



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)

(Stock Code: 0728)

Announcement of Interim Results for the Six Months Ended 30 June 2004

HIGHLIGHTS

- Total operating revenue was RMB80,217 million, up by 8.3%
- EBITDA reached RMB43,991 million
- Profit attributable to shareholders was RMB14,708 million
- Total number of access lines in service reached 178 million, up by 10.9% from the end of 2003
- Broadband subscribers reached 10.89 million, up by 50.6% from the end of 2003

CHAIRMAN'S STATEMENT

Dear Shareholders,

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

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

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

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

Since our initial public offering, our financial management has been improving continuously. The key importance of financial management in various aspects of the business continued to be emphasised, overall budget control has been more stringently implemented and cost control has been further improved. With more centralised network maintenance and higher efficiency, our network operations and support expenses have decreased. Following our philosophy of "expanding the enterprise in an industrious and economical way", we have focused effort in cutting our administrative expenses. As a result, our management and administrative expenditure continued to decrease. However, in order to ensure the continuing growth of our core business in a competitive environment, our sales expenses increased. Capital expenditure is expected to be more proportionate between the first half and second half of this year. The first half of this year recorded a total capital expenditure of RMB25,018 million, an increase of 12.4% from the same period last year.

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

In the first half of this year, Business Process Re-engineering ("BPR") has been extensively implemented throughout the Company. 212 out of our 228 local branch companies have adopted or are adopting BPR. With BPR as our platform to implement various new management measures, we were able to expand our process management over a strategy, implement process management reform at various levels, and improve our process management. The implementation of BPR has accelerated the establishment of a market-oriented, process-based management system, and further enhanced our local branch companies' overall marketing abilities, market responsiveness, provisioning capabilities and network management. This has in turn improved our operating efficiency and profitability.

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

BUSINESS REVIEW

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

Local Telephone Services

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

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

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

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

Internet Services

In the first half of this year, the revenue generated from Internet services reached RMB6,602 million, an increase of 51.6% from the same period last year. The total transmission volume for our domestic long distance services reached 39.4 billion minutes, an increase of 21.4% from the same period last year. We continued to maintain our leading position in this area.

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

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

Long Distance Services

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

While benefiting from increasing demands in the domestic long distance services market which was stimulated by the rapid growth of the Chinese economy, we adopted a flexible and efficient marketing strategy in the face of market competition. We maximised revenue from the domestic long distance services by adopting appropriate pricing strategies. Sales volume increased by 10.4% from the end of last year. Driven by the continuous expansion of our subscriber base and the overall growth in the domestic telecommunications market, the volume of inbound local calls reached 46.2 billion minutes in the first half of this year, an increase of 32.4% from the same period last year. The volume of inbound long distance calls also increased compared to the same period last year.

Value-added Services

We continued our efforts to develop wireline value-added services in the first half of this year and substantially increased the revenue generated from them. As at the end of June 2004, our subscribers for the caller ID service reached 98.19 million, representing a penetration rate of 55.0%, an increase of nearly 4 percentage points from the end of 2003. The semi-annual usage volume for our telephone information service reached 1,038 million minutes, an increase of 35.0% from the same period last year. Since the launch of the SMS over wireless local access service in the first half of this year, the volume of its usage has increased substantially and the service has demonstrated great potential for further development. As an important component of wireline services, value-added services continue to be one of our key focuses and an important source of our future growth.

OUTLOOK FOR THE SECOND HALF OF THE YEAR

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

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

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

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

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

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

In summary, we will adhere to our goal of becoming "a world-class telecommunications operator". Focusing on rapid development, continued business reform, effective management and human-resources-based strategy, we will strive to achieve the sustainable and sound development of the business and maximise shareholders' value.

Zhou Deqiang

Chairman and CEO

Beijing, PRC

1 September 2004

GROUP RESULTS

China Telecom Corporation Limited (the "Company") is pleased to announce the unaudited consolidated results of the Company and its subsidiaries (the "Group") for the six months ended 30 June 2004.

CONSOLIDATED BALANCE SHEET (UNAUDITED)

at 30 June 2004

(Amounts in millions)

	30 June 2004	31 December 2003
	RMB	RMB
ASSETS		
Non-current assets		
Property, plant and equipment, net	303,725	309,896
Construction in progress	39,522	31,517
Lease prepayments	4,555	4,485
Interests in associates	500	513
Investment loss	237	206
Deferred tax assets	10,662	10,523
Other assets	13,323	13,609
Total non-current assets	372,524	370,849
Current assets		
Inventories	3,227	3,253
Accounts receivable, net	15,186	12,951
Prepayments and other current assets	3,715	3,695
Time deposits with maturity over three months	350	473
Cash and cash equivalents	16,710	12,721
Total current assets	39,188	33,093
Total assets	411,712	403,942

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities		
Short-term debt	6	56,243
Current portion of long-term debt	14,970	13,957
Accounts payable	34,591	35,629
Accrued expenses and other payables	30,300	26,004
Income tax payable	3,664	3,395
Current portion of finance lease obligations	117	50
Current portion of deferred revenues	12,656	13,857
Total current liabilities	161,809	149,135
Net current liabilities	(122,621)	(116,042)
Total assets less current liabilities	249,093	254,807
Non-current liabilities		
Long-term debt	72,491	68,632
Finance lease obligations	153	43
Deferred revenues	29,219	32,744
Deferred tax liabilities	1,575	1,325
Total non-current liabilities	103,440	102,744
Total liabilities	265,249	251,879
Minority interests	1,349	1,269
Shareholders' equity		
Share capital	80,932	75,614
Reserves	64,182	75,180
Total shareholders' equity	145,114	150,794
Total liabilities and shareholders' equity	411,712	403,942

CONSOLIDATED STATEMENT OF INCOME (UNAUDITED)

for the six-month period ended 30 June 2004

(Amounts in millions, except per share data)

	2004	2003
	RMB	RMB
Operating revenues	80,217	74,068
Operating expenses		
Depreciation and amortisation	(23,255)	(22,666)
Network operations and support	(20,325)	(20,767)
Selling, general and administrative	(14,105)	(10,866)
Other operating expenses	(1,796)	(1,541)
Total operating expenses	(59,481)	(55,840)
Operating profit	20,736	18,228
Net finance costs	(2,341)	(1,728)
Investment loss	3,664	(85)
Share of profit from associates	6	—
Profit before taxation and minority interests	18,401	16,415
Taxation	(3,681)	(3,333)
Profit before minority interests	14,720	13,082
Minority interests	(12)	(24)
Profit attributable to shareholders	14,708	13,058
Basic earnings per share	0.19	0.17
Weighted average number of shares	76,725	75,614

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (UNAUDITED)

for the six-month period ended 30 June 2004

(Amounts in millions)

	Share capital	Capital reserve	Share premium	Revaluation reserve	Surplus reserves	Statutory common fund	Other reserves	Retained earnings	Total equity
	RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB
Balance as at 1 January 2003	75,614	20,955	3,362	4,904	8,121	1,624	31,064	7,204	152,848
Adjusted for the Second Acquisition	1	—	—	—	—	—	34,177	—	34,177
Balance as at 1 January 2003, as adjusted	75,614	20,955	3,362	4,904	8,121	1,624	65,241	7,204	187,025
Net profit for the six-month period ended 30 June 2004	—	—	—	—	—	—	—	13,058	13,058
Contributions from China Telecom	—	—	—	—	—	—	—	215	215
Distributions to China Telecom	—	—	—	—	—	—	—	(214)	(214)
Transfer from retained earnings to other reserves	—	—	—	—	—	—	—	—	—
Revaluation surplus realised	—	—	—	—	—	—	3,823	(3,823)	(673)
Effect of change in tax rate	—	—	—	—	—	—	—	4	4
Dividends	—	—	—	—	—	—	—	(76)	(76)
Rights realised	—	—	—	—	—	—	—	—	—
Balance as at 30 June 2004	75,614	20,955	3,362	4,900	8,121	1,624	68,988	15,847	199,411
Net profit for the six-month period ended 31 December 2003	—	—	—	—	—	—	—	824	824
Contributions from China Telecom	—	—	—	—	—	—	—	4,094	4,094
Distributions to China Telecom	—	—	—	—	—	—	—	(1,020)	(1,020)
Assets distributed to China Telecom in connection with the Second Acquisition	—	—	—	—	—	—	—	(10,762)	(10,762)
Recognition of deferred tax	—	—	—	—	—	—	—	2,209	2,209
Transfer from retained earnings to other reserves	—	—	—	—	—	—	—	—	—
Revaluation surplus realised	—	—	—	—	—	—	—	(15,635)	(15,635)
Consideration for the acquisition of the First Acquired Group	—	—	—	—	—	—	—	(45,649)	(45,649)
Appropriation	—	—	—	—	7,340	1,748	—	(9,088)	(9,088)
Transfer from other reserves to capital reserve	—	—	—	—	—	—	—	14,388	14,388
Revaluation surplus realised	—	—	—	—	—	—	—	1,537	1,537
Revaluation surplus realised	—	—	—	—	—	—	—	150	150
Revaluation surplus realised	—	—	—	—	—	—	—	13	13
Deferred tax on land use rights realised	—	—	—	—	—	—	—	(55)	(55)
Balance as at 31 December 2003	75,614	6,567	3,362	6,424	15,461	3,372	24,246	15,748	150,794

	Share capital	Capital reserve	Share premium	Revaluation reserve	Surplus reserves	Statutory common fund	Other reserves	Retained earnings	Total equity
	RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB
Issue of shares, net of issuing expenses of RMB294 million	5,318	—	7,384	—	—	—	—	—	12,702
Net profit for the six-month period ended 30 June 2004	—	—	—	—	—	—	—	14,708	14,708
Contributions from China Telecom	—	—	—	—	—	—	—	100	100
Transfer from retained earnings to other reserves	—	—	—	—	—	—	—	2,653	(2,653)
Consideration for the acquisition of the Second Acquired Group	1	—	—	—	—	—	—	(27,800)	(27,800)
Transfer from other reserves to capital reserve	—	—	—	—	—	—	—	9,371	(9,371)
Dividends	—	—	—	—	—	—	—	(5,224)	(5,224)
Revaluation surplus realised	—	—	—	—	—	—	—	8	8
Effect of change in tax rate	—	—	—	—	—	—	—	(166)	(166)
Deferred tax on land use rights realised	—	—	—	—	—	—	—	(74)	(74)
Balance as at 30 June 2004	80,932	(2,804)	10,746	6,416	15,461	3,372	8,230	22,761	145,114

CONSOLIDATED STATEMENT OF CASH FLOW (UNAUDITED)

for the six-month period ended 30 June 2004

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

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

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

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

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

2. BASIS OF PREPARATION

These interim financial statements have been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" promulgated by the International Accounting Standards Board and the disclosure requirements of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. These interim financial statements reflect the unaudited financial position of the Group as at 30 June 2004 and the unaudited results of operations and cash flows of the Group for the six-month period then ended, which are not necessarily indicative of the results of operations and cash flows expected for the year ending 31 December 2004.

These interim financial statements have been authorised for issue by the Board of Directors on 1 September 2004. These interim financial statements are unaudited, but have been reviewed by the Audit Committee of the Company. These interim financial statements have also been reviewed by the Company's international auditors, KPMG, in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the Hong Kong Society of Accountants.

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

3. SEGMENTAL REPORTING

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

4. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net, are analysed as follows:

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

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

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

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

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

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

5. CASH AND CASH EQUIVALENTS

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

6. SHORT-TERM DEBT

Short-term debt is analysed as follows:

	30 June 2004	31 December 2003
	RMB millions	RMB millions
Bank loans	56,042	56,243
Loans from China Telecom	9,469	—
Total short-term debt	<u>65,511</u>	<u>56,243</u>

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

7. LONG-TERM DEBT

Long-term debt is analysed as follows:

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

Note: (i) As at 30 June 2004, bank loans of RMB6 million (2003: RMB22 million) were secured by certain of the Group's property, plant and equipment. The net book value of the property, plant and equipment pledged as security amounted to RMB1 million as at 30 June 2004 (2003: RMB27 million).

(ii) This represents the deferred consideration payable to China Telecom in respect of the First Acquisition (Note 1). The amount is unsecured, and for the first five years after the date of the First Acquisition, the Company pays interest on the outstanding balance at the rate of 5.184% per annum. Thereafter the interest rate is adjusted based on the prevailing market interest rate. This amount is repayable on 31 December 2013 and the Company may, from time to time, repay all or part of the amount at any time until 31 December 2013 without penalty.

(iii) This represents the remaining balance of the deferred consideration payable to China Telecom in respect of the Second Acquisition (Note 1). The amount is unsecured, and for the first five years after the date of the Second Acquisition, the Company pays interest on the outstanding balance at the rate of 5.184% per annum. Thereafter the interest rate is adjusted based on the prevailing market interest rate. This amount is repayable on 30 June 2014 and the Company may, from time to time, repay all or part of the amount at any time until 30 June 2014 without penalty.

8. ACCOUNTS PAYABLE

Accounts payable are analysed as follows:

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

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

Ageing analysis of accounts payable is as follows:

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

9. DEFERRED TAX ASSETS AND LIABILITIES

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

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

Movements in temporary differences are as follows:

	Balance at 1 January 2004		Recognised in statement of income		Recognised in shareholders' equity		Balance at 30 June 2004	
	RMB millions	RMB millions	RMB millions	RMB millions	RMB millions	RMB millions	RMB millions	RMB millions
Current								
Provisions, primarily for receivables	198	128	—	—	—	—	198	128
Property, plant and equipment	(512)	(148)	—	—	—	—	(512)	(148)
Deferred revenues and installation costs	1,042	1,191	—	—	—	—	1,042	1,191
Land use rights	8,470	(74)	—	—	—	—	8,470	(74)
Net deferred tax assets	<u>9,198</u>	<u>9,087</u>	<u>55</u>	<u>(166)</u>	<u>—</u>	<u>—</u>	<u>9,087</u>	<u>8,921</u>

(Note 14)

Note:

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

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

10. SHARE CAPITAL

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

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

11. OPERATING REVENUES

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

	Six-month periods ended 30 June	
	2004	2003
	RMB millions	RMB millions
Upfront connection fees	4,236	4,886
Upfront installation fees	1,432	1,301
Monthly fees	15,023	13,829
Local usage fees	24,972	22,486
ILD	13,145	12,693
DLD	1,906	1,951
Internet	6,602	4,355
Managed data	1,524	1,628
Interconnections	5,013	4,095
Leased line	2,112	2,608
Others	5,152	4,236
	<u>80,217</u>	<u>74,068</u>

Note:

- (i) Represent the amortised amount of the upfront fees received for the initial activation of wireline services.
- (ii) Represent the amortised amount of the upfront fees received for installation of wireline services.
- (iii) Represent amounts charged to customers each month for their use of the Group's telephone services.
- (iv) Represent usage fees charged to customers for the provision of telephone services.
- (v) Represent amounts charged to customers for the provision of Internet access services.
- (vi) Represent amounts charged to customers for the provision of managed data transmission services.
- (vii) Represent amounts charged to domestic and foreign telecommunications operators for delivery of calls connecting to the Group's wireline telecommunications networks.
- (viii) Represent lease income from other domestic telecommunications operators and business customers for the usage of the Group's wireline telecommunications networks and is measured by the number of lines leased and the agreed upon rate per line leased. The lease arrangements are primarily on a year-to-year basis.
- (ix) Represent primarily revenues from provision of value-added telecommunications services to customers, sale and repairs and maintenance of customer-end equipment, and lease of telecommunications network facilities.

12. NET FINANCE COSTS

Net finance costs comprise:

	Six-month periods ended 30 June	
	2004	2003
	RMB millions	RMB millions
Interest expense incurred	3,260	2,576
Less: Interest expense capitalised*	(738)	(756)
Net interest expense	2,522	1,820
Interest income	(109)	(151)
Foreign exchange losses	4	100
Foreign exchange gains	(76)	(41)
	<u>2,341</u>	<u>1,728</u>

* Interest expense was capitalised in construction in progress at the following rates per annum

	<u>4.1%–5.2%</u>	<u>4.3%–5.5%</u>
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13. PROFIT BEFORE TAXATION AND MINORITY INTERESTS

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

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

14. TAXATION

Taxation in the consolidated statement of income comprises:

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

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

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

(i) The provision for PRC current income tax is based on a statutory rate of 33% of the assessable income of the Group as determined in accordance with the relevant income tax rules and regulations of the PRC, except for certain subsidiaries of the Group which are taxed at a preferential rate of 15%.

(ii) Amounts represent personnel and other miscellaneous expenses in excess of statutory deductible limits for tax purpose.

(iii) Amounts primarily represent connection fees received from customers which are not subject to income tax.

15. DIVIDENDS

Pursuant to the shareholders' approval at the Annual General Meeting held on 3 May 2004, a final dividend of RMB0.00983 per share totaling RMB5,224 million in respect of the year ended 31 December 2003 was declared and was paid on 20 May 2004.

Pursuant to the shareholders' approval at the Annual General Meeting held on 20 June 2003, a final dividend of RMB0.00897 per share totaling RMB673 million in respect of the year ended 31 December 2002 was declared and was paid on 10 July 2003.

The Board of Directors has resolved not to pay an interim dividend for the year ending 31 December 2004.

16. BASIC EARNINGS PER SHARE

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

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

17. CAPITAL COMMITMENTS

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

	30 June 2004		31 December 2003	
	RMB millions	RMB millions	RMB millions	RMB millions
Authorised and contracted for				
Properties	2,268	1,857	—	—
Telecommunications network plant and equipment	5,124	9,257	—	—
	<u>7,392</u>	<u>11,114</u>		
Authorised but not contracted for				
Properties	2,105	2,458	—</	