interconnection agreement and the engineering agreements, community services agreements and ancillary telecommunications services agreements are subject to Rule 14.25(1) of the Hong Kong Listing Rules, which are on normal commercial terms in which the total consideration or value is not expected to exceed 3% of the book value of the net tangible assets of the Company as of June 30, 2003 and accordingly, disclosure requirement as set out in Rule 14.25(1) of the Hong Kong Listing Rules shall apply to each of such transactions. The Directors, including independent non-executive directors of the Company submit that no waivers are necessary for any of such transactions because details of the transactions as required under Rule 14.25(1) of the Hong Kong Listing Rules are published in the Company's annual report, accounts and press notice each year for so long as such transactions are in place. If at any time Rule 14.25(1) of the Hong Kong Listing Rules does not apply to any of these transactions, the Company will notify and consult with the Stock Exchange promptly.

7. DEFINITIONS

In this announcement, unless the context otherwise requires, the following expressions have the following meanings:

"Acquisition"	the proposed acquisition by the Company of the Target Assets pursuant to the Acquisition Agreement, as further described in this announcement
"Acquisition Agreement"	the conditional sale and purchase agreement dated October 26, 2003 between the Company and China Telecommunications Corporation relating to the Acquisition
"ADSs"	American depositary shares
"Anhui Telecom"	Anhui Telecom Company Limited, a company established with limited liability under the laws of the PRC and currently a wholly-owned subsidiary of the Parent which, upon the successful completion of the Acquisition, will become a wholly-owned subsidiary of the Company
"Associate"	has the meaning given to it by the Hong Kong Listing Rules
"Board"	the board of directors of the Company
"Business Day"	a day (excluding Saturdays) on which banks are generally open in Hong Kong, New York and the PRC for the transaction of normal banking business
"Chesterton"	Chesterton Petty Limited, a chartered surveyor and independent property valuer to the Company
"China or PRC"	the People's Republic of China (excluding, for the purposes of this circular, Hong Kong, Macau and Taiwan)
"China Mobile"	China Mobile Communications Corporation, a company established under the laws of the PRC
"China Netcom Group"	China Network Communications Group Corporation, a company established under the laws of the PRC
"China Railcom"	China Railway Communication Co., Ltd., a company established under the laws of the PRC
"China Unicom"	China United Telecommunications Corporation, a company established under the laws of the PRC
"China Telecommunications Corporation" or "Parent"	China Telecommunications Corporation (中国电信集團公司), a state-owned enterprise established under the laws of the PRC on May 17, 2000 and the controlling shareholder of the Company
"Chongqing Telecom"	Chongqing Telecom Company Limited, a company established with limited liability under the laws of the PRC and currently a wholly-owned subsidiary of the Parent which, upon the successful completion of the Acquisition, will become a wholly-owned subsidiary of the Company
"CICC"	China International Capital Corporation (Hong Kong) Limited, which is licensed by the Securities and Futures Commission for Types 1, 4 and 6 regulated activities under the Securities and Futures Ordinance, being a financial adviser to the Company in respect of the Acquisition, the Prospective Connected Transactions and supplemental agreements relating to the Existing Connected Transactions
"Combined Group"	the Listed Group and the Target Group
"Companies Ordinance"	the Companies Ordinance (Chapter 32 of the Laws of Hong Kong)
"Company"	China Telecom Corporation Limited (中国电信股份有限公司), a joint stock limited company incorporated in the PRC with limited liability on September 10, 2002, whose H Shares are listed on the Stock Exchange and whose ADSs are listed on the New York Stock Exchange
"Directors"	the directors of the Company
"Existing Connected Transactions"	the connected transactions entered into between a member of the Listed Group and Parent Group in respect of trademark licence agreement, centralized services agreement, interconnection agreement, optic fiber leasing agreement, engineering agreements, property leasing agreements, IT service agreements, equipment procurement service agreements, community services agreements, ancillary telecommunications services agreements and special communications services agreements
"Existing Waiver"	the waiver from the strict compliance with the relevant requirements of the Hong Kong Listing Rules granted by the Stock Exchange in its letter dated October 28, 2002 to the Company
"Extraordinary General Meeting" or "EGM"	the extraordinary general meeting of the Company to be convened on December 15, 2003, notice of which is set out at the end of the shareholders' circular to be dispatched by the Company, or any adjournment thereof
"Financial Advisers"	CICC and Morgan Stanley, being the financial advisers to the Company in respect of the Acquisition of the Target Assets from China Telecommunications Corporation and the Prospective Connected Transactions
"Fujian Telecom"	Fujian Telecom Company Limited, a company established with limited liability under the laws of the PRC and currently a wholly-owned subsidiary of the Parent which, upon the successful completion of the Acquisition, will become a wholly-owned subsidiary of the Company
"GDP"	gross domestic product
"Global Offering"	the global offering of the Company that took place in November 2002 in respect of 7,556,400,000 H Shares and an over-allotment option in respect of 471,010,000 H Shares
"Guangdong Telecom"	Guangdong Telecom Company Limited, a company established with limited liability under the laws of the PRC and a wholly-owned subsidiary of the Company
"Guangxi Telecom"	Guangxi Telecom Company Limited, a company established with limited liability under the laws of the PRC and currently a wholly-owned subsidiary of the Parent which, upon the successful completion of the Acquisition, will become a wholly-owned subsidiary of the Company
"H Share(s)"	overseas listed foreign invested shares in the Company's registered capital with a par value of RMB1.00 per share which are listed on the Stock Exchange
"Hong Kong"	Hong Kong Special Administrative Region of the PRC
"Hong Kong Listing Rules"	the Rules Governing the Listing of Securities on the Stock Exchange
"Hong Kong Underwriters"	the underwriters listed in the Section headed "Underwriting" under "Hong Kong Underwriters" of the Company's Prospectus
"IFRS"	International Financial Reporting Standards promulgated by the International Accounting Standards Board
"Independent Board Committee"	the committee of Directors, consisting of Zhang Youcai, Vincent Lo Hong Sui and Shi Wanpeng, who are independent non-executive Directors, formed to advise the Independent Shareholders in respect of the terms of the Acquisition, the terms of the Prospective Connected Transactions and the terms of certain supplemental agreements relating to the Existing Connected Transactions
"Independent Financial Adviser"	JPMorgan
"Independent Shareholders"	Shareholders other than China Telecommunications Corporation
"Jiangsu Telecom"	Jiangsu Telecom Company Limited, a company established with limited liability under the laws of the PRC and a wholly-owned subsidiary of the Company
"Jiangxi Telecom"	Jiangxi Telecom Company Limited, a company established with limited liability under the laws of the PRC and currently a wholly-owned subsidiary of the Parent which, upon successful completion of the Acquisition, will become a wholly-owned subsidiary of the Company
"JPMorgan"	J.P. Morgan Securities (Asia Pacific) Limited, which is licensed by the Securities and Futures Commission for Types 1, 4, 6 and 7 regulated activities under the Securities and Futures Ordinance, being the Independent Financial Adviser to the Independent Board Committee in respect of the Acquisition, the Prospective Connected Transactions and certain supplemental agreements relating to the Existing Connected Transactions
"Latest Practicable Date"	October 24, 2003, being the latest practicable date prior to the printing of this announcement for ascertaining certain information contained herein
"Listed Group"	the Company together with Shanghai Telecom, Guangdong Telecom, Jiangsu Telecom and Zhejiang Telecom and their subsidiaries from time to time. For the avoidance of doubt, references in this announcement to the Listed Group excludes the Target Group
"Listed Service Areas"	Shanghai municipality, Guangdong province, Jiangsu province and Zhejiang province
"MII"	the Ministry of Information Industry of the PRC (中華人民共和國信息產業部)
"MOFCOM"	the Ministry of Commerce of the PRC (中華人民共和國商務部)
"Morgan Stanley"	Morgan Stanley Dean Witter Asia Limited, which is licensed by the Securities and Futures Commission for Types 1, 4, 6 and 7 regulated activities under the Securities and Futures Ordinance, being a financial adviser to the Company in respect of the Acquisition, the Prospective Connected Transactions and supplemental agreements relating to the Existing Connected Transactions
"NDRC"	National Development and Reform Commission of the PRC (previously known as the State Development and Planning Commission) (中華人民共和國國家發展和改革委員會)
"Parent Group"	China Telecommunications Corporation and its subsidiaries. Unless otherwise expressly stated or the context otherwise requires, references to "Parent Group" exclude the Company, the Company's subsidiaries and the Target Group
"Prospective Connected Transactions"	the connected transactions between the Target Group and the Parent Group described in the section headed "Connected Transactions — Ongoing Connected Transactions Between Subsidiaries of the Company and Subsidiaries/Associates of China Telecommunications Corporation"
"Prospectus"	the prospectus dated November 6, 2002 issued by the Company in connection with its initial public offering
"Reorganization"	the successive steps whereby China Telecommunications Corporation transferred the telecommunication operations in the Target Service Areas and related assets and liabilities to the Target Companies, as further described in the Section headed "the Reorganization" of this announcement
"RMB"	Renminbi, the lawful currency of the PRC
"Shanghai Telecom"	Shanghai Telecom Company Limited, a company established with limited liability under the laws of the PRC and a wholly-owned subsidiary of the Company
"Shareholders"	shareholders of the Company
"Sichuan Telecom"	Sichuan Telecom Company Limited, a company established with limited liability under the laws of the PRC, and currently a wholly-owned subsidiary of the Parent which, upon the successful completion of the Acquisition, will become a wholly-owned subsidiary of the Company
"Sponsors"	China International Capital Corporation Limited, Merrill Lynch Far East Limited and Morgan Stanley Dean Witter Asia Limited (in alphabetical order)
"State Council"	the State Council of the PRC (中華人民共和國國務院)
"Stock Exchange"	The Stock Exchange of Hong Kong Limited
"Target Assets"	the entire issued share capital of each of the Target Companies and certain network management, research and development facilities currently owned by the Parent which are to be acquired by the Company pursuant to the Acquisition Agreement
"Target Companies"	Anhui Telecom, Fujian Telecom, Jiangxi Telecom, Guangxi Telecom, Chongqing Telecom and Sichuan Telecom
"Target Group"	the Target Companies and their subsidiaries, from time to time
"Target Service Areas"	Auhui province, Fujian province, Jiangxi province, Guangxi Zhuang autonomous region, Chongqing municipality and Sichuan province
"Telecommunications Regulations"	The PRC Telecommunications Regulations (中華人民共和國電信條例) which became effective as of September 25, 2000
"U.S. dollars" or "US$"	United States dollars, the lawful currency of the United States of America
"Zhejiang Telecom"	Zhejiang Telecom Company Limited, a company established with limited liability under the laws of the PRC and a wholly-owned subsidiary of the Company

For your convenience, this announcement contains translations between U.S. dollars and RMB amounts at US$1 = RMB8.2768, the prevailing rate on the Latest Practicable Date. The translations are not representations that the Renminbi amounts could actually be converted into U.S. dollars at that rate, or at all.

FURTHER INFORMATION

China Telecommunications Corporation currently owns approximately 77.78% of the issued share capital of the Company and the total purchase price for the Acquisition is approximately 37% of the book value of the net tangible assets value of the Company as at December 31, 2002. Accordingly, under the Listing Rules, the Acquisition constitutes both a discloseable transaction and a connected transaction for the Company.

An Independent Board Committee has been established to advise the Independent Shareholders in respect of the terms of the Acquisition, the terms of the Prospective Connected Transactions and the terms of certain supplemental agreements relating to the Existing Connected Transactions. JPMorgan has been retained as the Independent Financial Adviser to the Independent Board Committee.

China Telecommunications Corporation and its Associates being connected persons to the Acquisition, will abstain from voting on the ordinary resolutions to approve the terms of the Acquisition, the terms of certain Prospective Connected Transactions and the terms of certain supplemental agreements relating to Existing Connected Transactions.

A circular containing, amongst other things, details of the terms of the Acquisition, the Prospective Connected Transactions and the supplemental agreements relating to the Existing Connected Transactions, letters from the Independent Board Committee and from JPMorgan (the independent financial adviser), further financial and other information of the Target Companies and a notice to shareholders of the Company convening an Extraordinary General Meeting to approve, amongst other things, the terms of the Acquisition, the terms of certain Prospective Connected Transactions and the terms of certain supplemental agreements relating to the Existing Connected Transactions will be dispatched to the Shareholders as soon as practicable.

Yours faithfully,
China Telecom Corporation Limited
Zhou Deqiang
Chairman and CEO

Beijing, October 26, 2003